CREDIT MANAGEMENT POLICIES AND LOAN PORTFOLIO PERFORMANCE IN COMMERCIAL BANKS: A CASE OF EQUITY BANK, ADJUMANI BRANCH

BY

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DECLARATION

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This dissertation has been submitted to Uganda Management Institute for examination with our approval as supervisors.

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LIST OF ABBREVIATIONS

SPSS Statistical Package for Social Scientist

ABSTRACT

This study was about the relationship between credit management policies and loan portfolio performance in commercial banks in Uganda focusing on Equity Bank Adjumani Branch as the case study. This study was guided by three research objectives which included; establishing the effect of Credit terms on loan portfolio performance in Equity Bank Adjumani Branch; to assess the effect of credit standards on loan portfolio performance in Equity Bank Adjumani Branch and to find out the relationship between collection procedures and loan portfolio performance in Equity Bank Adjumani Branch. The study used a cross sectional case study design which involved triangulation (use of multiple data collection techniques simultaneously) i.e. utilizing both quantitative and qualitative approaches. A representative sample of 218 respondents was selected from a population of 420 based on the Krejcie and Morgan 1970 table (Amin, 2005) for determining sample size for research activities. Out of the two hundred and eighteen (218) questionnaires distributed to the respondents, only 192 (one hundred and ninety two) questionnaires were returned representing 88.07% response rate. The findings revealed that Credit terms had a positive correlation with the Loan Portfolio Performance in commercial banks($r = 0.259^{**}$ $P< 0.01$). This meant that the two variables are positively related. On the other hand, Correlation results indicated a significant positive relationship between Credit standards and Loan portfolio performance ($r = 0.845^{**}$, $p<.01$) while on the other hand collection procedures had a positive correlation the loan portfolio performance ($r =0.169^{**}$, $p<.01$). This means that the two variables were positively related. The study recommended improvement of staff and customer understanding on recovery of loans and its benefits. That loan scoring process is shortened. That credit department be properly resourced and facilitated to visit the client regularly.

CHAPTER ONE

INTRODUCTION

1.0: Introduction

This was a study about the relationship between Credit management policies and loan portfolio performance in commercial banks in Uganda focusing on Equity Bank Adjumani Branch as the case study. Credit management policies were the independent variable where as loan portfolio performance was the dependent variable. This chapter presents the background to the study, problem statement, and purpose of the study, objectives of the study, research questions, research hypotheses, scope of the study, significance of the study, study justification, conceptual framework and the operational definitions of key terms.

1.1 Background to the Study

1.1.1 Historical background

Goddard et al (2009) provided an account of the global financial crises in Western Europe and global economic depression that knocked almost all big economies throughout the world down in the past old centuries as still kept in many people's minds. They detailed measures that were enacted by governments and central banks to deal with toxic assets and recapitalize through injection of liquidity into the banking system. It was triggered by the United States financial sector that passed the Glass- Steagall Act 1930 (Khambata,1996) requiring that commercial banks only engage in banking activities (accepting deposits and making loans, as well as other fee based services), whereas investment banks were limited to capital markets activities. One key reason for the collapse or nearly-collapse of the financial institutions is the badly-functioned subprime mortgage lending to companies/people with bad and unreliable credit. When the prices

of houses used as securities for the loans slumped, those loans became non-performing loans or bad debts. (OECD 2008 and the Renegade Economist 2009).

As soon as the world began to see the signs of the recovery period, the financial sector, this time in the Euro-zone, suffered another great distress at the serious debt crisis in Greece that possessed a risk to the European Central Bank (ECB) and many other institutions in the industry. As a result, a number of European banks have made investments in Greek government bonds and other securities and use them as collaterals to obtain loans from ECB. And now when Greece defaults, the collateral subsequently loses its value and the ECBs balance sheet is put at risk as it fails to recollect the loans. Greek banks are not the only ones in danger. French and German banking business are on the same boat with respectively $80 billion and $45 billion exposure to the troubled country. Recently, the Basel Committee on Bank Supervision demands a jump in both tier 1 and tier 2 capital levels as a response to the crises these days (Wall Street Journal 2010). It urges the effect of a sound credit risk management in lending organizations.

In a small country like Vietnam, the financial sector is still in the development phase and many small commercial banks have not been able to establish a bank policy management framework, particularly credit policy management, in order to prevent unfavourable events. This is dangerous when Vietnamese banks customer services are still in their infancy and banks revenue depends heavily on lending activities and credit growth is central to any banking organizations profit (Infotv, 2010). In addition, the control work from the central bank, though playing a growing role, has not been protective enough. Access to credit information and history is very limited. Some years ago, unofficial news arose that a small bank was going to file for bankruptcy

due to bad credit assessment practices brought a big loss to the bank and high loan portfolio performance. “Smoke cannot be released without a fire”. There must have been something wrong in that bank’s credit procedures (Khambata, 1996). However, the quality of the trade accounts accepted the length of the credit period, the cash discount for an easy payment and the collection procedures have not been effective in loan recovery. This in turn becomes costly to the institution on top of affecting the volume of sales. Such decreases in the percentage of a loan recovery could be attributed to inappropriate credit policies that are not effective. Therefore this instigates that there appears to be a problem in paying back the loans got from the commercial banks by their clients and this can be partly attributed to credit policy employed (Khambata, 1996).

The year period 2003 to 2004 saw a number of banks being forced to close down in what was termed the Zimbabwean Banking Crisis and the main cause being poor credit risk management. In Zimbabwe the number of financial institutions declined from forty as at 31 December 2003 to twenty nine (29) as at 31 December 2004 and the effect of effective credit risk management on bank survival cannot be overemphasized. Some financial institutions were forced to close down and others were placed under curatorship (Khambata, 1996). The main cause of the banking crisis was poor credit risk management practices typified by high levels of insider loans, speculative lending, and high concentration of credit in certain sectors among other issues. The failure to effectively manage credit risk created similar problems in countries such as Venezuela. This situation tends to be exacerbated by the failure of institutions to properly implement an effective credit risk management framework. Financial institutions 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 (Gil Diaz, 1994).

Kenya's banking sector has evolved from the first commercial bank established in 1906 – the National Bank of India which later became the Grindlays Bank and is now the Stanbic Bank - to the current 22 commercial banks, six credit institutions and three Microfinance Deposit-taking Institutions (MDIs). These are in addition to the rapidly growing semi-formal and informal financial sector in the country. The evolution of the banking sector has been characterized by bank closures, mergers and acquisitions. Before the country's independence in 1962, the banking sector was dominated mainly by foreign owned commercial banks (Beck & Hesse, 2006). In addition to the National Bank of India, Standard Bank was opened in 1912 and the Bank of the Netherlands was opened in 1954 and later merged with Grindlays Bank

The banking system in Uganda at pre-independence was foreign owned and dominated by foreign banks like standard chartered bank, Grindlays bank, Equity Bank bank, Bank of Baroda and Bank of India. These banks were very conservative in their lending policies often giving loans on strict commercial criteria. The banking system was however discriminatory against Africans /Ugandan. Africans had not come into the age of accessibility of acceptable banking security like land titles, life insurance policies, Bills of exchange. The banking system was also discriminatory because Africans were more engaged in high risk and non-commercial ventures such as agriculture and animal husbandry on a small scale (Jacobson, (1999) and Carlton *et. al.*, (2001). In 1950 cognizant of the inadequacy of the foreign owned banks, the colonial

government passed the Uganda credit and savings Bank Act and this created the first savings and credit Bank. The rationale for the Bank was to enable facilitation of the loans to Africans to further agriculture commercial exports, building and cooperative society purpose.

