CREDIT POLICY AND PERFORMANCE OF FINANCIAL INSTITUTIONS:

A CASE STUDY OF

OPPORTUNITY BANK UGANDA LIMITED

BY

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OCTOBER, 2014

DECLARATION BY THE CANDIDATE

I hereby declare that this dissertation has never been submitted to any University or institution of higher learning for any academic award. This is my own independent work and investigations, where it is indebted to the work of others, the acknowledgment has been made.

Signed: _____ Date: 30/12/14

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Candidate

CERTIFICATE OF APPROVAL

I hereby declare that this dissertation has been fully supervised and is now ready for submission. It is from the student's own work and effort and all other sources of information used have been acknowledged. This dissertation has been submitted with my approval.

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DEDICATION

I dedicate this piece of work to MBA class of Kyambogo University 2012 and to my Dear Family (Dr Pius, Ethan and Elsie), your innovativeness and support have enabled me to become an achiever. To you all I owe my success.

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ABSTRACT

The research was carried on credit policy and financial performance of financial institutions, a case study of Opportunity Bank. The study was based on four objectives that is; to assess the relationship between credit rating procedure of loan applicants on the financial performance of Opportunity Bank, to determine the effect of interest rates on financial performance of Opportunity Bank, to examine the relationship between the loan collection procedures and the financial performance of Opportunity Bank.

The study used a case study research design and both primary and secondary data were utilized. Primary data was obtained through interviews and by use of self-administered questionnaires. Secondary data was got from past dissertations, business manuals, company reports and journals. The study revealed that there is a positive significant relationship between Opportunity bank's credit rating procedures and financial performance of the bank. The study found out that there is a positive relationship between loan collection procedures and the performance of the bank. The study further revealed that there is a positive relationship between loan interest, loan portfolio growth and performance of financial institutions. It was concluded that there is a positive relationship between credit policy and financial performance of Opportunity bank (U) limited.

The researcher recommends that the bank should reduce on its debt collection periods, carry out intensive loan applicant assessment, strengthen the bank's loan recovery/collection effort and procedures as well as re-designing and further strengthening its credit policies.

The key words used were loan collection procedure, credit rating procedures, interest rates as well as financial performance.

CHAPTER ONE

INTRODUCTION

1.1 Introduction

The chapter presents the background of the study, the problem statement, the purpose of the study, objectives of the study, research questions, research hypotheses, conceptual framework, significance of the study, scope of study and definitions to key concepts and terms.

1.2 Background to the Study

The traditional role of a bank is lending and loans make up the bulk of their assets. However, many financial institutions all over the world have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties (Christensen, 2002).

The poor financial performance of most banks in the world are attributed to improper lending practices, lack of experience, organizational and informational systems to adequately assess credit risk in the falling economy (Christensen, 2002).

Many attributed the failure to perform of most banks to poor credit policy in most banks all over the world. In this case, Edmiston (2010) defined credit policy to refer to written guidelines that set the terms and conditions for supplying goods or services on credit, customer qualification criteria, procedure for making collections, and steps to be taken in case of customer delinquency.

Other Scholars like Pandey (2009) have defined credit as the sum of money or goods in monetary value lent by a bank, trading organization or a financial institution to an individual, organization or a company for a specified period of time under specified terms agreed by both parties. It could also be an extension of a paying period for a contract made. This means that one party to a contract has fully satisfied his or her part whereas the other owes a duty to set off the debt in the future.

Credit policy is used to refer to the combination of three decision variables; credit standards, credit terms and collection efforts (Pandey, 2009). For purposes of this study and here in after credit policy referred to credit rating procedure, loan collection procedure and lending policies.

According to Okello (2009), in East Africa banks are primary source of short and long term financing, a feature that distinguishes it from other types of business. One of the best ways of assisting business people to improve their levels of incomes is the provision of financial tools on credit, which in turn improves the profit level of the Banks when interest is paid back in time.

For most Banks, these credits are repayable in periodic installments; monthly, quarterly, semiannual or annual that covers both interest and principal. The payment schedule calls for equal periodic installments but it may specify regular amounts or repayment in one lump sum at final maturity. However provision of credit is a risky business therefore the Banks or business organizations attitudes to risk vary from time usually in line with general economic conditions.

In most cases credit price is usually higher than cash price due to the addition of interest on top of the actual price of a loan. These credit facilities are found in banking institutions, wholesale and retail trade and between countries (Ochieng, 2006). For any loan transaction to take place the terms must be clearly put down in writing and should be understood properly.

The credit rating policy in Uganda is mostly done if the Bank alters its credit policy. For example, a Bank may attempt to convince the market of its credit evaluation abilities by concealing the extent of bad loans originated. It can do this by maintaining a liberal credit policy: extending the term of loans, lending new money so that insolvent borrowers can keep up the pretense of being current on their loans, and weakening covenants so as to avoid recognizing default. Isomorphically, the bank may attempt to convince the market of the profitability of its lending. Again, it can achieve this with a liberal credit policy that generates up-front fees at the expense of future credit quality. In general, a liberal credit policy boosts current earnings at the expense of future earnings. The bank is trapped into this second-best credit policy simply because the market expects (Musinguzi, 2001).

According to Mutebile (March 2013), prime lending rates are currently between 14% and 33 %. However banks operating in Uganda have revised its lending rate to 20 % from 33 %. This policy has already been followed by some banks like Citi Bank, Standard Chartered Bank Ltd, Opportunity Bank, Equity Bank, Stanbic Bank, Stanhope Investment Bank and other banks are expected to follow. Banking institutions usually require the client to give collateral security which stands in the position for the value of credit in case the client defaults to the contract, (Ugandan Banker, 2010). Collateral security is usually assets which have long term useful life and are crucial in one's life for example land tittles, buildings, motor vehicles (Lawrence, 2006).

The poor credit management in some banks in Uganda has led to closure of many banks like Greenland Bank, Co-operative Bank, Teffe Trust Bank, International Credit Bank and Uganda Co-operative Bank. This therefore calls for a restrictive credit control to restrain from

unnecessary lending. Credit officials of banking institutions should always ensure that loan provision is carried out diligently by choosing the most appropriate security in the circumstances and ensuring that the legal process of registering the same is followed to the later. These way financial institutions will stop losing millions of money through negligent or reckless provision of credit (Ochieng, 2006).

According to the Christensen (2002), failure to recover loan is costly to financial institutions as they influence the profit of the bank. This means that to attain profit, the business must be innovative in order to identify viable areas for investment.

Today, Opportunity Bank is one of the banks that are trying to get acclimatized to the existing credit policy. Opportunity Bank Uganda Limited is a member of the Opportunity Transformational Inc (OTI). Started in 1995 as Faulu Uganda owned by Food for the Hungry International (FHI), in 2006 OTI acquired 63%, from FHI and it is the intention of OTI to continue increasing its % shareholding. It is a leading Ugandan Micro Finance Institution. In December 2008, Opportunity Bank Uganda Limited acquired a Tier 2 Financial Institutions license from Bank of Uganda to operate as a regulated Credit Institution making Opportunity Bank Uganda Limited effectively a Savings & Loan Organization offering micro loans, savings and insurance products specializing in transformational lending in urban, peri-urban and rural environments (Opportunity Bank Uganda, 2012). Today Opportunity Bank' s performance is being affected by the existing Bank credit policy, it could be the reason as to why the bank has incurred some losses in the past financial years but the situation is debatable hence prompting this study. It is against this background that the researcher seeks to examine the relationship between credit policy and the financial performance of Opportunity Bank Uganda Limited.

1.3 Statement of the problem

In 2013, Opportunity bank revenue was reported at Ugx.6, 834,703,000, losses made were Ugx.572, 333,000 and operating losses were reported at Ugx.284, 678,000 (Opportunity Bank's Report, 2013). Opportunity Bank has in place policies like Credit rating procedures, loan collection methods and lending policies. One therefore wonders what the cause could be; could it be failed credit management policies, management reluctance or the general global financial crisis? It is against this background that the researcher seeks to examine the relationship between credit policy and the financial performance of Opportunity Bank Uganda Limited.

1.4 Purpose of the study

The main purpose of the study was to examine the relationship between the credit policy and the financial performance of Opportunity Bank Uganda Limited.

1.5 Specific objectives

The study premised on the following research objectives:

(i) To assess the relationship between credit rating procedure of loan applicants on the financial performance of Opportunity Bank.

(ii) To assess the relationship between interest rates and financial performance of Opportunity Bank.

(iii) To examine the relationship between loan collection procedures and financial performance of Opportunity Bank.

1.6 Research Questions

The study attempted to answer the following research questions

(i) What is the relationship between credit rating procedure of loan applicants and the financial performance of Opportunity Bank?

(ii) What is the relationship between interest rates and financial performance of Opportunity Bank?

(iii) What is the relationship between loan collection procedures and financial performance of Opportunity Bank?

1.7 Scope of the study

1.7.1 Content scope

Credit policy comprises of Credit rating procedures, Loan Collection Procedures and lending policies. Financial performance focused on the amount of assets, loan amount and net profits.

1.7.2 Time scope

The study covered the financial year 2013-2014.

1.7.3 Geographical Scope

The study was carried out at 4 of the Opportunity Bank branches in Uganda which included Head Office at Kololo, Kira Branch, Nansana, and Gayaza branches. This was because from the report (Opportunity Bank's Report of 2013), Nansana and Gayaza Branches had a high loss margin whereas Kira and Kololo branches had the lowest loss margin.

1.8 Significance of the study

The research findings were of importance to a number of stakeholders. It is hoped that:

The results of the study may be used in policy formulation and implementation by the government in the governance of financial institutions in Uganda.

The study further provided guiding points for the institutions involved in funding banking business in Uganda a part from banks.

The information shall be used by the government to analyze the facts underlying the failure of financial institutions so that it revises its policies such as the bank rate.

The findings helped Opportunity Bank to undertake strategic corporate loan portfolio changes that will help the bank to be sustainable and consequently become profitable.

Through the resultant interaction between the researcher and the respondents, the researcher's knowledge, skills and understanding of research improved.

The study findings will act as a reference point and add knowledge to the pool for future researchers and academicians.

The study has added value to the body of existing knowledge and perhaps shall lead to ventures in further research.

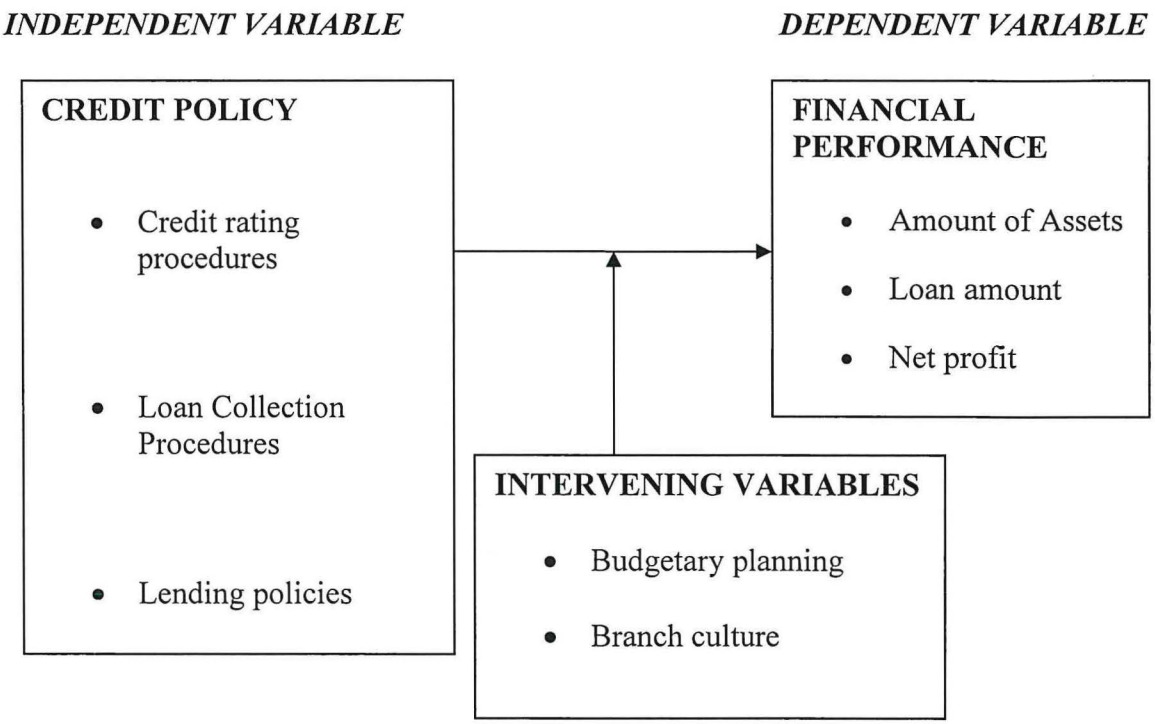
1.9 Conceptual Framework

A conceptual framework is described as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation (Reichel & Ramey, 1987). When clearly articulated, a conceptual framework has potential usefulness as a tool to scaffold research and, therefore, to assist a researcher to make meaning of subsequent findings thus be

able to understand the tenets of Credit policy and performance of financial institutions in Uganda.