In 1955 the banking Act was launched in Uganda and some of the traits/tenants /characteristics of the Banking Act included that Banks were required to have paid up capital of 1 million UGX , Register with the registrar of companies and the banking Act provided for sector regulation. However there was no central bank to regulate, monitor the work of the other banks. The luck of a CB was in part due to the fact that hitherto that the foreign banks that had their own management systems, supervision rules and prudential regulations.

The expansion of the banking sector was based on a very inadequate legal framework which would threaten systematic collapse of the banking sector nearly a decade later. An alternative argument says that the legacy of colonial rule and the dominancy of foreign owned banks- because these banks were subsistence and they had their own prudential management rules challenged the creation of a robust legal framework for the sector. The flip side however, the government at the time should have exercised diligence when rolling out local banks. The rapid expansion of the cooperative society Bank and Uganda Commercial Bank – operated in an environment that was short of experience and professional personnel. These circumstances coupled with the weak regulatory framework undermined the banks efficiency and internal controls. The banks were managed in the absence of prudential lending regulations- leading UCB to accumulate non performing loans of 75% of it total portfolio (Khambata, 1996).

The yardstick for measuring loan portfolio performance in the bank like any other business is profitability (Muungu, 2004). Increased profitability is a signal that there is some degree of efficiency and therefore a measure against which performance is appraised hence good credit policy reduces a level of credit risk leading to profitability of commercial banks but poor loan recovery rates and outright defaults by bank borrowers remain a big problem in Ugandan commercial banks. According to Bank of Uganda, many banks in Uganda charge high lending rates to borrowers for example Equity and Stanbic banks charge a lending rate of 24%, Crane bank charge 22%, Orient and Citibank charge 20%.Stanbic bank and Cairo bank have the lowest rates at 15% and 16% respectively,(Daily Monitor 2010). The high rates have scared away customers and thus reducing the profitability and increasing loan portfolio performances of most commercial banks in Uganda. In the last 3 years, Equity bank has continued to lend money with a proportionate increase in provision and bad debts written off as shown in the table 1 below.

Table 1: Loan Default Rate in Equity bank

Quarter/ Year	2010		(UGX Million)		2011	(UGX Million)			2012 (UGX Million)			
	Loan Disbursed	Loan Paid	Arrear	%of loan Paid	Loan Disbursed	Loan Paid	Arrear	%of loan Paid	Loan Disbursed	Loan Paid	Arrear	loan Paid
Qter 1	32	13	19	59%	211	39	172	19%	396	102	294	26 010
Qter 2	180	55	125	31%	461	116	346	25%	359	222	136	62%
Qter 3	155	20	134	20%	437	131	305	30%	397	212	184	53%
Qter4	277	52	224	19%	233	165	68	70%	386	160	226	41%
Total	644	140	502	32%	1,342	451	891	36 %	1,538	696	840	46 %

Source: ***Equity Bank Financial Statements(2010/2012)***

From table 1 above, the bank recovered on average 32% value of 644 million worth of loans disbursed in 2010, 36% of 1,342 million in 2011 and 46% of total loan value of 1,535 million

disbursed in 2012. This clearly showed that the default rate is high with more than 50 % of the loan disbursed yearly not repaid. Notably, Equity bank continued to face similar challenges of loan default like any other financial institution in Uganda.

The money lent to customers are often paid late or not paid at all leaving the bank exposed to default risk. It is important to note that despite the rigorous screening undertaken in the credit assessment process which includes among others; proof that customer does not have other credit obligation, analysis of their account performance, sustainability of their income level, security and ability to pay (International Credit Manual, 2003); on average 5% of the total loan book had to be provided for fully. The provision was in line with the Financial Institutions Statute (FIS) 2004 issued by Bank of Uganda. This requirement largely depended on the product portfolios undertaken. In Equity bank, Equity loan and lending constitutes about 50% of the total loan book. Equity bank has the highest rates at 24 % respectively, (Daily Monitor 2010). The high rates have scared away customers and thus reducing the profitability and increasing loan portfolio performance of most banks in Uganda

1.1.2 Theoretical background

This study was guided by three theories that is Loanable funds theory, modern portfolio theory and Portfolio theory.

The Loanable funds theory was created by Knut Wicksell (1851-1926), who was a well-known Swedish economist. It was widely accepted before the work of the English economist John Maynard Keynes (1883-1946). Loanable funds theory explains that the calculation of the rate of interest is on the basis of demand and supply of loanable funds which are available in the capital market. An increase in the demand of loanable funds leads to an increase in the interest rate and

vice versa. Also an increase in the supply of loanable funds results in the falls of interest rate. If both the demand and supply of the loanable funds changes, the resultant interest rate depends on the level and route of the movement of the loanable funds. The loanable funds theory encourages that both savings and investments are responsible for the determination of the rates of interest. The short-term interest rates are assessed on the basis of the financial conditions of an economy. In case of loanable funds theory the determination of the interest rates depends on the availability of the loan amount. The availability of loan amount is based on certain factors like net increase in currency deposits, amount of savings made, and willingness to enhance cash balances.

The theory is relevant to the study because it states that the availability of such loan amounts is based on certain factors like the net increase in currency deposits, the amount of savings made, willingness to enhance cash balances and opportunities for the formation of fresh capitals. Traditionally, banks have taken an asset-by-asset approach to credit management. While each bank's method varies, in general this approach involves periodically evaluating the credit quality of loans and other credit exposures, applying a credit risk rating, and aggregating the results of this analysis to identify a portfolio's expected losses.

The liquidity preference theory or liquidity preference hypothesis, proposed by J. M. Keynes (1967), explains the relation between the generation of a debt instrument and its maturity period. The liquidity preference theory states that investors maintain their funds in liquid form like cash rather than less liquid assets like stocks, bonds and commodities. Banks offer interest to investors to compensate for their liquidity losses which ultimately promote long-term investments. The liquidity preference theory does not deal with liquidity, but deals with the risks associated with maturity. According to this theory, the risks related to the maturity of debt

instruments are directly proportional to the length of the maturity period. According to the liquidity preference theory, if the investors possess debt instruments that have longer term periods then they will receive a premium of the rates of interest over a long-term period.

Portfolio theory is a descriptive and normative theory. On the one hand it studies how people should combine assets (normative view). The leading idea can be summarized as the maxim "Do not put all eggs in one basket", which is known as the principle of diversification (William & Margrabe, 2007). On the other hand portfolio theory describes how investors do combine assets (descriptive view). This second aspect has important implications for asset pricing, because if one knows how investors form their portfolios then one can determine how assets are priced. This is because prices are determined by the demand and supply generated by the investors` portfolios decisions.

Portfolio theory in the banking sector is applied in constitution of loan portfolios of banks where there are guidelines on loans that banks should extend to their clients, such as limit in terms of credit that should be extended to third parties. The agency theory contends that many banks are managed by the managers and not by the owners.

Basing on the study, the Portfolio theory in the banking sector was the best theory since banks apply it the in constitution of loan portfolios of banks where there are guidelines on loans that banks should extend to their clients, such as limit in terms of credit that should be extended to third parties as a way of improving their loan portfolio performance in relation to credit management. Commercial banks should be properly managed and management should be "fit and proper" to be able to make decisions on credit risk management and that which should steer banks to low loan portfolio performance.

1.1.3 Conceptual background

A credit policy is defined as an institution's method of analyzing credit requests and decisions criteria for accepting or rejecting credit application (Edminister, 2012). A credit policy is the blue print used by a business in making its decision to extend credit to a customer. The primary goal of credit policy is to avoid extending credit to customers who wasunable to clear their accounts.

According to Gitman (2009) Credit monitoring is a service through which a monitoring firm watches its credit reports for changes. Credit monitoring tool allows banks and financial institutions to Manage, Monitor and Control performance of their assets (Loans) in a proactive manner to prevent them from turning into non- performing assets (NPA).

Credit management is the executive responsibility of determining customers' credit ratings as part of the credit control function (Terry, 2011). Performance refers to the accomplishment of a given task measured against pre set known standards of accuracy, completeness, fast and speeds in a contract. Performance is deemed to be fulfilment of an obligation in a manner that releases the performer from all the liabilities under the contract (Business Dictionary .Com).

According to Gitman (2009), credit terms are terms like 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. The decision to change any of the mentioned variables /components of credit terms depend on the direction and the degree of change.

Loan portfolio; Loan portfolio refers to the total amount of money given out as loans indifferent loan products, to the different types of borrowers (Van Horne,1989). Loan portfolio performance; refers to rate of loan portfolio performance or rate of return of an investment in various loan products (Krestlow et al., 1992). Thus broadly, it looks at the number of clients applying for loans, how much they are borrowing, timely payment of instalments, security pledged against the borrowed funds, rate of arrears recovery and the number of loan products on the chain.

Loan portfolio refers to the total amount of money given out in different loan products, to the different types of borrowers. This may be comprised of salary loans, group guaranteed loans, individual loans and corporate loans (Puxty et al., 2011). It looks at the number of clients with loans and the total amount in loans (Wester, 1993).

Credit standards include 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 (Pandy 1993) and Julius Kakuru (2000).

Credit risk is the initial credit-granting process, an efficient balanced approval process and a competent lending staff. The lending bank / prospective borrower credit relationship is first created at the appraisal and approval stage. It is here that the Credit Officer applies all his skills and salesmanship to give the first and lasting good image and impression of the bank's credit system (Stanbic Bank credit policies and procedures, 2005).

Credit Pricing or Interest rate is the price of accessing and utilizing credit resources. Interest rates can be looked at from the borrowers and the lenders point of view. To the borrower, interest rate

is the cost of borrowing money expressed as a percentage of the amount borrowed (Martin, 1998).

Van Horne, (1996), noted that client screening involves obtaining information on loan applicants and then using the information to analyze and determine the credit worthiness of the applicant to make credit decisions. Information is obtained from the applicant's financial statements, credit rating reports, trade checking and experience in business. Van Horne, (1996) further observed that this information helps in the analysis of not only credit worthiness and ability of the applicant to meet the minimum standards for qualifying for the loan being applied for but also the probability of bad debts.

1.1.4 Contextual background

Equity Bank Adjumani Branch is one of the leading commercial banks and one of the active institutions in loan extension to the entire community in Adjumani, which was was created in 2008 when the Equity Bank Group purchased Uganda Microfinance Limited, a Tier II, Ugandan Microfinance Company for an all-share price valued at US$27 million.

Equity Bank Limited - Uganda (EBLU) started in July 2008 when Equity Bank Kenya successfully acquired a 100% stake in Uganda Microfinance Limited (UML) and entered the market with a footprint of 30 branches and 16 contact offices spread over 29 districts in Uganda. Currently the bank is one of the fastest growing banks in Uganda, with the fourth largest network of 38 branches and 35 ATMs located in all regions of the country.

In 2008 the Bank transformed its Credit department into two main departments, namely; Micro Credit and Corporate/Commercial credit and hired a chief manager, Corporate/commercial credit. In a further bid to strengthen the Corporate/commercial credit department and at the same time have serious control over the growing loan portfolio, the Bank upgraded the credit department to a full division in 2009 and hired a General Manager to manage it. From that date the bank has seen tremendous growth of the credit policies management and loan portfolio to date.

According to Annual Report (2009), the loan portfolio has grown from 193 billion to 287 billion (48.2%). The loan portfolio is a major contributor to the income generated by Equity Bank Adjumani Branch and if major steps are not taken to improve its performance through the creation of credit management policies, the survival of the Bank was at a Risk. Unfortunately it appears the bank has failed to achieve its planned loan portfolio performance thus causing failure to recover the loaned money. According to its financial report 2008/2009, the bank continued to face similar challenges of loan default like any other financial institution in Uganda. The money lent to customers are often paid late or not paid at all leaving the bank exposed to default risk. It is important to note that despite the rigorous screening undertaken in the credit assessment process which includes among others; proof that customer does not have other credit obligation, analysis of their account performance, sustainability of their income level, security and ability to pay (International Credit Manual, 2003); on average 5% of the total loan book had to be provided for fully. The provision was in line with the Financial Institutions Statute (FIS) 2004 issued by Bank of Uganda. This requirement largely depended on the product portfolios undertaken. It is still further evident that in Equity Bank Adjumani Branch, loan and corporate lending constituted about 50% of the total loan book but however the branch continued to face

on average between 20-40% bad debts written off yearly (BoU, *2005).* Repeatedly from 2008 to 2012, approximately 169 million shilling was written off by Equity Bank Adjumani Branch as bad debts.

Further more, Debt Recovery Unit (DRU) report 2012 revealed that 10Billion shillings were still held in their books as unrecovered debt (Finance & Trade Report, 2006). This is due to its failure to recover the loaned money and if this situation continues, the bank is more likely to close down there by causing discontent among its clients. This therefore raises cause for concern, leading to pressing need to investigate whether it can be attributed to credit management policies. The yardstick for measuring performance in the bank like any other business is profitability. Reduced loan portfolio performance is a signal that there is some degree of efficiency and therefore a measure against which performance is appraised hence good credit policy reduces a level of credit risk leading to profitability of commercial banks but poor loan recovery rates and out right defaults by bank borrowers remain a big problem in Ugandan commercial banks.

1.2. Statement of the problem

Equity bank limited is one of the banks that were set up to be the champions of social economic prosperity in Africa through offering financial service that are socially and economic empowering the people. In an effort to address her client's needs, the bank has set up fully pledged branches in the different parts of the country such as Adjumani Branch. In the case of Equity Bank Adjumani Branch, Income from lending constitutes on average 75-80% of the total bank income. There are credit management policies and procedures at the branch which were designed to guide lending and ensure prudent lending operations as a way of improving loan portfolio performance.

However in spite the rigorous credit assessment process in place that Equity Bank Adjumani Branch uses like; proof that customer does not have other credit obligation, analysis of their account performance, sustainability of their income levels, security and ability to pay (International Credit Manual, 2003), the branch is faced with poor management of its loan portfolio as noted in Credit reference Bureaux Report (2012).

The bank appears to have failed in achieving its planned loan portfolio performance thus causing failure in recovery of the loaned money despite having policies like collaterisation of loans, loan tracking system and Debt Recovery Unit.

It is evident that Equity Bank Adjumani Branch, loan and corporate lending constituted about 50% of the total loan book but however the branch continued to face on average between 20-40% bad debts written off yearly, the loan loss rate increased from -0.10% to 2.81%, and the number of outstanding loans increased from $18795 to $24479.

This could therefore be due to its failure to recover the loaned money. Hence if this situation continues, the bank is more likely to close down there by causing discontent among its clients. This therefore raises cause for concern, leading to pressing need to investigate whether it can be attributed to credit management policies.

1.3 Purpose of the Study

The purpose of this study was to establish the relationship between credit management policies and loan portfolio performance in commercial banks in Uganda focusing on Equity Bank Adjumani Branch as the case study.

1.4 Research Objectives

This study was guided by the following research objectives:

i. To establish the effect of Credit terms on loan portfolio performance in Equity Bank Adjumani Branch.

ii. To assess the effect of credit standards on loan portfolio performance in Equity Bank Adjumani Branch.

iii. To find out the relationship between collection procedures and loan portfolio performance in Equity Bank Adjumani Branch.

1.5 Research Questions

The study aimed at answering the following questions

i. What is the effect of Credit terms on loan portfolio performance in Equity Bank Adjumani Branch?

ii. What is the effect of credit standards on loan portfolio performance in Equity Bank Adjumani Branch?

iii. What is the relationship between collection procedures and loan portfolio performance in Equity Bank Adjumani Branch?