Credit rating procedures, Loan Collection Procedures and Lending policies must be well managed and should operate as a unit. It is the total relationship between the three policies as a package that affect the dependent variable which is Financial Performance.

Figure 1: Conceptual frame work



Source: adopted from Audenhove, (1999)

Credit rating procedures: Credit rating is an assessment of one's ability to pay his/her financial obligations. The ability to pay financial obligations is referred to as "creditworthiness."

For the case of this research, credit rating procedures referred to credit worthiness and collateral security. Balanced credit rating standards leads to high performance of financial institutions.

Loan collection procedures: These are steps that can be used as an escalation process to contact customers about an outstanding payment from friendly reminder through to letter of demand and bad debt collection. These were measured in terms Dialogue and Periodical payments. A good loan collection procedure should be able to improve the financial performance of the bank; this is because it reduces on the default rate and minimizes losses.

Lending policies: These are Philosophies, standards, and guidelines of a lending institution's lending approach. Employees of the institution must comply with this approach in granting or refusing a loan request. For the case of this research lending policies refered to interest rate and payback period.

Financial performance: Performance is the prime variable of interest; the dependent variable was looked at in terms of Amount of Assets, Loan amount as well as Net profit

Intervening variable: The intervening variable are hypothetical internal states that are used to explain relationships between observed variables, such independent and dependent variables. For this research the intervening variables included budgetary planning as well as the branch culture

When the credit rating procedures are well designed and administered, the loan collection procedures are favorable, and the lending procedures clear and practiced, then the bank's financial performance is high.

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

2.1 Introduction

This chapter covers the reviewed literature of the earlier scholars. The literature is presented following the variables used in the study and comprises a critical review of related literature. The literature discussed was based on the themes of the study guided by the objectives of the study. The review was extensive which enabled the researcher to obtain detailed knowledge of the topic studied and revealed procedure measuring instruments and strategies that were useful in finding out or investigating the problems in question (Mugenda & Mugenda, 1999). Literature was obtained from journals, manuals, documents, text books, dissertations, internet, government publications and research papers. The literature was reviewed under the following sub headings: This section presents the related literature which is presented according to the objectives of the study (credit rating procedures, loan collection procedures and lending policies)

2.2 Credit rating procedure and financial performance.

Audenhove (1999), describes a credit policy as a management philosophy spelling out the decision variables of credit standards, credit terms and collection efforts by which managers in banks have an influence on their operations. The credit policy impacts on the outreach of banks depending on the lending approaches used to screen clients for credit facilities which are either liberal or stringent in nature. These approaches are effective provided managers are competent with the relevant skills, knowledge and experience of leading teams to achieve targets set (Frey, 2010). Research by Bonbright (2004) shows that a credit policy adopted impacts on outreach and

customer retention in banks. However, the research under looked the impact of managerial competence while implementing the credit policy as fundamental to achieve lending goals.

A bank's credit policy provides a criteria for determining whether to give credit to an applicant and how much to give. It's of pertinent importance to establish credit standards while making credit decisions, while it may be easy to establish a credit standard; it's another thing altogether to implement it, thus Aryeetey (1996B) writes that a poor credit policy will not provide optimal results. The term credit policy entails the combination of standards, terms and collection efforts in terms of credit perspective. The combination of the mentioned variables is stepping stone to establishing an optimum credit policy thus the variables are very important. On the other hand credit policy can also be defined as an institutional method of analyzing credit requests and its demand criteria for accepting or refusing credit applications (Edminister, 1980). However in the proposed study, the researcher used the term credit rating procedures to refer to credit worthiness and collateral security.

Collateral, character, consideration, capital and capacity are important considerations that a financial manager should carefully think about to make good financial decision and to estimate the probable default in payment (Pandey, 2009). Loose credit standards will accumulate a huge loan portfolio which is good thing but will have to bear a burden of loan debtors and defaulters yet having a strict and high credit policy and extending credit to only those applicants considered reliable and strong may not enable the bank to expand its lending though little or no bad loans and bad debtors may occur. Ensuring a balance between the two is necessary to achieve the required results. Having a relaxed and a strict standard will slow down the whole process of credit management hence an optimal one is required (Bitekerezzo and Tulip, 2003).

According to Barongo (2004)., credit rating agencies play a key role in structured financial transactions, a term that may refer to asset-backed securities, residential mortgage-backed securities, commercial mortgage-backed securities, collateralized debt obligations , "synthetic CDOs", or derivatives. Credit ratings for structured finance instruments may be distinguished from ratings for other debt securities in several important ways. These securities are more complex and an accurate prognoses of repayment more difficult than with other debt ratings. This is because they are formed by pooling debt usually consumer credit assets, such as mortgages, credit card or auto loans and structured by "slicing" the pool into multiple "tranches", each with a different priority of payment. This does not address credit policy in the case of the banking institutions in Uganda.

Under terms ,payback period ,interest rate charged on a loan ,discounts especially cash discounts are some of the variables comprising credit terms .Any detection of laxity and negative changes highly affect the banks' lending ,profits , collection period and other expenses associated with bad loans.(Ddumba, 2005).The researcher is cognizant of the fact that decision to change any of the mentioned variables /components of credit terms depend on the direction and the degree of change.

A credit policy spells out guidelines which are followed in extending credit to customers including the procedures for recovering loans in arrears. A credit policy is important because of its impact on customer retention and outreach strategies adopted by banks (Edminister, 2010). A stringent credit policy turns away potential customers and slows the loan portfolio growth which lowers customer retention whereas a liberal credit policy attracts slow paying customers and

increases the arrears rate. Therefore a good credit policy is one which strikes a balance between customer retention and defection to facilitate outreach.

In addition a credit policy whether stringent or liberal is composed of lending terms which are the methods used to analyze credit requests and used in decision making. Lending terms are therefore are a combination of credit conditions and standards of advancing credit. Recovery includes all efforts of collecting loan balances in arrears to maintain a profitable loan portfolio (Lawrence, 2006). Kiggundu (2009), adds that a credit policy is the primary means by which senior management and the Board of an institution guides the lending activities.

It therefore provides the scope for achieving the loan portfolio quality and returns, guides the risk tolerance levels in a manner commensurate with the institutions strategic direction. Forwards that a credit policy enables a bank to limit bad debts and improve cash flows since loans are in most cases the core business activities in banks. The credit policy also assures a degree of consistency among departments by writing down what is expected of each department as well as ensuring consistence in handling customers based on pre-determined parameters.

The credit rating policy addresses procedures that are followed to reinforce the collection policy and these among others include, letters, telephone calls, personal visits, use of collection agencies and litigation, litigation needs to be of last resort because it's likely to tarnish the banks' reputation and chase away potential customers. The collection policies determine the type and degree of effort employed to collect overdue loans and this highly depends on the costs of collection and benefits from reduced collection periods and few bad loans. Ochieng (2006), the

policy regarding collection is important because customers need to be pushed first for them to pay. The policy should aim at increasing turnover while keeping costs low and bad loans within the limits (Pandey, 2009). Much as the author above addresses the issue of credit rating, he does not link it to financial performance which is the central focus of this study.

2.3 Loan Collection Procedures and Financial performance

A positive response or a negative response is what follows after a customer has lodged in his or her request for a loan from the bank. A positive response will depend on the soundness of the lending proposition. An individual bank should try to establish its own unique lending policy according to Brown (2003) because a policy that has worked for one bank may fail in the other. According to Brown (2003) while designing a loan policy, there are external factors that are initial to the lending function and include customer mix, stability of trade and growth element in the economy and also the economic conditions prevailing at the moment banks have an obligation to meet the depositors' demands through being liquid. The required reserve should be at an acceptable level to allow the banks have ability to lend and keep in mind that a good loan to deposit ratio is a requirement that is important. Other factors include past experience with seasonal loan demands and seasons deposits which should be a factor in your loan policy. Credit objectivity has to do with how the proposed borrower meets the objectives of the bank ,qualifications of the personnel also has a strong bearing on the credit policy design in terms of types and numbers in consideration to the competition ,institutional status ,availability of data and information ,risk and legal system factors (The Uganda Banker, 1998).

The eventual decline in bank lending in Uganda between 1990 to 2000 is roughly contemporaneous with a decline in economic activity as measured by industrial production or GDP. Unfortunately, focusing on business lending still does not resolve the debate. One recent study that specifically looks at how bank business lending responds to policy tightening finds business lending does not decline when policy is tightened (Sullin, 2006). All of the decline in total lending comes from a reduction in consumer and real estate loans. Moreover, when the analysis is narrowed further to loans to manufacturing firms, bank lending actually shows a significant increase in response to tighter policy. Indeed, for manufacturing firms, most of the increased lending appears to go to large firms; while loans to small manufacturing firms are largely unaffected by policy.

In contrast to this study, Stilglitz and Wess (2011) find evidence that business lending may respond to a tightening of monetary policy. They examine the lending behavior of small and large banks, rather than loans received by small and large firms. Stilglitz and Wess (2011) find that when policy is tightened, both total loans and business loans at small banks fall, while loans at large banks are unaffected. The differential response of small banks may indicate they have less access to alternative funding sources than large banks and so are less able to avoid the loss of core deposits when policy is tightened. Since small banks lend primarily to smaller firms this research is consistent with the view that monetary policy may work, in part, through a credit channel.

Another line of research consistent with Stilglitz and Wess (2011) examines the behavior of business loans not made under terms of a loan commitment. These loans would appear to be

most vulnerable to monetary tightening. This line of research provides evidence that uncommitted loans fall in periods of monetary tightening, while loans made under the terms of an existing commitment are unaffected. Thus, restrictive policy may work primarily by reducing the availability of bank credit to business borrowers without a loan commitment.

Information on the terms of bank lending may also be useful in distinguishing between the "lending view" and the "credit rationing" explanations of a bank credit channel. In particular, Musinguzi (2001) notes that the lending view is a statement about the relative magnitude of shifts in the demand for and supply of loans when policy is tightened. According to the lending view, the volume of new loans should decline and loan rates should rise relative to market rates when policy is tightened. This behavior would indicate loan supply shifts are relatively larger than loan demand shifts. In contrast, most theories of credit rationing suggest that, while the volume of new loans should decline when policy is tightened, bank loan rates should actually increase less than market rates. Recent studies on bank lending using survey data on the terms of lending have found little evidence in favor of either credit rationing or the lending view. For example, in work specifically designed to investigate credit rationing, Burnett (2002) find little supporting evidence. While they do find a key element of rationing, a sluggish response of bank loan rates to market rates, other characteristics of rationing are not present. In particular, Burnett (2002) note that interest rates on loans made under commitment are as sluggish as rates on uncommitted loans. Since loans made under commitment are presumably not subject to credit rationing, this suggests the slow response of loan rates is not due to rationing. In addition, they find that the volume of new bank loans, both uncommitted and committed, rises in periods of tight credit, while credit rationing would imply a reduction in loans made without a commitment.

While Burnett (2002) do not directly examine the lending view, the stickiness of bank loan rates found in their study suggests banks do not reduce the supply of new loans when monetary Policy is tightened.