1.6 Hypotheses

The study was guided by the following hypotheses:

H_1: Credit terms positively affect loan portfolio performance in commercial banks.

H_2: Credit standards positively affect loan portfolio performance in commercial banks.

H_3: Collection procedures positively affect loan portfolio performance in commercial banks.

1.7 Conceptual Framework

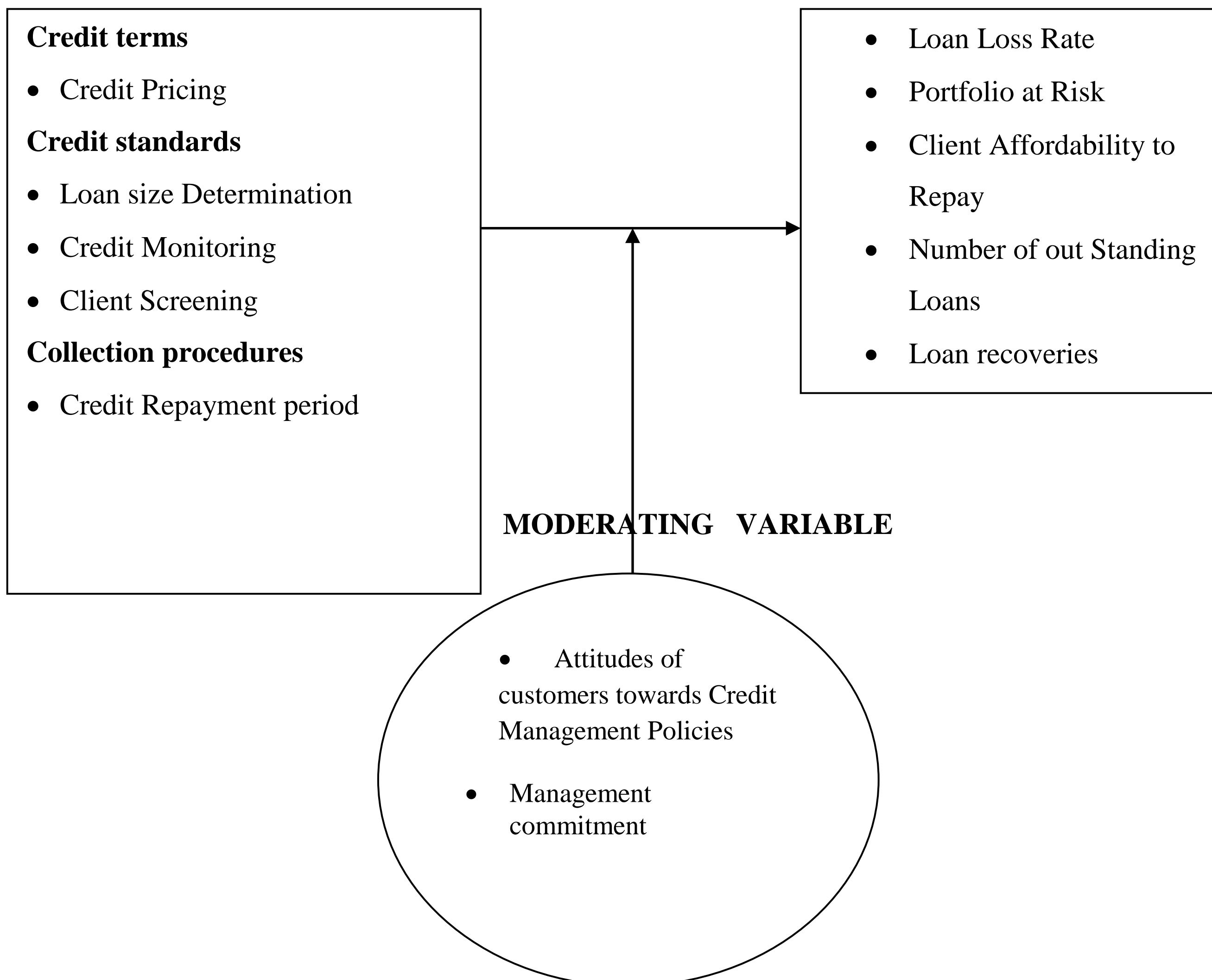

Figure 1: Conceptual framework showing the relationship between credit management policies (independent variable) and loan portfolio performance (dependent variable) and the moderaing variables. Source (Modification of Van Horne, (1996), Model of financial management and policy)

From the conceptual framework in Figure 1 above; Credit Management Policies was considered as the independent variable which was operationalised in terms of Credit Variables such as Credit terms, credit standards and collection procedures.

Loan Portfolio Performance was hypothesized as the dependent variable and operationalised in terms of the causes of poor loan portfolio performance such as loan loss rate, portfolio at risk, client affordability to repay and number of outstanding loans

Attitudes of staff towards Credit variables, management commitment to the implementation of Credit Management Policies were considered as moderating variables as adopted by Taylor (2001).

1.8 Significance of the Study

This study was considered beneficial in the following ways:

1.8.1 The study findings may result into Equity Bank Adjumani Branch top management appreciating issues surrounding the investment in credit management policies and loan portfolio performance in the organization, hence solving problems surrounding loan portfolio management.

1.8.2 Furthermore, the findings may be used to develop a more comprehensive and efficient policies in managing the credit management policies and the findings may add to available knowledge.

1.8.3 The findings of this study may help management of different organizations as it tries to articulate the factors that can cause inefficiency in credit management policies and causing poor loan portfolio performance in the banking institution.

1.9 Justification

Leslie Rare (2003) asserts that in-service credit management policies exist to allow the credit department to operate more efficiently. Ambiguity is reduced over how to proceed when policies are clearly-defined thus offering specific rules in regard to the loan amounts, type of customers,

debt-to-income ratios, collateral requirements, payment terms and interest rates. But this has not been the case of Equity Bank ltd that appears to have failed to achieve its planned loan portfolio performance thus causing failure to recover the loaned money. According to its financial report 2008/2009, the loan loss rate increased from -0.10% to 2.81%, and the number of outstanding loans increased from $18795 to $24479.

This is due to its failure to recover the loaned money and if this situation continues, the company is more likely to close down there by causing discontent among its clients. Therefore it is imperative to establish the relationship between credit management policies and loan portfolio performance in Equity bank and yet no study had been undertaken on understanding the relationship between the two variables in this institution, which indicated that there was a need for a comprehensive study to establish the relationship between credit management policies and loan portfolio performance in Equity bank.

1.10 Scope of the Study

1.10.1 Geographical Scope

This study was conducted at Equity Bank Adjumani Branch with its offices on Plot 26, Wani Road Adjumani Town Council, Adjumani, district.

1.10.2 Content Scope

The study focused on different credit management policies and their effect on loan portfolio performance in terms of content scope.

1.10.3 Time Scope

The study was restricted to a period of 4 years 2008 to 2012. This period was selected because it was within that period that the Equity Bank Adjumani Branch invested a lot of money in the creation and implementation of credit management policies.

1.11 Operational Definitions of Key Terms

Credit Policy; A credit policy as a marketing tool acting as abridge for movements of goods and services through production and distribution stages and finally to customers.

Loan portfolio; Loan portfolio refers to the total amount of money given out as loans indifferent loan products, to the different types of borrowers.

Loan portfolio performance; refers to rate of loan portfolio performance or rate of return of an investment in various loan products .thus broadly, it looks at the number of clients applying for loans, how much they are borrowing, timely payment of instalments, security pledged against the borrowed funds, rate of arrears recovery and the number of loan products on the chain.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter covers the theoretical review of the literature on credit management policies and loan portfolio performance. It also reviews the relationship between Credit Pricing on loan portfolio performance, the effect of Credit Monitoring on loan portfolio performance, the relationship between Credit control on loan portfolio performance, the causes of poor loan portfolio performance and the relationship between credit management policies and loan portfolio performance.