Loan collection procedures vary from institution to institution and are always supplemented to by more detailed guidelines and procedures (Edmiston, 2010). The variations arise due market conditions, geographical locations, personnel and portfolio objectives but under all circumstances credit policies tally with the lending activities. AMFIU (2010) notes that banks write credit policies describing the extent to which they can position themselves in the market basing on the risks and rewards existing which are identified on the different loan products offered to customers. The credit policies are therefore translated and interpreted to staff by assigning targets and objectives to be achieved in specified periods. This implies that a credit policy provides direction for banks to respond to good business opportunities while controlling risk as they advance credit. In addition a credit policy specifies the authorization procedures for credit decisions Edmiston (2010).

This can be illustrated where banks Management give Branch managers' authority to approve loans depending on the limits and risks associated with given credit applicant (Barongo, (2004). Loans exceeding Branch limits are forwarded to senior management usually at regional levels and head office hence influencing outreach. Alternatively efforts at Branch levels to increase outreach involves the empowerment of staff to make credit decisions from Branch loan committees as well as the of management credit committees for corporate credit customers

(Ddumba, 2005). The purpose of these committees is to control loan quality by encouraging members to share knowledge and experience from different customers served. This experience is used in credit decisions to control credit quality since files are discussed with due objectivity. Credit decisions are also used to establish targets for credit quality. Birungi (2004), notes that the purpose of loan collection procedures is to ensure that credit is granted to customers who have the ability to settle obligations at regular intervals in accordance to agreed credit terms. But Kiggundu (2009) disagrees that the credit policy is beyond screening customers' capacity basing on payments by asserting that a credit policy sets general frameworks for managing the credit portfolio other than focusing on customer capacity.

Obura (2006) agrees with Kiggundu (2009) that it is important to focus on particular customer traits if the credit quality is to be maintained to reduce on the risks of bad debts and high loan loss provisions other than focusing on the entire credit policy.

2.4 Lending Procedures and Financial performance

Cost effectiveness, self-sufficiency and portfolio quality are the broad three types of financial indications that measures and evaluates the performance of financial institutions in relation to credit rating. The loan portifolio being generally the most important revenue generating asset of a bank calls for quality and managements' major role of ensuring the overall financial health of the bank or any financial institution (Christensen, 2002). Lending is the biggest source of revenue for most banks though it's also the biggest exposure to loss of bank assets. A quality credit in its policy should require a credit report and other retailer information on your borrower, checking with the customers previous banker is important, since it's an assurance that the credit

worthy borrowers obtain loan from their bank, lending officers need a limit in the lending with specified secured credit, anything above the limit should be in the knowledge of the management groups or directors. This should be so whether disbursed by the chief executive or the most junior loan officer. Previous size of loans made, honesty and intensity, experience and the general past details of the loan officers are supposed to be checked thoroughly. Direct loan reviews should be in place and loans be regularly reviewed by the directors. The above factors are some of the identified loan control elements for good management of the loan today the researcher notes (Burnett, 2002).

Despite all the benefits of lending for both lenders and their customers, the lending process bears careful monitoring at all times. When a lender gets into serious financial trouble, the problems usually spring from loans that have become uncollectible due to mismanagement, illegal manipulation, misguided policies, or an unexpected economic downturn. No wonder then that when examiners appear at a regulated lending institution they conduct a thorough review of its loan portfolio. Usually this involves a detailed analysis of the documentation and collateral for the largest loans, a review of a sample of small loans, and an evaluation of loan policies to ensure they are sound and prudent in order to protect the public's funds.

2.5 Lending Policies and Financial Performance

While there is widespread agreement that banks play a key part in the transmission of monetary policy actions to the economy, there is considerable controversy over the precise role that banks play. The focus of this debate is whether bank lending plays a special part in the monetary transmission mechanism. If a special lending or credit channel exists, changes in the willingness

and ability of banks to extend credit may have implications for aggregate economic activity. Moreover, ongoing changes in the role banks play in financial markets may affect this credit channel and so alter the monetary transmission mechanism. Recent research on a bank credit channel has focused on two questions. Are certain borrowers so dependent on bank lending that any change in banks' willingness to lend immediately affects investment and spending decisions? And, do monetary policy changes directly constrain bank lending? Both conditions are necessary for bank lending to play a special role in the monetary transmission mechanism. Thus far, research on a credit channel has yielded mixed results. Some recent research provides support for the view that certain borrowers, such as small businesses, are very dependent on banks for financing. This finding suggests that disruptions in bank credit could affect economic activity. At the same time, there is conflicting evidence that bank lending is directly constrained by monetary policy actions (Ddumba, 2005).

There is general agreement among economists and policymakers that monetary policy works mainly through interest rates. When policy is tightened through a decrease in reserve provision, for example, interest rates rise. A rise in interest rates leads to a reduction in spending by interest sensitive sectors of the economy, such as housing and consumer purchases of durable goods. Banks play a part in this interest rate mechanism since a reduction in the money supply which consists mainly of deposit liabilities of banks is one of the principal factors pushing up interest rates. In this standard view of the monetary transmission mechanism, however, there is nothing unique about bank lending. Indeed, the interest rate mechanism does not depend on what assets banks hold; the same response would occur regardless of the proportions of a bank's assets that are held as loans or securities (Bitekerezzo & Tulip, 2003).

If bank lending plays a central role in the monetary transmission mechanism, changes in bank lending practices or in the role that banks play in financial markets can alter the transmission mechanism and have important policy implications. Two institutional changes that may have affected the transmission mechanism are the secular decline in bank lending to business and the growing use of bank loan commitments. Banks have traditionally been a primary source of short-term credit for business. Businesses borrow from banks to finance inventories and working capital, to obtain short-term construction and land development loans, and to provide bridge financing for mergers and acquisitions. Over time, however, business dependence on bank loans has diminished as alternatives such as the commercial paper market and nonbank intermediaries have allowed businesses to bypass banks. Thus, the proportion of short-term business finance provided by banks has dropped dramatically over the past 20 years (Lawrence, 2006).

The decline in bank lending to businesses suggests that if a credit channel exists, its importance may have changed over time. If so, the monetary transmission mechanism also may have changed, with less of the impact of policy occurring through bank lending and more occurring through interest rates. Such a change could complicate monetary policy. Without an accurate measure of the impact of these changes, for example, the Federal Reserve could underestimate the change in interest rates needed to achieve a slowing in economic activity, resulting in an inflationary bias to policy. A second institutional change in banking with policy implications is the growing use of loan commitments. A loan commitment is an agreement between a borrower and lender that allows the borrower to draw down a line of credit at his discretion. In effect, a loan commitment provides guaranteed funding up to a credit limit, protecting the borrower from being denied credit (Burnett, 2002).

Recent research on whether a lending policies plays an important part in the monetary transmission mechanism has focused on two issues: whether certain borrowers are dependent on bank loans and whether bank lending is constrained by monetary policy. While there is some evidence that small firms may be especially dependent on banks for financing, there are conflicting opinions on whether bank lending is directly affected by monetary policy actions. An additional problem with many of these studies is that they use total bank loans, which include consumer and real estate lending, rather than business loans. Based on the discussion of credit market imperfections above, business lending would appear to be the more appropriate measure in testing for a credit channel. Indeed, given the large number of nonbank credit sources for consumer and real estate lending and the extensive securitization of these loans, it is difficult to believe the informational problems that make small businesses dependent on bank credit would apply to other types of lending (Kelly, 2001).

According to Sullin (2006) effective loan management includes the following, strategic planning, this is important because it defines the goals and objectives of the loan portfolio and provides the director an opportunity to anticipate conditions and react accordingly. Underwriting, standard credit policy creates a frame work for lending and reflects a banks' credit culture and ethical business standards. The credit policy establishes a clear set of underwriting (lending) standards for varied loan products that are advanced and these standards represent criteria by which loans are advanced to different applicants. Other key control elements for a good credit policy are purpose of the loan, repayment terms, and amount of the loan, security, bank policy and consequences of not lending.

A commercial contract between the two parties where one party has a future obligation to repay money to the other with the risk that those moneys will not be repaid poor settlement is lifted or rescheduled gives rise to a credit risk. credit risk otherwise is known as a bank counter party risk concerned with counter party limits between bank and focusing on acceptable levels (Stilglitz and Wess, 2011). Lack of clearly laid down leading procedures for the high credit risk in Uganda as identified in the Uganda banker (march 1996), state owned banks frequently suffer political pressure in making credit decisions where as private owned banks are at times owned by interest groups whose main objectives is to access money to finance their businesses elsewhere and liquidity to friends and there is also a problem of inside borrowing. The journal identified other sources;

a) Weak legal frame work, which does not facilitate debt recovery.

b) Lack of provision standard and inappropriate loan classification

c) Overdraft lending facilities are abused.

d) Unreliable value of reports issued by some professional firms that misled the assessment process.

e) Over reliance on collateral security as a source of repayment items regulating proper procedures of loan assessment.

Managing risk is a duty that lies with senior management of the bank but not merely with the regulators who provide structures and functions within which to operate .An experienced lending banker focuses on credit rating agencies, credit scoring, credit and financial analysis and other techniques (Tisch & Wallace, 2004).

Lending policies are periodically reviewed and revised by management to incorporate changes in strategic direction and risk tolerance or market conditions. Policies are revised to incorporate customer preferences so that they are served according to their expectations. MFIs review credit policies on average after three years (Credit manual, 2009). The reviews are used to evaluate the performance of the policy in terms of achieving desired objectives ranging from profitability to customer growth and outreach (Pandey, 2009) .

Similarly banks use on time service delivery to serve customers by allowing customers to fill in loan documents at once before loans are disbursed. The documents are key to credit quality and they are needed to legally enforce loan agreements including the analysis of the borrower's financial capacity. Common loan documents used include promissory notes, note guarantees, collateral agreements, and chattel mortgage and loan application appraisal forms. These documents are kept safely since they act as evidence that the customer took the loan. In case one document is missing or improperly filled, the chances of losing a legal action when a customer defaults is high and becomes a loss to the company (Andrey and Martin, 2009).

The lending policy also addresses the procedures of recovering loan from customers which are due for payment but stuck in the portfolio (Audenhove, 1999). Banks therefore carry out continuous education and training of customers on loan usage and importance's of on time payments to influence customer compliance to the loan terms. They in addition use management information systems to track loan payments and arrears on a daily basis through activities like ringing clients' mobile phones before the due date, sending text messages and physical visits to defaulting customers. On time loan payments therefore encourages customer loyalty due to the limited inconveniences received from credit staff leading to good financial performance.

Similarly the lending policy designates responsibilities to staff that are accountable for the accuracy of risk ratings (Birungi, 2004). In most cases banks use Branch accountants to analyze the credit information contained in loan files before credit decisions are taken. This ensures that loans advanced are subjected to minimal transactional risk from the Branch which helps in portfolio quality control.

2.6 Summary of the Literature Review

Ongoing changes in the banking industry have brought renewed attention to the role banks play in the monetary transmission mechanism. To the extent certain borrowers are dependent on bank credit and bank lending is constrained by monetary policy, restrictive policy may affect the economy through a bank credit channel. Structural changes in the role banks play in the financial system may then affect the credit policy by altering this credit channel. The analysis presented in the reviewed literature above finds little evidence that the financial performance of banks is constrained by the credit policy. At the same time, it is important to recognize that the evidence presented in the literature reviewed does not imply that bank credit is unimportant. Indeed, to the extent that some borrowers are dependent on bank credit, sudden disruptions in bank lending could alter their spending decisions and affect the level of economic activity including the financial performance of banks.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter gives the description of the research design, geographical area and population of study, sample population, sampling population strategies, data collection methods, data quality control, study of variables, administration of the instruments, data processing and presentation, data analysis and limitations of the study.

3.1 Research design

The study used a case study research design and both primary and secondary researches were utilized. This is an in depth study of a particular situation rather than a sweeping statistical survey. It is a method used to narrow down a very broad field of research into one easily researchable topic. The case study design was used because of its appropriateness to investigate the research in hand, the ability of case study method in accommodating different research techniques; it was also because of the suitability of case study research over other research strategies as well as the opportunity presented by being part of a wider research study Yin (2003b)

The study applied both quantitative and qualitative approaches. Amin (2005) states that quantitative designs are plans for carrying out research oriented towards quantification and are applied in order to describe current conditions or to investigate relationships, including cause and effect relationships. Quantitative approaches were employed while sampling, collecting data, during data quality control and in data analysis.

This study applied qualitative approaches which involved an in depth probe and application of subjectively interpreted data (Sekaran, 2003). Qualitative researchers aim at gathering an in-depth understanding of human behavior and the reasons that govern such behavior. Qualitative approaches were applied while sampling, collecting data, data quality control and in data analysis. Hence, smaller but focused samples were more often needed than large samples. This study integrated these two approaches since the researcher believed what Creswell (2003) asserts that researchers who use one style alone do not always communicate well with those using the other.

Steps of conducting a case study research were; established the broad case to investigate, established the research questions, selected the precise case to be used and finally determined the data gathering and analysis technique.

3.3 Study population

The study was based on a total population of 61 employees from the four selected branches of Opportunity bank, 19 employees were from Kira branch, 13 from Gayaza branch, 17 from Kololo branch and 12 from Nansana branch. Out of the 61 employees, only 58 were technical staffs, other 3 employees were casual staff (Opportunity Human Resource report 2013). The 58 technical staff included staff from Operations department, credit department, risk department, Audit, Customer care as well as human resource department.

The study was based on a sample size of 50 that was drawn from a population of 58. The sample size of 50 was sufficient and this is recommended by Krejcie &Morgan (1970). Krejcie & Morgan (1970) assert that treat each sub-group as a population and then use the table to determine the recommended sample size for each sub-group.

Table 3. 1: Sample Size and Selection Techniques

Department	Target population	Sample Size	Sampling Technique
Human Resource	02	02	Purposive
Loans	33	28	Simple random
Accounting and finance	2	2	Purposive
Operations	16	13	Simple random
Risk	3	3	Purposive
Sales and Marketing	2	2	Purposive
Total	**58**	**50**	

Source: *Opportunity Bank Manual (2013)* & Krejcie *& Morgan (1970) tables*

3.3.1 Sampling Techniques and Procedure

3.3.1.1 Probability Sampling

Probability sampling, or random sampling, is a sampling technique in which the probability of getting any particular sample may be calculated (Creswell, 2003). The advantage of non-probability sampling is its lower cost compared to probability sampling. However, one can say much less on the basis of a non-probability sample than on the basis of a probability sample (Mugenda & Mugenda, 1999). The study used simple random sampling techniques. This technique was used to sample staff in both the credit and operations department. According to Amin (2005), simple random sampling ensures that every member has an equal chance of being recruited into the sample. A sample frame was constructed and then the members were randomly sampled.

3.3.1.2 Non Probability Sampling

Non probability is a type of sampling that employs non randomness in selecting the study sample. The study used purposive sampling technique; it was employed while selecting human resource staff, accounting and finance staff, risk as well and staff from sales and marketing

department. According to Creswell (2003) purposive sampling enables a researcher to choose participants based on her own knowledge, interest and judgment.

3.4 Data collection methods

The researcher used two types of data collection methods namely; primary data collection and secondary data collection.

3.4.1 Primary data

Primary data was obtained through the use of self-administered questionnaires to respondents following systematic and established academic procedures, as suggested by Mugenda & Mugenda (1999). The questionnaires were used for the collection of data from staff.

Primary data were collected using questionnaires which were administered to Opportunity Bank staff by the researcher and were prepared in English. Other methods like use of telephone interviews as well as personal interviews were used.

Telephone Interviewing: Telephone interviews were also used; this is because it was a quick method, more flexible as the interviewer was able to explain questions not understood by the respondent. An interview also depending on respondent's answer was able to skip some Questions and probe more on others which allowed greater sample control

3.4.2 Secondary data

Secondary data was used in this study; this involved reviewing both published and unpublished reports for example past dissertations, business manuals, company reports and journals.

3.5 Data Quality Control (Validity and Reliability)

3.5.1 Validity

To establish validity qualitatively , the instruments was given to 5 experts to evaluate the relevance of each item in the instrument to the objectives and rate each item on the scale of very relevant (4), quite relevant (3), somewhat relevant (2), and not relevant (1). The researcher ensured that instruments had adequate traits through consultations with the supervisor, colleagues and two research consultants. The research experts helped in strengthening the validity of the research instruments. Content related validity was established through inter judge with two research experts. Each rated the items of the questionnaire on a two point rating scale of Relevant (R) and Irrelevant (IR). The computation of Content Validity Index (CVI) was done by summing up the judges rating on either side of the scale and dividing by two to get the average. The formula was;

$$CVI = \frac{\text{Number of relevant items}}{\text{Total number of items}} \times 100$$

Amin (2005) observes that in a survey, the least CVI recommended in a case study should be 0.70 (or 70%), the study was based on this recommendation and a CVI of 70% was considered. Some adjustments were made to make the questions more valid.

3.5.2 Reliability

Reliability is the extent to which a research instrument yields consistent results across the various items when it is administered again at a different point in time (Sekaran, 2003). To establish reliability, the instrument was pilot-tested twice on the same subjects at a time interval of one week. According to Amin (2005), test-retest reliability should be used to measure the extent to which the instrument could produce consistent scores when the same group of individuals is

repeatedly measured under same conditions. The results from the pretest were used to modify the items in the instruments.

To ensure reliability of quantitative data, the Cronbach's Alpha Reliability Coefficient for Likert-Type Scales test was performed. In statistics, Cronbach's alpha is a coefficient of reliability. It is commonly used as a measure of the internal consistency or reliability of a psychometric test score for a sample of examinees. According to Sekaran (2003) some professionals as a rule of thumb, require a reliability of 0.70 or higher (obtained on a substantial sample) before they use an instrument. Upon performing the test, the results that were above 0.7 were considered reliable.

3.6 Study of variables

The variables under the study were categorized into three; independent variables, dependent variables and intervening variables.

3.6.1 Independent variables

The independent variables included; Credit rating procedures, loan collection procedures and lending policies.

3.6.1.1 Dependent variables

In this study the dependent variable was performance of financial institutions. Performance is the action or process of carrying out or accomplishing an action, task, or function.

3.6.1.2 Extraneous variables

The extraneous variables in this study included budgetary planning and Organisational culture.

3.7 Measurement of variables

Credit policy and performance were measured basing on the item scale adapted from Berger and Udell, (2002). The items in the domain were 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 Mugenda & Mugenda, (1999). The items in the domain 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 Amin (2005).

3.8 Administration of the instruments

The researcher pre tested her instruments of data collection by designing questionnaires which were simple and unambiguous. The questionnaires contained both open and closed ended questions. The researcher used questionnaires because; it was a quick method of getting data, it was also more practical and because large amounts of information can be collected from a large number of people in a short period of time and in a relatively cost effective way

The researcher then obtained a letter of introduction from the Dean's Office Faculty of Vocational Studies Kyambogo University which was presented to the of study population. The letter was used to get permission from the Bank Manager Opportunity Bank to carry out research in the Bank. After getting permission the researcher then identified the respondents and requested them to provide responses to the study. During the data collection, respondents were

assured that the study was purely for academic purposes and responses were to be kept strictly confidential and anonymous. The researcher then visited the Bank manager, Head of Credit department and Heads of Internal Auditing with in Opportunity Bank for purposes of introduction and administration of results. The researcher herself administered the questionnaires and the exercise took four weeks contrary to the three weeks that were planned for in the proposal. Thereafter the information or responses in the questionnaires were used to interpret the data collected. This information was then used to examine the impact of credit policy on the performance of financial institutions in Uganda.

3.9 Data processing and presentation

The data was collected from the field and first edited to check its completeness and accuracy so as to derive at a statistical meaning of the data collected. Thereafter improvements were made and finally data was presented in frequencies and percentages.

3.10 Data Analysis

The Questionnaire was coded. In the coding process, a coding sheet was constructed.

A number was assigned to each answer in the questionnaire with a corresponding number on the coding sheet. Then the same questionnaire was constructed on the computer using Statistical Packages for Social Scientist (SPSS). Other non-descriptive statistics such as tables were also used to analyze the data collected. The method of analysis will be percentage score method

The Pearson's correlation analysis was used to present the relationships between the study variables and correlation co efficiency was used to study the variance in performance caused by

a combined effect of Credit rating procedures, loan collection procedures as well as lending policies on the financial performance of the bank in question.

3.11 Ethical Considerations

There are several reasons why it is important to adhere to ethical norms in research. First, norms promote the aims of research, such as knowledge, truth, and avoidance of error. For example, prohibitions against fabricating, falsifying, or misrepresenting research data promote the truth and avoid error. Second, since research often involves a great deal of cooperation and coordination among many different people in different disciplines and institutions, ethical standards promote the values that are essential to collaborative work, such as trust, accountability, mutual respect, and fairness.

In order to promote ethics in the study, respondent's names were withheld to ensure anonymity and confidentiality in terms of any future prospects. In order to avoid bias, the researcher interviewed the respondents' one after the other and ensured that she informed them about the nature and extent of her study and on the other hand, she gave them reasons as to why she was interviewing them.

3.12 Challenges of the Study

The researcher studied one case; therefore the results could not be generalized to other cases. However, the researcher encountered some limitations during the study especially when it comes to interviewing some respondents. Some were hesitant to give information unless paid; this was minimized by motivating the respondents with tangible gifts like hankies and designer pens.

The researcher also had to wait till late in the evening when the respondents are through with their work and when the field officers are back from the field so as to interview them, this was minimized by ensuring that she approaches the officers in the early morning hours before the bank opens so as to be helped before clients start walking in, also interviews were rescheduled to fit their timetables.

The research also turned out to be costly and took longer than anticipated because of the to and fro movements to the different branches of the bank and a big time lag between the time the questionnaires would be issued and when they would be ready for correction.

There was also a problem of absenteeism of members of staff mostly those who were on leave; this was minimized by following up some of the employees to their homes and also using telephone interviews especially the influential parties. More so frequent visits were made at the selected branches so as to minimize this challenge.

The researcher tried to manage these challenges by sensitizing the respondents on the importance and significance of the study. The Kyambogo University introductory letter also helped to allay the fears and doubts among some respondents. Efforts were made to maintain confidentiality of the responses.

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 FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION OF FINDINGS

4.1 Introduction

The chapter presents the analysis and interpretation of findings. The findings of the study were presented and analyzed by use of percentage tables.

This was based on the objectives of the study. The objectives included, to assess the relationship between credit rating procedure of loan applicants on the financial performance of Opportunity Bank, to determine the effect of interest rates on financial performance of Opportunity Bank and to examine the relationship between the loan collection procedures and the financial performance of Opportunity Bank. The key aspects are respondent's bio data, Credit rating procedures and financial performance, Performance of Opportunity bank and the extent of the relationship between credit policy and performance of opportunity bank.