2.1 Theoretical review

Several theories have been put forward which have implications on credit management policies.

2.1.1 Portfolio theory

Portfolio theory is a descriptive and normative theory. On the one hand it studies how people should combine assets (normative view). The leading idea can be summarized as the maxim "Do not put all eggs in one basket", which is known as the principle of diversification. On the other hand portfolio theory describes how investors do combine assets (descriptive view). This second aspect has important implications for asset pricing, because if one knows how investors form their portfolios then one can determine how assets are priced. This is because prices are determined by the demand and supply generated by the investors` portfolios decisions.

Portfolio theory in the banking sector is applied in constitution of loan portfolios of banks where there are guidelines on loans that banks should extend to their clients, such as limit in terms of

credit that should be extended to third parties. The agency theory contends that many banks are managed by the managers and not by the owners. Banks that are managed by professional managers are expected to better analyze and monitor credit awarded to their clients. Commercial banks should be properly managed and management should be “fit and proper” to be able to make decisions on credit risk management and that which should steer banks to low loan portfolio performance.

2.1.2 Loanable Funds Theory

Loanable funds theory explains that the calculation of the rate of interest is on the basis of demand and supply of loanable funds which are available in the capital market. The concept was created by Knut Wicksell (1851-1926), who was a well-known Swedish economist. It was widely accepted before the work of the English economist John Maynard Keynes (1883-1946). An increase in the demand of loanable funds leads to an increase in the interest rate and vice versa. Also an increase in the supply of loanable funds results in the falls of interest rate. If both the demand and supply of the loanable funds changes, the resultant interest rate depends on the level and route of the movement of the loanable funds. The loanable funds theory encourages that both savings and investments are responsible for the determination of the rates of interest. The short-term interest rates are assessed on the basis of the financial conditions of an economy. In case of loanable funds theory the determination of the interest rates depends on the availability of the loan amount. The availability of loan amount is based on certain factors like net increase in currency deposits, amount of savings made, and willingness to enhance cash balances.

Interest rates theories recognize that interest rates have an effect on credit management because the higher the interest rate the higher the risk that the loan might not be repaid and thus the higher the credit risk. The term structure of interest rate theories contends that the long-term interest rates are more risky than short term interest rates, thus investors expect a higher return if they have to be motivated to hold instruments that are long-term interest bearing instrument. Theories of financial crises contend that a crisis in the financial sector affects the ability of commercial banks to extend credit as well as the ability of the borrowers to service their loans.

The Loanable Funds Theory of Interest advocates that both savings and investments are responsible for the determination of the rates of interest in the long run. On the other hand, short-term interest rates are calculated on the basis of the financial conditions of a particular economy. The determination of the interest rates in case of the Loanable Funds Theory of the Rate of Interest depends essentially on the availability of loan amounts. The availability of such loan amounts is based on certain factors like the net increase in currency deposits, the amount of savings made, willingness to enhance cash balances and opportunities for the formation of fresh capitals.

According to the loanable funds theory of interest the nominal rate of interest is determined by the interaction between the demand and supply of loanable funds. Keeping the same level of supply, an increase in the demand for loanable funds would lead to an increase in the interest rate and the vice versa is true. Conversely an increase in the supply of loanable funds would result in fall in the rate of interest. If both the demand and supply of the loanable funds change, the

resultant interest rate would depend much on the magnitude and direction of movement of the demand and supply of the loanable funds.

Now, the demand for loanable funds is basically derived from the demand from the final goods and services. These final goods and services are again generated from the use of capital that is financed by the loanable funds. The demand for loanable funds is also generated from the government. The Loanable Funds Theory of the Rate of Interest has similarity with the Liquidity-Preference Theory of Interest in the sense that both of them identify the effect of the cash balance preferences and the role played by the banking sector to ensure security of the investment funds.

2.1.3 Liquidity preference theory

The liquidity preference theory or liquidity preference hypothesis, proposed by J. M. Keynes, explains the relation between the generation of a debt instrument and its maturity period. The liquidity preference theory states that investors maintain their funds in liquid form like cash rather than less liquid assets like stocks, bonds and commodities. Banks offer interest to investors to compensate for their liquidity losses which ultimately promote long-term investments. The liquidity preference theory does not deal with liquidity, but deals with the risks associated with maturity. According to this theory, the risks related to the maturity of debt instruments are directly proportional to the length of the maturity period. According to the liquidity preference theory, if the investors possess debt instruments that have longer term periods then they will receive a premium of the rates of interest over a long-term period. This premium is known as the liquidity premium. Liquidity premium stabilizes the financial risks that the investors have suffered due to the investment in debt instruments that had longer term periods. As a result of the

premium, the generation of the debt instrument that has a longer periodic term is higher compared to debt instruments having shorter term periods. Liquidity preference is a potentiality or functional tendency, which arranges the quantity of money which the public will hold when the rate of interest is given; so if r is the rate of interest, M the quantity of money and L the function of liquidity preference, we can define $M = L(r)$.

Liquidity preference theory is preferred among most of the theories. The liquidity preference theory is a short-run model of interest rate determination. It describes economic fluctuations around the long-run drift. It provides a suitable analytical framework to investigate the role of monetary policy and the financial system. The liquidity preference theory also proposes the concept of risks and liquidity premium to predict the future rates. Investors have a preference for investing in short-term securities.

But, when the market interest rates change, the prices of long-term bonds fluctuate more than the prices of short-term bonds. The added risk prevents some investors from investing in long-term bonds. To attract investors, the long-term bonds must offer a return that exceeds the expected return on a series of short-term bonds. Therefore, when the yield curve rises up, we cannot be sure whether this is the result of investors expecting interest rates to rise in the future. The liquidity preference theory recognizes this problem. It depicts that the yield curve slope is influenced by the expected interest rate changes and the liquidity premium that investors require on long-term bonds.

2.2 Credit Management Policies

Credit policies are set of objectives, standards and parameters to guide bank officers who grant loans and manage the loan portfolio. Thus, they are procedures, guidelines and rules designed to minimize costs associated with credit while maximizing the benefit from it (Ahimbishwe, 2002). The main objective of credit policy is to have an optimal investment in debtors that minimizes costs while maximizing benefits hence ensuring loan portfolio performance and sustainability of banking institutions as commercial institutions. The credit policy of an organization may be stringent or lenient depending on the manager's regulation of variables that come with credit policy ,there are three main variables(elements of credit policy) namely; Credit terms ,credit standards and credit procedures (Hulmes,1992). Managers use these variables to evaluate client's creditworthiness, repayment period and interest an loan, collection methods and procedures to take in case of loan default.

According to Van Horne (2011), credit is a marketing tool acting as abridge for movements of goods and services through production and distribution stages and finally to customers. That's to say companies can use credit policy to maintain market share, retain old customers and create new ones. According to Edmister, (2009), granting credit is intrinsically risky. Some people are not able to pay causing the firm to a loss. Therefore it has to be managed very well. Credit policy is important because it saves time by ensuring same idea is not discussed over and over again each time a decision is to be made. It also ensures decisions are consistent and fair and that people in the same circumstances get treated in the same manner Katanga (2006).

Kakuru (1998), states that a company may follow a lenient or stringent credit policy. The company following a lenient credit policy tends to sell on credit to customers on very liberal terms and standards, and credits are granted for a big period, even to those customers whose credit worthiness is not fully known and the reverse is true if a company follows stringent credit policy where by the company sells on credit to customers on very strict terms, only to customer whose credit worthiness is fully known.