4.2 Respondents bio data

This section presents the gender, education, duration, and age of the respondents as indicated in table 4.1 below

Table 4. 1: Gender of the respondent

The table looks at the gender of the respondents in Opportunity bank; it brings out clearly whether an employee is male or female

Gender	Frequency	Valid Percent (%)
Male	31	62.0
Female	19	38.0
Total	**50**	**100.0**

Source: ***Primary Data***

From the table 4.1 above, most of the respondents were male represented by 31respondents (62%) and only 19 respondents (38%) were female. This implies that most of the employees of Opportunity bank are male. An interview with the credit manager indicated that the bank prefers males to females for the loan section because it involves hectic field works. The credit manager continued to reiterate that apart from gender, age of loan officers is also an issue of consideration as indicated in table 4.2 below

Table 4. 2: Age of the respondents

Table 4.2 explains the age of the respondents which was classified in three groups as indicated below

Age	Frequency	Valid Percent (%)
20 – 29	35	70.0
30 – 39	13	26.0
40 – 49	2	4.0
Total	**50**	**100.0**

Source: ***Primary Data***

From table 4.2 above, most of the respondents were between the age of 20 and 29 represented by 35 (70%), a few were aged between 30 and 39 years and these were represented by 13 respondents (26%) whereas only 2 respondents were between the age of 40 and 49 years (4%). This indicates that most of the employees of Opportunity bank are between 20-29 years of age,

this was made more clear by an interview with the Human Resource Officer who also brought out the fact that employees between the age of 20 and 29 are preferred by the organization especially for the post of field officers since they tend to be more energetic and flexible, she however said that not only do they consider gender and age but also go ahead to look at the education levels of the employees as indicated in table 4 below

Table 4. 3: Level of education of the respondents

Table 4.3 points out the levels of education of the employees at Opportunity bank, these levels are classified under diploma, degree, professional or Master's Degree

Education	Frequency	Valid Percent (%)
Diploma	12	24.0
Degree	32	64.0
Professional	2	4.0
Masters	4	8.0
Total	**50**	**100.0**

Source: ***Primary Data***

Most of the respondent were degree holders represented by 32 (64%), followed by 12 (24%) who had diploma qualifications, 4 (8%) had masters qualifications and only 2 (4%) had professional qualifications. This implies Opportunity bank has qualified and skilled human resources. The researcher went ahead to look at the duration of the employees in the organization as indicated in table 4.4

Table 4. 4 Duration of employment

Duration (Years)	Frequency	Valid Percent (%)
Less than 2 Years	32	64.0
3 - 6 Years	11	22.0
More than 6 Years	7	14.0
Total	**50**	**100.0**

Source: ***Primary Data***

From the table 4.4 above, most of the respondents had worked with Opportunity bank for less than 2 year represented by 32 respondents (64%), 11 respondents had worked with opportunity bank for 3-6 years, this represents 22%, the other 7 respondents had worked with the bank for more than 6 years (14%), it can thus be concluded that most of Opportunity employees are young in the organization. An interview with the Human resource officer attributed this to the high rate of employee turnover at the bank.

Table 4. 5: Respondents department

Department	Frequency	Valid Percent (%)
Operations	16	32.0
Human resource	3	6.0
Loan/credit	27	54.0
Risk	2	4.0
Sales and marketing	2	4.0
Total	**50**	**100.0**

Source: ***Primary Data***

From the table 4.5 above, 27 respondents belonged to the loans/credit department represented by (54%), 16 respondents belonged to Operations department (32%), other 3 respondents belonged to the human resource department (6%), 2 respondents (4%) belonged to the risk department and 2 respondents belonged to sales and marketing department (4%). In an interview with the

relationship manager of Nansana branch, she attributed this to staff in the credit department having more information about credit policy than any other department.

4.2 Credit rating procedures and financial performance

Under this objective, the researcher concentrated on loan applicants' occupational stability, bank references, attachment to a reorganized institution, general economic trends, business climate, physical inspection of loan applicants' business/plant, previous experience/ transactions, the adequacy of resources, inspection of property, rights exercisable against loan applicants' property and sufficiency of funds.

Table 4. 6: Credit rating procedure

Statement/variable	SA	A	NS	DA	SD
The loan applicant's occupational stability is taken into account before the loan is advanced.	0(0%)	3(6%)	1(2%)	9(18%)	37(74%)
Bank references are usually made before a loan is advanced.	0(0%)	0(0%)	1(2%)	18(36%)	31(62%)
Attachment to a reorganized institution is considered before a loan is advanced.	2(4%)	4(8%)	6(12%)	31(62%)	7(14%)
The general economic trends and special developments in the country are assessed before loans are granted.	0(0%)	10(20%)	15(30%)	11(22%)	14(28%)
The business climates in which loan applicants are operating are always assessed.	0(0%)	2(4%)	3(6%)	26(52%)	19(36%)
Physical inspection of loan applicants' business/plant is carried out before any loan is advanced.	0(0%)	2(4%)	2(4%)	10(20%)	36(72%)
Previous experience/transactions loan applicant is considered before a	0(0%)	2(4%)	7(14%)	21(42%)	20(40%)

loan is advanced.					
The adequacy of resources is taken into account before am given credit.	0(0%)	2(4%)	9(18%)	27(54%)	12(24%)
Property is inspected before a loan is advanced.	0(0%)	2(4%)	5(10%)	8(16%)	35(70%)
Opportunity Bank Uganda is offered rights exercisable against loan applicants' property to enable the bank discharge the debt obligation.	0(0%)	2(4%)	10(20%)	17(34%)	21(42%)
The loan applicants must be with sufficient funds in business to qualify for the loans.	2(4%)	9(18%)	6(12%)	18(36%)	15(30%)
The income generating activity is physically inspected the loan is advanced.	0(0%)	2(4%)	6(12%)	18(36%)	24(48%)
The loan applicants' savings are considered before a loan is advanced.	0(0%)	8(16%)	4(8%)	18(36%)	20(40%)
Loan applicants are required to present a collateral security before the loan is advanced.	1(2%)	4(8%)	6(12%)	14(28%)	25(50%)
Collateral security is limited to large loan sizes	8(16%)	17(34%)	6(12%)	10(20%)	9(18%)
The collateral security is always valued by professional values.	0(0%)	7(14%)	2(4%)	17(34%)	24(48%)
The value of the collateral security is always more than the loan advanced.	0(0%)	2(4%)	4(8%)	15(30%)	29(58%)
The collateral security is inspected by the loan officer before the loan is approved.	0(0%)	2(4%)	4(8%)	16(32%)	28(56%)

Source: ***Primary Data***

In an interview with respondents and using the self-administered questionnaire, the criteria of assessing loan applicants to determine their potential of loan applicant before the loan is advanced were revealed as; the history of one credit reference bureau report determines the amount to be approved, capacity of the loan applicant, the willing of the loan applicant to pay the borrowed amount, valuing of books of accounts to see how viable the business is as well as other

assets of the borrowers, purpose of borrowing, management capability and monitor the saving discipline by using bank statement.

According to the table 4.6, majority of the respondents 46 (92%) disagreed that loan applicants occupational stability is taken into account before the loan is advanced and only 3 (6%) agreed applicants occupational stability is taken into account before the loan is advanced . This implies loan at Opportunity bank are advanced without assessment of applicant's potential to pay the borrowed amounts and this subsequently may lead to increased rate of default.

Opportunity bank does not assess the economic trends and special developments before advancing loans to applicants represented by 25 (50%) of the total respondents who disagreed whereas 15 (30%) were not sure and only 10 (20%) agreed. This implies that condition as an element of credit standards is not considered by Opportunity bank wile assessing loan applicants.

According to the findings of the study, most of the respondents 33 (66%) disagreed that the loan applicant must have sufficient funds to qualify for loan whereas 11 (11%) agreed and only 6 (11%) were not sure. These findings imply the loan applicant's capacity to repay is not assessed by the loans officers. This probably explains the low rate of repayment of borrowed amounts at Opportunity bank.

The findings of the study revealed that most of the loan applicants are not required by the bank to present a collateral security before the loan is advanced represented by 29 (78%), 6 (12%) were not sure and only 5 (10%) agreed that the loan applicants are required by the bank to present a

collateral security before the loan is advanced. This means that 78% of loans advanced by Opportunity are not secured and thus in case of default the bank has nothing to sell to recover the defaulted amounts.

The criteria of determining the collateral security was revealed as; depends on the loan size applied for the more the amount the more the collateral security, its monetary value should be more than the loan to be taken, uses the forced sale value basin on the market value of the security, officers judgment, professional valuation and visiting the location of security and verification of the security with relevant authority such as URA and Ministry of lands

The researcher probed further and asked the respondents if the credit rating procedure of Opportunity has got weaknesses. The following weaknesses of credit rating procedure of Opportunity bank were revealed by the interviewed respondents; loan appraisal and committees taking long, long procedures when making /carrying out assessment, non-assessment of guarantors, some of the securities pledged by the loan applicants are less valued compared to the loan requested, it does not capture the consistency of deposits for example applicants know their statements, some securities are forded, securities are sold by the applicant before paying the loan, structural approach to loan appraisal.

The respondents suggested the following measures to overcome the weakness of credit procedure of Opportunity bank; ensure that the securities are more valuable than the loan applied for, proper monitoring of the loan applicants/borrower, inspect the securities and assess the worthiness, guarantors should be physically assessed, training of loans officers, portfolio frequency reduction and should look at the consistency and how often they deposit on the savings accounts.

4.2.1 Credit terms of Opportunity bank

The researcher was interested in establishing the credit terms of Opportunity banks which are one of the components of credit policy. The findings were presented in the table 4.7 below for further analysis.

Table 4. 7: Credit terms of Opportunity bank

Statement/variable	SA	A	NS	DA	SD
The bank has got maximum amount of loan to customers.	4(8%)	2(4%)	5(10%)	18(36%)	21(42)
The loans are approved by the head of credit.	1(2%)	6(12%)	4(8%)	19(38%)	20(40%)
The loan size advanced depends on the financial potential of the loan the applicant	0(0%)	0(0%)	12(24%)	18(36%)	20(40%)
The bank has a set loan repayment period	0(0%)	2(4%)	4(8%)	15(30%)	29(58%)
Borrowers who default are always fined and the collateral security sold.	2(4%)	2(4%)	11(22%)	17(34%)	18(36%)
Borrowers are always given grace period	1(2%)	6(12%)	12(24%)	12(24%)	19(38%)
The interest charged on the loans is favorable to the customers.	5(10%)	5(10%)	14(28%)	13(26%)	13(26%)
Sometimes borrowers are given a discount in case they pay on time	6(12%)	7(14%)	14(28%)	12(24%)	11(22%)
The interest rate charged leads to borrowers default due to	10(20%)	7(14%)	16(32%)	10(20%)	7(14%)

accumulated amounts.					
The interest rate is negotiable between the bank and the loan applicant.	4(8%)	12(24%)	5(10%)	19(38%)	10(20%)
The repayment period is sufficient to enable borrowers pay back the loans.	5(10%)	3(6%)	5(10%0	19(38%)	18(36%)

Source: ***Primary Data***

According to the findings in table 4.7, majority of the respondents 39 (78%) disagreed that the bank has got maximum loan amount, 5 (10%) were not sure and 6 (12%) agreed that the bank got maximum amount of the loan. The loan amount is one of the credit terms which the researcher wished to establish, the basis of determining the maximum amount of the loan was revealed as; use the 5Cs to determine the maximum amount for example the capital of the loan applicant capacity and conditions of the business, value of the security and credit history of the applicant, the capital and the size of business of the applicant, the consistency of borrowers income and value of the security, credit policy guidelines and salary earned and assets possessed by the loan applicant.

Most of the respondents 34 (68%) disagreed that the bank has set loan repayment period, 12 (24%) were not sure and only 2 (4%) agreed that Opportunity bank has a set loan repayment period. This implies that the repayment is not standard for all e loan products.

The researcher asked the key respondents the basis of determining the loan repayment period. The basis was revealed as; cash flows of loan applicants business, it depends on the type of the loan for example the agriculture loans are paid at once, physical stand of the business, sales

revenue and operating expenses, depends on the customer's ability, the bank has got an acceptable repayment period, the period for which the loan applicant has requested for in line with the bank's policy, ability to pay and purpose of the loan and nature of the collateral security

According to the findings in the table above, most of the respondents 26 (52%) disagreed that the interest rate is favourable whereas 14 (28%) were not sure and only 10(2%) agreed that the rate of interest cared on the loan products is favourable. Basing on the findings of the study it implies interest rate on loans has not attracted many loan applicants and this probably explains retarded growth in loan portfolio of Opportunity bank. The criteria of determining the interest rate was revealed as; below that set by BOU - it's determined by bank of Uganda, it as to be above the inflation rate and amount of the loan applied for by the loan applicant.

Collection procedure and effort

The findings obtained using self-administered questionnaires regarding collection procedure and efforts of Opportunity bank are presented in the table 4.8 below;

Table 4. 8: Collection procedure and effort

Statement/variable	SA	A	NS	DA	SD
The loans officer normally makes reminders to the borrowers when the loan repayment is due.	0(0%)	0(0%)	9(18%)	18(36%)	23(46%)
The loans officers send reminder letters and personal visits to recover the loans.	3(6%)	0(0%)	9(18%)	16(32%)	22(44%)
Sometime the borrowers are taken to courts of law in case of failure to pay.	3(6%)	0(0%)	9(18%)	19(38%)	19(38%)
The bank sometimes sells the collateral to recover the defaulted	1(2%)	2(4%)	5(10%)	23(46%)	19(38%)

amount					
The bank uses court bailiffs/debtor collectors to recover loans from borrowers	2(4%)	4(8%)	10(20%)	16(32%)	18(36%)
The bank's collection procedure and efforts are effective	0(0%)	1(2%)	9(18%)	18(36%)	22(44%)
The loans officers are skilled and experienced in loan recovery	0(0%)	2(4%)	7(14%)	29(58%)	12(24%)
The bank's collection procedure and efforts has maximized loan recovery	0(0%)	1(2%)	12(24%)	24(48%)	13(26%)

Source: ***Primary Data***

The process of collection procedure and effort was revealed to be containing the following procedure; reminding borrowers through telephone calls, Good faith in case it fails, offering the demand notices to the borrowers, timely reminder to the borrowers, repayment due dates are agreed with borrowers and the consequences are discussed, it also depends on the type and amount of money defaulted; for big amounts, the bank uses debt collectors, for small amounts, loans are recovered by the recovery officers.

However, the following were revealed as the weaknesses of the bank collection procedure and effort; lack of support from management, for loans above 30 days demand, ineffectiveness of the recovery notes that are used, field officers are not enforced, corrupt officers, untrustworthy officers, long time lag between the time one starts defaulting and the time the collateral security is liquidated, pretense of borrowers to be ignorant of their obligations, restructuring the grace period, loan officers are not well trained and equipped with enough knowledge.

4.2.2 Limitations of credit policy of Opportunity bank

The researcher wished to establish the limitation of credit policy of Opportunity bank. In an interview with the respondents and using a self-administered questionnaire, the following were

revealed as the main limitations of credit policy; lack of uniformity in the collection procedure and effort, policies are passed without consulting the officers who do the implementation, the policy that doesn't protect staff as well as the bank, relaxed recovery policy, BOU consumer protection policy and the procedures are not standardized and clearly defined.

When the researcher probed further about the measures to overcome the limitations of credit policy, the target respondents revealed the following; strengthening the recovery policy and department, standardizing the lending procedure and collection effort and creating uniformity as well as reducing on group lending.

4.3 Performance of Opportunity Bank

4.3.1 Performance measures of Opportunity Bank

The researcher was interested in establishing the performance of Opportunity bank over the last periods. The performance measures indicated limited improvement in assets, growth in loan portfolio, and rate of default, profitability and customer base. The findings obtained using the self-administered questionnaires were presented in the table below;

Table 4. 9: Performance of opportunity Bank

Statement/variable	SA	A	NS	DA	SD
The bank's asset base has improved over the years.	0(0%)	3(6%)	10(20%)	25(50%)	12(24%)
The loan portfolio of Opportunity bank has grown over the past period.	0(0%)	2(4%)	14(28%)	19(38%)	15(30%)
There is always default and write off of bad loans.	0(0%)	2(4%)	15(30%)	21(42%)	12(24%)
The bank's profits have improved over the five years.	0(0%)	9(18%)	16(32%)	12(24%)	13(26%)
The Opportunity bank has a large customer base compared to banks.	0(0%)	8(16%)	17(34%)	20(40%)	5(10%)

Source: ***Primary Data***

From the table 9, majority of the respondent 37(74%) disagreed that the bank's assets base as improved over the past years, 10 (20%) were not sure and only 3 (6%) agreed. Basing on these findings and on the banks annual report of 2013, it implies that the bank has not performed in regard to assets base.

Majority of the respondents 34 (68%) disagreed that loan portfolio have grown over the past years whereas 14 (28%) were not sure and only 2 (4%) agreed that the loan portfolio of opportunity bank improved. However, most of the respondents 33 (66%) disagreed that their defaulted loans are always written off. This implies that the bank takes a long time to write off loans as bad in case borrowers default.

It is evident from the table above that the profits of Opportunity bank have not improved over the past years as represented by the most of the respondents who disagreed 25 (50%), whereas 16 (32%) were not sure and only 9 (18%) agreed that profits of the bank improved in the past five years. This implies that the bank profits have not improved insignificantly an indicator of mild performance in terms of profitability.

The customer base of Opportunity bank is still small compared to other financial institutions as represented by most of respondents 25 (50%) who disagreed followed by 17 (34%) who were not sure and only 8 (16%). The researcher asked the respondents why they think attracts customers to Opportunity bank, the reasons were revealed as; good customer care, range of loan products and services, micro lending to small businesses, low interest rate as compared to other banks, focusing on transformation other than commercial, free financial literacy, bank mission dealing with economically active poor, wide foot print and lending methodology of group lending.

4.4 Relationship between credit policy and performance of Opportunity Bank

The researcher wished to establish the relationship between credit policy and performance of financial institutions in Uganda and this was broken down into the following;

4.4.1 Credit rating procedure and performance of Opportunity Bank

The respondents were asked if the credit rating procedures/standards are favourable and whether they have improved on the performance of Opportunity Bank. The responses obtained using the research questionnaires were presented in the table below;

Table 4. 10: Credit rating procedure and performance of Opportunity Bank

Response	Frequency	Valid Percent (%)	Cumulative Percent
Agree	4	8.0	8.0
Not sure	19	38.0	46.0
Disagree	17	34.0	80.0
Strongly disagree	10	20.0	100.0
Total	**50**	**100.0**	

Source: ***Primary Data***

From table 10 most of respondents 27 (54%) disagreed with the statement that credit rating procedure have improved the performance of Opportunity Bank, 19 (38%) were not sure and only 4 (8%) agreed that the rating procedure improved the performance of Opportunity bank. Basing on the findings of the above it implies that the credit rating procedure of bank is ineffective and thus an improvement in the credit rating procedure is needed to maximize the bank's performance.

4.4.2 Credit terms and performance of Opportunity bank

Respondents were asked to indicate their agreement with whether credit terms have improved performance. The results are indicated in table 4.11 below

Table 4. 11: Credit terms and performance of Opportunity bank

Response	Frequency	Valid Percent (%)	Cumulative Percent
Agree	2	4.0	4.0
Not sure	17	34.0	38.0
Disagree	19	38.0	76.0
Strongly disagree	12	24.0	100.0
Total	**50**	**100.0**	

Source: ***Primary Data***

According to the findings in the table 4.11 above, most of respondents 31 (62%) disagreed with the fact that credit terms have improved the performance of Opportunity bank, 17 (34%) were not sure and only 4 (8%) agreed that the credit terms improved the performance of Opportunity bank. Basing on the findings of the above it implies the credit terms of opportunity bank seem not to be favorable to enhance the bank's performance.

4.4.3 Loan size and growth of loan portfolio

Respondents were also asked to indicate their agreement with whether the loan size has affected loan portfolio growth. The results are indicated in table 4.12 below

Table 4. 12: Loan size and growth of loan portfolio

Response	Frequency	Valid Percent (%)	Cumulative Percent
Agree	9	18.0	18.0
Not sure	10	20.0	38.0
Disagree	21	42.0	80.0
Strongly disagree	10	20.0	100.0
Total	**50**	**100.0**	

Source: ***Primary Data*** From the findings in the table 4.12, most of respondents 31 (62%) disagreed with the statement that loan size advanced improved growth of loan portfolio 10 (20%) were not sure and only 9 (18%) agreed that the loan size leads to growth in loan portfolio. Basing on the findings of the above it implies that there are other factors that contribute to the growth of loan portfolio of Opportunity bank.

4.4.4 Interest rate, loan portfolio growth and performance of Opportunity bank

The findings obtained regarding the relationship between interest rate and loan portfolio growth were presented in the table below;

Table 4. 13: Interest rate and loan acquisition

In table 4.13, the respondents either agree, disagree are not sure, disagree or strongly disagree as to whether interest rate affects loan acquisition.

Response	Frequency	Valid Percent (%)	Cumulative Percent
Agree	14	28.0	28.0
Not sure	8	16.0	44.0
Disagree	20	40.0	84.0
Strongly disagree	8	16.0	100.0
Total	**50**	**100.0**	

Source: ***Primary Data***

According to the findings in the table 4.13, majority of respondents 14 (28%) agreed to the statement that interest rate affects loan acquisition from Opportunity bank, 8 (16%) were not sure and only 8 (16%) disagreed that the interest rate improved loan acquisition. Basing on the findings above it implies that the rate of interest on loan products rate is not favorable to attract loan applicants leading to loan portfolio growth. It also means that if the rate of interest was favorable, then it would attract more loan applicants thus is can be concluded that there is a relationship between interest and loan portfolio growth and performance of financial institutions.

4.4.5 Collection procedure and loan recovery maximization

The researcher was interested in finding out whether collection procedure and effort of Opportunity bank maximizes loan recovery from borrowers, the findings obtained using a self-administered questionnaire were presented in the table 14 below

Table 4. 14: Collection procedure and loan recovery maximization

In table 14, the respondents either agree, disagree are not sure, disagree or strongly disagree as to whether collection procedure affects loan recovery maximization

Response	Frequency	Valid Percent (%)	Cumulative Percent
Strongly Agree	0	0.0	0.0
Agree	1	2.0	2.0
Not sure	16	32.0	34.0
Disagree	29	58.0	92.0
Strongly disagree	4	8.0	100.0
Total	**50**	**100.0**	

Source: ***Primary Data***

According to table 14, majority of the respondents 33 (66%) disagreed with an opinion that collection procedure and efforts maximize loan recovery from borrowers, 16(32%) respondents were not sure where as only 1 respondent agreed with the opinion.

Basing on the findings above it implies that collection procedures and effort of Opportunity bank do not effect loan recovery maximization.

4.4.6 Collection procedure and bank's performance

In table 15, the respondents either agree, disagree are not sure, disagree or strongly disagree as to whether collection procedure affects bank's performance

Table 4. 15: Collection procedure and effort and the bank's performance

Response	Frequency	Valid Percent (%)	Cumulative Percent
Strongly agree	2	4.0	4.0
Agree	3	6.0	10.0
Not sure	8	16.0	26.0
Disagree	29	58.0	84.0
Strongly disagree	8	16.0	100.0
Total	**50**	**100.0**	

Source: ***Primary Data***

According to the findings in table 15, majority of respondents 37 (74%) disagreed that the collection effort and procedure have improved the performance of Opportunity bank, 8 (16%) were not sure and only 5 (10%) agreed that the collection effort and procedure improves the performance of Opportunity bank. Basing on the findings of the above it implies the collection effort and procedure is not effective and a lot is desired to ensure that it maximizes loan recovery and enhances the bank's performance.

4.5 Extent of the relationship between credit policy and performance of opportunity bank

4.5.1 The effect of credit rating procedure on performance of Opportunity bank

Statistical analysis was further conducted on the effect of credit rating procedure/credit standards on performance using Pearson correlation coefficient and the results are presented in the table 16;

Table 4. 16: Effect of credit rating procedure on performance

		Credit rating procedure	Performance of Opportunity bank
Credit rating procedures/credit standards	Pearson Correlation	1	.745(**)
	Sig. (2-tailed)	.	.000
	N	50	50
Performance of Opportunity	Pearson Correlation	.745(**)	1
	Sig. (2-tailed)	.000	.
	N	50	50
** Correlation is significant at the 0.01 level (2-tailed).			

Source: ***Primary Data***

The findings in the table 16 shows Pearson's correlation coefficient r= 0.745** generated from the statistical analysis with the p-value = 0.000<0.01 implying that there is a significant positive correlation between credit rating procedure/credit standards and performance (r = 0.745**, p=0.000<0.01). This implies a linear relationship between the two variables. That is, if the credit rating procedures are properly followed when assessing loan applicants it would lead to an improvement in performance measures of assets base, loan portfolio growth, customer base, reduced default rate and profitability. Therefore the correlation results indicated that Opportunity bank credit rating procedure has a positive significant relationship with performance since 0.000 is less than 0.01 which is the accepted level.

4.5.2 The effect of credit terms on performance of Opportunity bank

Correlation were generated using Pearson correlation coefficient test during the study to assess the effect of credit terms on performance and the results generated are presented in the table 17;

Table 4. 17: Effect of credit terms on performance

		Credit terms	Performance of Opportunity bank
Credit terms	Pearson Correlation	1	.445(**)
	Sig. (2-tailed)	.	.000
	N	50	50
Performance of Opportunity	Pearson Correlation	.445(**)	1
	Sig. (2-tailed)	.000	.
	N	50	50
** Correlation is significant at the 0.01 level (2-tailed).			