A stringent credit policy gives credit to customers on a highly selective basis. Only customers who have proven creditworthiness and strong financial base are given loans, the main target of a stringent credit policy is to minimize the cost of collection, bad debts and unnecessary legal costs (Pandey, 2001). A lenient credit policy on the other hand gives credit to customers on very liberal, lax terms and standards .The main purpose of a lenient credit policy is to increase gains through extending more credits to customers (Kakuru, 1998 & Pandey 2001).therefore a firm must try to balance between these two extremes in order to maximize portfolio performance. According to Johansson and Terry (2011), credit policy means procedures aimed at checking and controlling the granting of credit facilities, to follow up procedures used to obtain collection of debts outstanding.

The essence of credit policy is to maximize the value of a firm. (Puxty & Dodds, 2011).An optimum credit policy is achieved through proper adjustment of credit standards, credit terms and collection efforts. These are the controllable decision variables that should be considered in the extension of credit to optimize investment in accounts receivable. Credit policy is a guide to successful credit administration and benefits must be weighed against the cost to ensure the

benefits are worth the effort of administering the credit. Benefits like increase in market share, retention of existing customers, acquisition of new ones, must be weighed against costs like selling and production costs, administration costs incurred during assessment, supervision and collection of credit and bad debts losses (Pandey, 2001).

Credit policy is aimed at having an optimal investment ,this is the level of investment where there is a tradeoff between the benefits and costs associated with it, that point where the objective of liquidity ,security and loan portfolio performance are harmonized .Bad debt ,underperforming loans and untimely payments can be minimized through proper administration of the credit policy, this can be done by obtaining collateral ,third party guarantors ,proper assessment of credit worthiness, optimum interest rate and credit period and setting time limits before which the credit is to be repaid and fines for late payment(Rao, 2009).

In order to ensure high loan recovery rates and loan portfolio performance, financial institutions should opt for an optimum credit policy .An optimum credit policy is that, which maximizes the firm's value; the value of the firm is maximized when the incremental rate of return (marginal rate of return) of an investment set is equal to the incremental costs of funds (marginal cost of capital) used to finance the investment. (Van Horne, (1989)

According to Benner & Tushman, (2002); Spear & Bowen, (1999) when there are credit management policies in existence and are well implemented, they will positively affect the loan portfolio performance and in the same way affect credit management policies and vise versa. Staff attitudes towards credit management policies can affect credit management policies and

loan portfolio performance in the same way thereby becoming an intervening variable and may cause change in expected results.

Kaufmann (1998) observed that a credit policy is implemented effectively, it has to show the company's intended way of doing business and avoids confusion and potential misunderstanding, thus this affects loan portfolio performance by enabling them to improve on the way a business plays a part in the life of a sale and equally in the death of a sale, and therefore the debtors' asset. However Bowen & Ostroff (2004) assert that when there is no management commitment to the implementation of credit management policies, loan portfolio performance and credit management policies may be affected in the same way thus affecting the two variables.

Credit terms and collection procedures are a very important dimension of credit management policies and once it is ignored, the banking institution may find it very difficult to update both a sales and credit agreements of their customers to insure not only the performance of the sales objectives but that the credit department has the tools in place to meet company and department goals. This affects their loan portfolio performance thereby not rendering quality service and they are not able to satisfy customers as highlighted by Borsook & Higginbotham-Wheat (2002). According to Purcell (2003), credit standards are also an important dimension of credit management policies, like loan size determination, it can improve the loan portfolio performance. Chris (2010) observed that poor loan portfolio performance may be related to numerous causes within the banking institution, such as loan loss rate, portfolio at risk, client affordability to repay and number of outstanding loans, but there is a definite relationship

between credit management policies and loan portfolio performance as credit policies can address numerous problems that related to poor loan portfolio performance.

2.3 The effect of Credit terms and loan portfolio performance

A Credit terms is a contractual stipulation under which a firm grants credit to customers (Wamasembe, 2002); furthermore these terms give the credit period and the credit limit. The firm should make terms more attractive to act as an incentive to clients without incurring unnecessary high levels of bad debts. Credit terms normally stipulate the credit period, interest rate, method of calculating interest and frequency of loan instalments. Kakuru (1998) explains the effect of discounts in credit terms. Discounts are offered to induce clients to pay up within the stipulated period or before the end of the credit period .This discount is normally expressed as a percentage of the loan .discounts are meant to accelerate timely collection to cut back on the amount of doubtful debts and associated costs.

2.3.1 Credit Pricing or Interest rate and loan portfolio performance

Credit Pricing or Interest rate is the price of accessing and utilizing credit resources. Interest rates can be looked at from the borrowers and the lenders point of view. To the borrower, interest rate is the cost of borrowing money expressed as a percentage of the amount borrowed (Martin, 1998). A customer evaluates all costs including interest rates and expected returns before deciding either to take a loan or not.

To the lender, Credit Pricing or Interest rate is determined by factoring in costs such as cost of production, the inflation rates, cost of production delivery, personal and administrative costs and

loan loss provision (Kasibante, 2001). The rate charged should be able to cover costs and make a contribution for the financial institution. Credit Pricing or Interest rates charged by banks are relatively higher than that of commercial banks. Justification given for high rates is that smaller enterprises have a high turnover which has a direct relationship with income and repayment capacity of the client and that the rates are lower than what is being charged by loan sharks (Kagwa, 2005).

2.4 The effect of credit standards on loan portfolio performance

Credit standards; according to Mehta (1972), in advancing loans, credit standard must be emphasized such that the credit supplier gains an acceptable level of confidence to attain the maximum amount of credit at the lowest as possible cost. Credit standards can be tight or loose (Van Horne, 1994).Tight credit standards make a firm lose a big number of customers and when credit are loose the firm gets an increased number of clients but at a risk of loss through bad debts. A loose credit policy may not necessarily mean an increase in loan portfolio performance because the increased number of customers may lead to increased costs in terms of loan administration and bad debts recovery. In agreement with other scholars Van Horne, (1994), advocated for an optimum credit policy, which would help to cut through weaknesses of both tight and loose credit standards so, the firm can make profits.

According to Pandey (1998), credit period is the length of time for which credit is extended, generally stated in terms of net date .Length of the periods usually determined by industry customs, repayment habits of clients, and the level of repetitive borrowing. Shorter periods are preferred because if clients are defaulting frequently bad debts losses can be checked before it is

too late to take corrective action. The debt collection costs also reduce with shorter credit periods.

2.4.1 Loan size Determination and loan portfolio performance

Commercial banks provide bigger initial loans, and then gradually increase the amount as relationship of trust between borrower and the bank grows Oketch, (1997). The approach assists borrowers to learn on the loan before a bigger loan is given. The basic definition of Commercial banks loan is that it's a small or big loan in terms of amount of money involved (Kagwa, 2005). Providing small loans means that large number of clients are served thus spreading the risk but also increasing loan administrative cost, hence affecting the loan portfolio performance.

2.4.2 Credit Monitoring and loan portfolio performance

In developing countries, existing legal systems are very weak and banks grant loans without fully observing security precautions and often in violation of basic provisions. Further there are no serious monitoring and recovery internal controls in place (Opira, 2005). The monitoring process is one which is simple but at the same time very difficult to effectively implement. This process involves constant reconciliation by the bank of the customer's loan account with project site visit reports. The idea is to continuously remind him that the funds in hands belong to somebody else and must be repaid back with a fee within a stipulated period of time. It's at the monitoring and recovery stages of the credit processing system when credit personnel collude with customers to reduce frequency of site visits and ignore updating loan records, (Opira, 2005).

Opira, (2005), observed that in order to strengthen monitoring, the following measures should be adopted. All credit accounting records should be maintained by competent accounting trained

staff, all collateral must be kept under company lock, frequent and abrupt site visits to customer's projects to be carried out and priority credit reports should be furnished to head office as a matter of policy.