Source: ***Primary Data*** The findings in the table 17 above show Pearson's correlation coefficient r= 0.445** generated from the statistical analysis with the p-value = 0.000<0.01 implying that there is a mild positive correlation between credit terms and performance of performance (r = 0.445**, p=0.000<0.01). This implies a linear relationship between the credit terms and performance. This means that the credit terms of Opportunity bank are not favorable and insignificantly effect performance. This therefore suggests that the credit terms need to be made favorable to attract loan applicants and this would lead to improvement in performance measures of assets base, loan portfolio growth, customer base, reduced default rate and profitability. Therefore the correlation results indicate that Opportunity bank credit terms has mild positive significant relationship with performance since 0.000 is less than 0.01 which is the accepted level.

4.5.3 The effect of collection procedure on financial performance of Opportunity bank

To assess the extent to which collection procedure and effort effect performance of Opportunity bank, Pearson correlation coefficient test was used during the study and the results generated are presented in the table 18;

Table 4. 18: Effect of collection procedure and effort on performance

		Collection procedure and effort	Performance of Opportunity bank
Collection procedure and effort	Pearson Correlation	1	.685(**)
	Sig. (2-tailed)	.	.000
	N	50	50
Performance of Opportunity bank	Pearson Correlation	.685(**)	1
	Sig. (2-tailed)	.000	.
	N	50	50
** Correlation is significant at the 0.01 level (2-tailed).			

Source: ***Primary Data***

From table 18, the Pearson's correlation coefficient r= 0.685** generated from the statistical analysis with the p-value = 0.000<0.01 implying that there is a positive correlation between collection procedures and effort and performance (r = 0.685**, p=0.000<0.01). This means that the collection effort and procedure of Opportunity bank still as defects and more effective evidenced by default rate by customers. However, the correlation results indicate that

Opportunity bank collection procedure and effort has above average positive significant relationship with performance since 0.000 is less than 0.01 which is the accepted level.

4.5.4 Challenges faced by Opportunity bank

In an interview with the respondents and using the researcher questionnaire the following were revealed as the major challenges faced by Opportunity bank; high employee turnover, long loan processing period, untrustworthy staff, competition from other banks, ignorant clients and high default rate.

When the researcher probed further through an interview with the Credit manager of Kira Branch and through the administered questionnaire, the respondents suggested that the above challenges can be overcome by the following measures; improve on the working conditions of the employees, improve on the management of information system, more efforts to empower staff, ensuring good valuation of collateral, educate their customers about the management of loans and repayment, assimilation of local dynamics, strengthen the recovery teams, training of staff in loan recovery and assessment of loan applicants and use of third parties like court bailiffs to recover loaned amounts.

CHAPTER FIVE

DISCUSSION AND SUMMARY OF THE FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings, conclusions and the recommendations relating to the objectives of the study as discussed in the previous chapters. It focuses on the summary and discussion of the study findings, conclusion and researchers recommendations.

5.2 Discussion and Summary of the Study Findings

The discussion and summary of the study findings were based on the objectives and the research question as discussed below;

5.2.1 Findings on credit policy

The main elements of credit Policy were identified as credit standards, credit terms and collection procedures. Where credit terms refers to the criteria followed in selecting customers for the purpose of credit extension which include; capacity, character, condition, collateral, capital.

The study found out that the criteria of assessing loan applicants at Opportunity bank is as follows; the history of one's CRB report determines the amount to be approved, capacity of the loan applicant, the willingness of the loan applicant to pay the borrowed amount, valuing of books of accounts to see how viable the business is as well as other assets of the borrowers, purpose of borrowing, management capability in case of group loans and monitoring the saving

discipline by using bank statement. This is contrary to Kiggundu (2009) who disagrees that the credit policy is beyond screening customers' capacity basing on payments by asserting that a credit policy sets general frameworks for managing the credit portfolio other than focusing on customer capacity.

Loan applicant's occupational stability is not taken into account before the loan is advanced (92%). Opportunity bank does not assess the economic trends and special developments before advancing loans to applicants represented by (50%). This implies that condition as an element of credit standards is not considered by Opportunity bank while assessing loan applicants. The loan applicants need not to have sufficient funds to qualify for loan (66%).

The study found out that not all loan applicants are required by the bank to present collateral security before the loan is advanced (78%). This implies that 78% of loans advanced by Opportunity bank are not secured and thus in case of default the bank has nothing to sell to recover the defaulted amounts.

The above findings contradict (Pandey, 2009) who states that Collateral, character, consideration, capital and capacity are important considerations that a financial manager should carefully think about to make good financial decision and to estimate the probable default in payment.

The study found out the following as weaknesses of credit rating procedure of Opportunity bank; loan appraisal and committees take long, long procedures when making assessment, no

assessment of guarantors, some of the securities pledged by the loan applicants are less valued compared to the loan amount requested, consistency of deposits is not considered, some securities are forged, securities are sold by the applicant before paying the loan, structural approach to loan appraisal. This reaffirms Aryeetey (1996B) research finding that a poor credit policy will not provide optimal results.

The study found that Opportunity bank does not have maximum loan amount (78%). The loan amount depends on the capital of the loan applicant capacity and conditions of the business, value of the security and credit history of the applicant, the capital and the size of business of the applicant, the consistency of borrowers income and value of the security, credit policy guidelines and salary earned as well as assets possessed by the loan applicant

The bank does not have a standard loan repayment period (68%). This implies that the repayment period varies alongside loan products. The basis of determining the loan repayment period was found as; cash flows of loan applicants business, type of the loan, physical stand of the business, sales revenue and operating expenses, customer's ability, purpose of the loan and nature of the collateral security. This finding is in agreement with(Ddumba, 2005) who states that any detection of laxity and negative changes highly affect the banks' lending ,profits , collection period and other expenses associated with bad loans.

The study also found out that interest rate is not favourable (52%). The criteria of determining the interest rate was found to be determined by BOU which ensures that it is above the inflation

rate, it is also determined in accordance with the amount of loan applied for by the loan applicant.

The process of collection procedure and effort was revealed to be containing the following procedure; reminding borrowers through telephone calls, good faith in case it fails, offering the demand notices to the borrowers, timely reminder to the borrowers, repayment due dates are agreed with borrowers and the consequences are discussed, it depends on the type and amount of money defaulted; for big amounts debt collectors are used, for small amounts, recovery officers are used. These procedures were being implemented by the bank following (Lawrence, 2006) who stressed that recovery includes all efforts of collecting loan balances in arrears to maintain a profitable loan portfolio

However, the study revealed the following as the weaknesses of the bank's collection procedure and effort; lack of support from management, for loans above 30 days demand, recovery notes are not effective, field officers are not enforced, corrupt officers, death of the borrower , untrustworthy officers, long time lag between the time one starts defaulting and the time the security is liquidated, pretense of borrowers to be ignorant of their obligations, restructuring the race period, loan officers are not well trained and equipped with enough knowledge

In an interview with the respondents and using a self-administered questionnaire, the following were revealed as the main limitations of credit policy; Lack of uniformity in the collection procedure and effort, policies are passed without consulting the officers who implement them, relaxed recovery policy, BOU consumer protection policy that does not protect staff/bank and the procedures that are not standardized and clearly defined.

Credit terms are stipulations under which credit is granted and it also includes; credit period and cash discounts. In Uganda, banks rarely provide these incentives to borrowers simply over 90% of their transaction are on credit basis.

The study found out that the collection procedures of Opportunity bank include; delivery of remainder letter by the loan's officers, personal visits, employing collection agency (factors), personal calls and finally a legal action that is taken against the borrower in case the above procedures fail.

5.2.2 Findings on financial performance of opportunity Bank

The study found out that the bank's assets base had not improved over the past years (74%). Loan portfolio has not grown over the past years (68%). The study also found out that the profits of Opportunity bank had not improved over the past years represented by (50%). The customer base of Opportunity bank was still small compared to other financial institutions (50%).

However it was found that the reasons which attracted customers to Opportunity banks were; good customer care, a wide range of loan products and services, micro lending to small businesses, focusing on transformation other than commercial goals, free financial literacy, bank's mission of dealing with economically active poor, wide foot print and the lending methodology of group lending.

The study also found out that other factors affecting the performance of Opportunity bank were; limited employees motivation, weak recovery policy, bureaucracy in disbursing loans, high default rates, high employee turnover, small market share, long procedure of acquiring individual

loans, competition from other banks and financial institutions and longtime taken before replacing staff who exit the bank.

5.2.3 Findings on the relationship between credit policy and performance of Opportunity bank

Findings on the effect of credit rating procedure on financial performance indicate that there is a linear relationship between the two variables, that is, if the credit rating procedures are properly followed when assessing loan applicants it would lead to an improvement in performance measures of assets base, loan portfolio growth, customer base, reduced default rate and profitability. Thus there is a positive significant relationship between Opportunity bank's credit rating procedures and financial performance of the bank.

Findings on the Effect of credit terms on performance indicate that there is a linear relationship between the credit terms and performance. This implies that the credit terms of Opportunity bank are not favorable and insignificantly effect performance since they scare away applicants and increase on the default rate thus reducing the profitability of the bank. Therefore there is a mild positive significant relationship between credit terms and financial performance of the bank.

Findings on the effect of collection procedure and financial performance of Opportunity bank indicate that there is a positive correlation between collection procedures and effort and performance of the bank, this implies that the collection effort and procedure of Opportunity bank still have defects and this was evidenced by high default rate by customers.

It was found out that credit rating procedures have not improved the performance of Opportunity bank (54%). The finding revealed that the credit rating procedure of Opportunity bank is ineffective and thus an improvement in the credit rating procedure is needed to maximize the bank's performance. According to the findings of study credit terms have not improved the performance of Opportunity bank (62%).

The study findings revealed that the interest rate on loan products rate is not favorable to attract loan applicants leading to low loan portfolio growth. This means that if the rate of interest is favorable then it would attract loan applicants thus it can be concluded that there is a positive relationship between favorable loan interest, loan portfolio growth and performance of financial institutions.

The study found out that if a bank is lenient in collection of its loans advanced it may increase receivables but slow revenue collection maximization from borrowers. This can result into bad debts being written off in the long run. In light of the above it implies that to realize high loan recovery rate, the bank should design an appropriate credit management policy. Basing on this, it implies that there is a strong relationship between credit policy and loan recovery in financial institutions. To a greater extent, credit management of any financial institution effect loan recovery and loan portfolio performance.

5.3 Conclusions

From the findings on the effect of credit rating procedure on performance, the researcher concluded that performance of financial institutions is greatly affected by their credit policies.

Findings indicated a linear relationship between the two variables, that is, if the credit rating procedures are properly followed when assessing loan applicants it would lead to an improvement in performance measures of assets base, loan portfolio growth, customer base, reduced default rate and profitability. Thus there is a positive significant relationship between Opportunity bank's credit rating procedures and financial performance of the bank.

Following the findings on the Effect of credit terms on performance, the researcher concluded that there is a linear relationship between the credit terms and performance. This implies that the credit terms of Opportunity bank are not favorable and insignificantly effect performance since they scare away applicants and increase on the default rate thus reducing the profitability of the bank. Conclusively, there is a mild positive significant relationship between credit terms and financial performance of the bank.

From the findings on the effect of collection procedure and effort on performance of Opportunity bank, the researcher concluded that there is a positive correlation between collection procedures and effort and performance, this implies that the collection effort and procedure of Opportunity bank still have defects as evidenced by high default rate by customers.

The study pointed out that the bank has got weak credit policies that have resulted into poor performance according to the primary data collected from the field, literature reviewed and the documentary empirical evidence from financial institutions.

From the findings on credit standards, the researcher concluded that the credit standards which are applied are stringent and unfair. Borrowers lack such standards, this means that financial

institutions only offer loan linked and locked in savings systems. They are not providing facilities that allow the poor to save in a way that would help them meet their basic needs and opportunities to save for the future.

5.4 Recommendations

Basing on the findings of study the researcher made the following recommendation help the bank improve on its credit management and performance.

The bank should reduce on its debt collection periods so as to reduce on some of the unnecessary cost of debt management. For example opportunity bank needs to be strict on the set loan repayment period. This will further improve loan repayment and subsequently improved performance.

The bank should carry out intensive loan applicant assessment basing on standard criteria before advancing huge loans. This will reduce on cases of subsequent default in the long run.

Opportunity bank should strengthen its loan recovery/collection effort and procedures through; instant sending of the monthly statements, calls and employment of debt collectors to collect the loans on its behalf.

The researcher recommends that credit standards that hinder people to obtain enough credit especially collateral should be revised like requesting land tittles which people may not have. The researcher recommends that financial institutions should develop appropriate policies and

procedures to enhance the participation of low income borrowers in Uganda. Borrowers should also carry out adequate planning before borrowing the loan. They should avoid planning for loans after borrowing the money as in most cases poor planning result in diverting the money into unproductive ventures which result into failure to pay back the loans and later trapping ones' property hence leading to declining performance of financial institutions.

The bank should re-design and further strengthen its credit policies to foster loans recovery performance and reduce on other costs related to credit transaction. Also to increase on financial performance, the bank should introduce incentive scheme where borrowers who pay promptly within the stipulated credit period are motivated. These could include incentives like cash discounts and awards to motivate borrowers to pay on time.

5.5 Areas for Further Research

The study carried out was limited to establishing the effect of credit policy on performance of financial institutions in Uganda. Future researchers should carryout research in the following areas;

Carry out a comparative study on the effect of credit management on profitability performance of at least three companies; financial and non-financial institutions in Uganda.

Exhaustively look at other factors and challenges that affect performance of financial sector in Uganda.

Future researcher should carry intensive comparative research on the relationship between employees' competences and performance of financial institutions in Uganda.

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APPEDNDIX A: Questionnaire

Kyambogo University

Research Questionnaire

Dear respondent,

I am a student of Kyambogo University carrying out an academic research on **Credit Policy and Performance of Financial Institutions in Uganda; A case of Opportunity Bank Uganda**, as a target respondent; you have been selected to participate in the research by completing the questionnaire as per the instruction at the beginning of a given section. You are kindly requested to freely fill in the questionnaire. All your responses will be treated with utmost confidentially and used for academic purposes only. Please, kindly endeavor to fill all the parts of the questionnaire.

Section A: Respondents' bio data

Please help classify your responses by supplying appropriate facts about yourself as the case may be. Tick your appropriate choice in boxes provided.

1. Gender of the respondent
   Male ☐ Female ☐
2. Age of the respondent
   20 – 29 ☐ above 29 – 39 ☐
   Above 39 – 49 ☐ 49 and above ☐
3. Highest level of education of the respondent
   Diploma ☐ Degree ☐
   Professional ☐ Masters ☐
   Others (specify)----------
4. For how long have you worked with Opportunity Bank?
   Less than 2 years ☐ 2 – 6 years ☐
   above 6 years ☐
5. Which department do you work in?
   Operations ☐ Risk ☐
   Human resource ☐ Sales and marketing ☐
   Loans/credit ☐ Accounts and finance ☐

Section B: Credit policy of Opportunity Bank Uganda

i) Credit rating procedure

Please kindly specify the extent to which you agree or disagree with following statements (Strongly Agree 5, Agree 4, not sure 3, Disagree 2, Strongly disagree 1)

	Statement/variable	5:SA	4:A	3:NS	2:DA	1:SD
1.	The loan applicant's occupational stability is taken into account before the loan is advanced.					
2.	Bank references are usually made before a loan is advanced.					

3.	Attachment to a reorganized institution is considered before a loan is advanced.					
4.	The general economic trends and special developments in the country are assessed before loans are granted.					
5.	The business climates in which loan applicants are operating are always assessed.					
6.	Physical inspection of loan applicants' business/plant is carried out before any loan is advanced.					
7.	Previous experience/transactions loan applicant is considered before a loan is a advanced.					
8.	The adequacy of resources is taken into account before giving out credit.					
9.	Property is inspected before a loan is advanced.					
10.	Opportunity Bank Uganda has powers to sell the collateral security in case of default.					
11.	The loan applicants must be with sufficient funds in business to qualify for the loans.					
12	The income generating activity is physically inspected the loan is advanced.					
13.	The loan applicants' savings are considered before a loan is advanced.					
14.	Loan applicants are required to present a collateral security before the loan is advanced.					
15.	Collateral security is limited to large loan sizes					
16.	The collateral security is always valued by professional valuers.					
17	The value of the collateral security is always more than the loan advanced.					
18.	The collateral security is inspected by the loan officer before the loan is approved.					

19. What other criteria is used to assess the credit worth of the loan applicants? Please kindly explain the criteria.

---

20. What are the weaknesses of the criteria used by the bank to assess the loan applicants' credit worth?

---

21. In your own view what measures should be put in place to overcome the above weaknesses?

---

22. What criteria does the bank use to determine the collateral security?

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ii) Lending Policies

Please kindly specify the extent to which you agree or disagree with following statements. (Strongly Agree 5, Agree 4, Not sure 3, Disagree 2, Strongly disagree 1)

	Statement/variable	**5:SA**	**4:A**	**3:NS**	**2:DA**	**1:SD**
1.	The bank has got maximum amount of loan to customers.					
2.	The loans are approved by the head of credit.					
3.	The loan size advanced depends on the financial potential of the loan the applicant					
4.	The bank has a set loan repayment period					
5. 6.	Borrowers who default are always fined and the collateral security sold.					
7.	Borrowers are always given grace period					
8.	The interest charged on the loans is favorable to the customers.					
9.	Sometimes borrowers are given a discount in case they pay on time					
10.	The interest rate charged leads to customer default due to accumulated amounts.					
11.	The interest rate is negotiable between the bank and the loan applicant.					
12.	The repayment period is sufficient to enable borrowers pay back the loans.					

13. In your own view what is the basis of determining the maximum amount advanced to loan applicant?

---

14. What criteria does the bank use to determine the interest rate charged on the loans?

---

15. What is the basis of determine the loan repayment period? Please kindly explain?

---

16. What has been the trend of interest rate charged on the loans for the last five year?

Year	2010	2011	2012	2013	2014
Interest rate (%)					

ii) Collection effort and procedures

Please kindly specify the extent to which you agree or disagree with following statements. (Strongly Agree 5, Agree 4, not sure 3, Disagree 2, Strongly disagree 1)

	Statement/variable	5:SA	4:A	3:NS	2:DA	1:SD
1.	The loans officer normally makes reminders to the borrowers when the loan repayment is due.					
2.	The loans officers send reminder letters and personal visits to recover the loans.					
3.	Sometime the borrowers are taken to courts of law in case of failure to pay.					
4.	The bank sometimes sells the collateral to recover the defaulted amount					
5.	Borrowers sometimes do not even respond to the reminders made					
6.	The bank uses court bailiffs/debtor collectors to recover loans from borrowers					
7.	The bank's collection procedure and efforts are effective					
8.	The loans officers are skilled and experienced in loan recovery					
9.	The bank's collection procedure and efforts has maximized loan recovery					

10. What procedure (s) is used by Opportunity Bank to recover loans from borrowers?

---

11. In your own view what are the major weaknesses of the Opportunity Bank collection procedure and effort? Please kindly list them.

---

12. What challenges does the bank face in trying to recover loans from its borrowers? Please kindly list them.

---

13. In your own view what measures do you think should be put in place to overcome the above mentioned challenges? Please kindly list them.

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14. What are the main limitations of Opportunity Bank credit policy? Please kindly list them.

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15. In your own view what measures should be put in place to overcome the above limitations?

Section C: Performance of Opportunity Bank Uganda

Please kindly specify the extent to which you agree or disagree with following statement regarding the financial performance of Opportunity Bank

(Strongly Agree 5, Agree 4, Not sure 3, Disagree 2, Strongly disagree 1)

	Statement/variable	**5:SA**	**4:A**	**3:NS**	**2:DA**	**1:SD**
1.	The bank's asset base has improved over the years.					
2.	The loan portfolio of Opportunity bank has grown over the past period.					
3.	There is always default and write off of bad loans.					
4.	The bank's profits have improved over the five years.					
5.	The Opportunity bank has a large customer base compared to banks.					

6. What has been the trend in the following Opportunity bank's performance measures over the last five years?

Year	**2010**	**2011**	**2012**	**2013**	**2014**
Assets					
Loan portfolio amount (Shs)					
Income /interest income					
Profits					
Loan write off					

7. In your own view what do you think has attracted customers to Opportunity bank?

---

8. What factors do you think affects the performance of Opportunity bank?

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9. What measures do you think should be put in place to improve on the performance of Opportunity bank? Please kindly list them.

Section D: Credit policy and performance of Opportunity bank

Please kindly specify the extent to which you agree or disagree with following statement regarding the relationship between credit policy and financial performance.

(Strongly Agree 5, Agree 4, Not sure 3, Disagree 2, Strongly disagree 1)

	Statement/variable	5:SA	4:A	3:NS	2:DA	1:SD
1.	The credit rating procedure is favourable and improved the performance of opportunity bank					
2.	The credit terms has improved on the bank's performance					
3.	The loan size is large enough and has led to the growth of the loan portfolio.					
4.	The interest rate charged is favourable and has increased loan acquisition.					
5.	The interest charged/income on the loans has led to increase in the bank's profits.					
6.	The collection procedure and effort improved on the bank's performance.					
7.	The collection procedure and effort has maximised loan recovery.					

8. What challenges are faced by Opportunity Bank? Please kindly list them.

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9. In your own view what measures should be put in place to overcome the challenges?

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10. What are key challenges/problems facing the banking sector in Uganda?

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11. In your own view what measures do you think should be put in place to overcome the above challenges? Please kindly list them.

End

Thanks for Your Time and Cooperation

APPEDNDIX B: Interview Guide

Kyambogo University

Interview Guide for Key Informants

Dear Sir/Madam,

This interview guide is aimed at data collection on **Credit Policy and Financial Performance** of Opportunity bank. It is aimed at carrying out research work in partial fulfillment of the requirements for the award of Master's Degree in Business Administration.

Thank you for your co-operation.

1. What other criteria is used to assess the credit worth of the loan applicants?
2. What criteria does the bank use to determine the collateral security?
1. What procedure (s) is used by Opportunity Bank to recover loans from borrowers?
2. What challenges does the bank face in trying to recover loans from its borrowers?
3. What are the main limitations of Opportunity Bank credit policy?
4. In your own view what is the basis of determining the maximum amount advanced to loan applicant?
5. What criteria does the bank use to determine the interest rate charged on the loans?
6. What has been the trend in the following Opportunity bank's performance measures

Year	**2012**	**2013**	**2014**
Assets			
Loan portfolio amount (Shs)			
Income /interest income			
Profits			
Loan write off			

END

APPEDNDIX C: KRECIE & MORGAN SAMPLING TABLE

Population Size	**Sample Size**	**Population Size**	**Sample Size**	**Population Size**	**Sample Size**
10	10	**220**	140	**1200**	291
15	14	**230**	144	**1300**	297
20	19	**240**	148	**1400**	302
25	24	**250**	152	**1500**	306
30	28	**260**	155	**1600**	310
35	32	**270**	159	**1700**	313
40	36	**280**	162	**1800**	317
45	40	**290**	165	**1900**	320
50	44	**300**	169	**2000**	322
55	48	**320**	175	**2200**	327
60	52	**340**	181	**2400**	331
65	56	**360**	186	**2600**	335
70	59	**380**	191	**2800**	338
75	63	**400**	196	**3000**	341
80	66	**420**	201	**3500**	346
85	70	**440**	205	**4000**	351
90	73	**460**	210	**4500**	354
95	76	**480**	214	**5000**	357
100	80	**500**	217	**6000**	361
110	86	**550**	226	**7000**	364
120	92	**600**	234	**8000**	367
130	97	**650**	242	**9000**	368
140	103	**700**	248	**10000**	370
150	108	**750**	254	**15000**	375
160	113	**800**	260	**20000**	377
170	118	**850**	265	**30000**	379
180	123	**900**	269	**40000**	380
190	127	**950**	274	**50000**	381
200	132	**1000**	278	**75000**	382
210	136	**1100**	285	**100000**	384