2.4.3 Client Screening and loan portfolio performance

Van Horne (1996), noted that client screening involves obtaining information on loan applicants and then using the information to analyze and determine the credit worthiness of the applicant to make credit decisions. Information is obtained from the applicant's financial statements, credit rating reports, trade checking and experience in business. Van Horne, (1996) further observed that this information helps in the analysis of not only credit worthiness and ability of the applicant to meet the minimum standards for qualifying for the loan being applied for but also the probability of bad debts. All this is done so as to take an informed decision as to the extension of any loan.

Client screening deals with assessing the credit demand based on the repayment potential of loan applicants. for bank's, it basically focuses on the repayment capacity of the applicants based on the analyzed degree of credit worthiness, trust worthiness, type of business engaged in and level of faith that the bank derives from the information given by the applicant Hartmut (1997).

Even when most banks' clients do not have financial records to support their applications for required loans, prudent screening should not be based on verbal explanations, loan applicants have to submit details regarding why they need the loan, Karekaho (2005).

To Martin (2006), these details are usually submitted information of project proposals explaining the nature o the business for which the loan is required. Therefore, the analysis of credit worthiness of an applicant is based on submitted project proposals.

2.5 The relationship between collection procedures and loan portfolio performance

Collection procedures; collection policy establishes a set of procedures used to collect accounts receivables which was getting overdue (Van Horne, 1989). Methods used could include letters, telephone calls, visits by the firm's officials for face to face reminders to pay and legal enforcements. Dickerson et al., (1995) asserts that collection policy is a guide that ensures prompt payment and regular collections. The rationale is that not all clients meet their obligations, some just take it for granted, others simply forget while others just don't have a culture of paying until persuaded to do so. Therefore, emphasizing strict collection procedures keeps debtors' alert, reduces portfolio at risk and consequently reduces losses due to bad debts, hence greater loan portfolio performance.

Krestlow et al. (1992) emphasizes the need for using various methods in the collection efforts on past due accounts. In agreement with other scholars like Dickerson and Pandey, Kreslow noted that in determination of the method to apply, the cost and funds available for the purpose must be considered. The benefit of additional collection efforts is likely to decrease with increasing expenditure levels.

Ssemukono (1996), states that collection efforts are directed at accelerating recovery from slow payers and decreases bad debts losses .This therefore calls for vigorous collection efforts. The

yardstick to measurement of the effectiveness of the collection policy is its slackness in arousing slow paying customers.

Campsey & Brigham (1995) propounds that the evaluation of an individual should involve; gathering of relevant information on the applicant, analyzing the information to determine credit worthiness and making the decision to extend credit and to what tune. They suggested the use of the 5Cs criteria as a guide in analyzing credit worthiness. The 5Cs stand for; Capacity, Character, Collateral, Condition and Capital. Hence they defined each of the criteria in that; Capacity refers to the customer's ability to fulfil his/her financial obligations. Collateral is the property, fixed assets, chattels, pledged as security by clients. Capital portends the financial strength, more so in respect of net worth and working capital, evaluation of capital may be by way of analyzing the balance sheet using the financial ratios. Condition relates to the general economic climate and its influence on the clients ability to pay.

2.5.1 Credit Repayment period and loan portfolio performance

Under this, funds should always be available to carry on daily operations .the source of these fund s are collections from clients of the company. Katagwa (2006), observed that any possible method should be used to speed up the accounts receivable float. He added that the receivable float or credit period may affect a company's loan portfolio performance in three ways like increase in credit period leads to increase in sales volume which may have a positive effect on profit position, increase in credit period leads to increase in bad debts expenses which has negative effect on loan portfolio performance and increase in average collection period leads to

increase in investment in accounts receivables which has a negative effect on loan portfolio performance.

From the above therefore, a company should have a good credit period to ensure certainty of fund flow timing and loan portfolio performance.

2.6 Summary of reviewed literature

Existing literature indicates a strong effect of Credit terms on loan portfolio performance in Equity Bank Adjumani Branch. When bank undertake efforts to create credit terms, loan portfolio performance in Equity Bank Adjumani Branch is likely to improve while the reverse is also true. The literature is silent about the empirical results of the effect of Credit terms on loan portfolio performance in Equity Bank Adjumani Branch a concern that this study intends to fill the gap by providing new empirical result of the effect of Credit terms on loan portfolio performance in Equity Bank Adjumani Branch.

Existing literature also only talks about the effect of credit standards on loan portfolio performance in Equity Bank Adjumani Branch, literature doesn't mention of the empirical results of the effect of credit standards on loan portfolio performance in Equity Bank Adjumani Branch a concern this study intended to fill the gap by providing new empirical results on the the effect of credit standards on loan portfolio performance in commercial banks particularly Equity Bank Adjumani Branch.

From the literature review, it can be witnessed that collection procedures has an effect on loan portfolio performance in Equity Bank Adjumani Branch, literature does not mention of the

empirical results of the effect of collection procedures on loan portfolio performance in Equity Bank Adjumani Branch a concern this study intended to fill the gap by providing new empirical results on the effect of collection procedures on loan portfolio performance in commercial banks particularly Equity Bank Adjumani Branch.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter describes the methods that were employed in conducting the study. The chapter begins with research design, study population, sample size and selection, sampling techniques and procedure, data collection methods and instruments and validity and reliability of research instruments that was used. It further describes the data processing and analysis that was employed in the study and concludes with measurement of variables.

3.1 Research Design

The study used a cross sectional design. The cross sectional survey was used because it captures the state of the variable at a particular point in time in different areas of an organization. Therefore cross sectional involved triangulation (use of multiple data collection techniques simultaneously) i.e. utilizing both quantitative and qualitative approaches at the same time. Mugenda & Mugenda (1999) defined quantitative approach as that approach that produces discrete numerical data while the qualitative approach produces textual and non-numerical data. They further state that the advantages of using both approaches is that they help supplement each other as each method checks on another to reduce bias.

Quantitative approach was used to gather information for proper analysis and making appropriate inferences, generalizations and conclusions to the population (Mugenda & Mugenda, 1999). Qualitative approach was employed so as to capture the information on attitudes and behavior hence supplementing information from quantitative sources (Arya & Yesh, 2001).

3.2 Study Population

The study population comprised of 420 respondents (primary data) who were both customers and employees in Equity bank Uganda. The study involved 10 senior credit officers, 10 branch support team, 2 branch loan officers and 398 loan customers.

3.3 Sample size and selection

Table 1: Sample size and selection

Category	Target Population	Sample Size	Sampling Technique
Senior Credit Officers	10	10	Census
Branch support team	10	10	Census
Branch Loan Officers	2	2	Census
Loan Customers	398	196	Simple random sampling
Total	**420**	**218**	

Source: Primary Data

A representative sample of 218 respondents was selected from a population of 420,comprising of senior credit officers, branch support team, branch loan officer, loan customers of Adjumani branch. The selection of the sample size was based on the Krejcie and Morgan 1970 table (Amin, 2005) for determining sample size for research activities.

3.4 Sampling techniques and procedure

The researcher employed simple random sampling for selecting the branch loan officers and customers. A simple random sample is a subset of individuals (a sample) chosen from a larger set (a population). Each individual is chosen randomly and entirely by chance, such that each individual has the same probability of being chosen at any stage during the sampling process.

This was done by choosing randomly and entirely by chance, such that each individual had the same probability of being chosen at any stage during the sampling process, and hence rule out bias in the selection process.

Census sampling was used to select heads of department and Senior Credit Officers who are more knowledgeable about credit management policies and loan portfolio performance and these participated as key informants. A census is the procedure of systematically acquiring and recording information about the members of a given population. Information is obtained only from a subset of a population. This was done by basing upon a variety of criteria which included specialist knowledge about the effect of credit management policies on loan portfolio performance and also ability and willingness to participate in the research.

3.5: Data Collection Methods

Primary data was collected using questionnaire guided interviews and face to face interviews while secondary data was obtained through documentary reviews.

3.5.1: Questionnaire Survey

A questionnaire is a data collection method consisting of a series of questions and other prompts for the purpose of gathering information from respondents (Mellenbergh, 2008). A structured questionnaire was developed and administered to the respondents to extract information on their opinions on the effect of credit management policies on loan portfolio performance. The reason for selecting the questionnaire was because it is an appropriate method for collecting data, it offers greater assurance of anonymity, can be filled at the respondent's convenience hence

increasing chances of getting valid information and it is a cheap way of collecting data from a wide geographical area (Amin 2005).

3.5.2: Interviews

An interview is one of the methods of collecting data from respondents to obtain information on the issues of interest (Sekaran, 2003). Interviews can be unstructured or structured, and conducted either face to face or by telephone or online. Interviewing involves face to face encounters and requires maximum cooperation between the researcher and the respondent if reliable information is to be obtained.

In-depth interviews with key informants (KIs) were conducted to generate findings that were directly used in the report. Interviewing allows key informants a wider chance to give detailed information that is not possible to obtain using questionnaires.
This method was used to throw a completely different light on an issue that the interviewer has previously never considered on the kind of credit management policies on loan portfolio performance. The researcher gathered data through interviews with key informants and this helped the researcher to address the questions to one key informant at a time.

3.5.3: Documentary review

It involved obtaining information by studying written documents. These included; research reports, bank policy documents for example; loan portfolio performance reports and surveys, journals and conference papers.

3.6 Data Collection Instruments

The researcher used a set of data collection instruments namely questionnaires, interview guide, documentary review checklist and an observation checklist.

3.6.1: Questionnaire

The researcher used two sets of questionnaires namely self-administered and researcher administered questionnaires as data collection instruments to respondents (refer to Appendix 1).

A self-administered questionnaire designed on a likert scale was used to collect data from respondents who can write and read well. This enabled to reach a sparse population and also becoming time saving to researcher and respondents, cost saving to researcher while ensuring confidentiality.

3.6.2: Interview guide

An interview guide is a set of items that the researcher interviews about. It can have structured, semi- structured or unstructured questions (Kombo and Tromp, 2006).

An interview guide with pre-determined set of questions was followed and used during the interview to enable cover the variables under study. The instrument was followed by the researcher to ask questions prompting responses from KIs (refer to Appendix 2).

3.6.3: Documentary review guide

To support the interview and observation methods, a documentary review checklist and interview was used to gather and collect secondary data. This involved analyzing documents mainly the organization’s reports for additional information, reviewing books, articles, journal articles published with keen interest on the study variables. This also helped the researcher to

document literature as well as conceptualizing the variables in the study. The instrument was used in guiding the researcher to review relevant documents in order to collect data required to answer the research questions (Punch,2000, p.10).

3.7 Validity and Reliability of the Research Instruments

3.7.1: Validity

In order to test and improve the validity of data collection instruments, the researcher availed the instruments to the academic supervisors who looked at the items and checked on language clarity, relevancy, and comprehensiveness of content and length of the questionnaire. On realizing the mistakes in the data collection instruments, the researcher edited the instruments. On addition A Content Validity Index (CVI) was used to determine the degree to which elements of the questionnaire used were relevant to, and representative of, the targeted variables. The CVI was computed using the content validity ratio (CVR) developed by Lawshe (1975) on the basis of the formula $CVR = [(E - (N / 2)) / (N / 2)]$ where E represented number of experts who agreed that the question was relevant, N was number of experts. The CVR results range between -1 to +1 with positive values an indication of relevance. The CVR of the instrument had an average of 0.98 which was close to the benchmark set by Lawshe (1975) of 0.99.

3.7.2: Reliability

To ensure this, the researcher measured the internal consistency using the Cronbach alpha (Cronbach, 1951) basing on the five point likert scale items. The table 2 below shows the results the reliability results obtained.

Table 2; Reliability results

Variable	**Anchor**	**Cronbach Alpha Value**
Credit Terms	5-Point	.6832
Credit Standards	5-Point	.9134
Loan Portfolio Performance	5-Point	.8724

Source: Primary data

Credit Terms: This was measured using an instrument developed by Milani (1975). The instrument has a 5-point Likert-scale. A respondent's overall score for this variable was the average of the score for the items in the instrument. A reliability check of the instrument for the study revealed a Cronbach's alpha of 0.6832, which shows that the measure was reliable.

Credit Standards: This was measured using the Milani six item measure instrument developed by Milani (1975). The instrument has a 5-point Likert-scale. A respondent's overall score for this variable was the average of the score for the items in the instrument. A reliability check of the instrument for the study revealed a Cronbach's alpha of 0.9134, which shows that the measure was reliable.

Loan Portfolio Performance: this was measured by 5-point Likert-scale instrument developed by Hollenbeck et al, (1989). The scale ranges from 1 (strongly disagree) to 5 (strongly agree). A reliability check of the instrument for the study revealed a Cronbach's alpha of 0. 8724, which shows that the measure was reliable.

3.8: Procedure for Data Collection

Data collection procedures that were used in the study included self and researcher administered questionnaires, face to face interviews, taking notes from documentary review and visual occurrences under observation. In all data collection procedures, protocol was observed by obtaining and presenting permission letters to collect data both from UMI and Equity Bank Uganda, the case study institution to enable access to study elements and to convince them to give the data.

3.9: Data Analysis

Data analysis is the process of bringing order, structure and meaning to the mass of information gathered (Mugenda & Mugenda, 1999). Data collected from the field was sorted, coded by assigning themes to the study variables and later entered into a computer using statistical software (SPSS) to enable analysis. The data was able to answer the research questions and hypotheses.

3.9.1: Quantitative data analysis:

The analysis of quantitative data encompasses calculations such as averages, totals as compared to totals of responses expected. The process of data analysis involves editing, examining the collected raw data to detect errors and omissions and to correct this when possible. The first editing was done in the field and scrutinizing of the completed questionnaire. It was done on a daily basis after the interviews and at times on spot. After fieldwork, central editing was then done to review and edit when all questionnaires completed and returned to the researcher. Corrections for wrong entries and omissions were then done. After central editing, questionnaires

were brought back to where computer data entry was done into a statistical package for social scientist (SPSS) software.

SPSS was used to capture data, data analysis and management. Tables were generated and these were exported from SPSS into the word document and interpretation was done. In addition, the researcher described or summarized data using descriptive statistics. The researcher obtained measures of central tendency (mean, mode and median) as well as measures of dispersion (standard deviation). The final outputs and selected summary tables were transferred into the main report, findings presented, interpreted and conclusions deduced. In this study the ratio of Non-performing loan to loan & Advances and ratio of Total loan & Advances to Total deposit was used as indicators of credit risk while the ratio of Profit after Tax to total asset known as return on asset (ROA) indicated performance.

Regression was employed in the study to forecast the relationship between the variables and estimate the influence of each explanatory variable to the dependent variable.

3.9.2. Qualitative data analysis

The researcher organized and prepared data for analysis by sorting and arranging the data into various themes as it was reflected in the key informant guide. The researcher read through all the data to obtain a general understanding of the information collected, coded the responses, generated themes for analysis and interpretation of the meaning of the data.

3.10 Measurement of Variables

To measure variables in a quantitative approach is to transform attributes of the conceptual framework of variables studied into numerical quantities. According to Amin (2005, pg 261), measurement is the process of transforming abstractly conceived concepts or variables into numerical quantities. It involved quantifying observations about a quality or attribute. In measuring variables, there were different scales used. Attitude scales determine what an individual believes, perceives or feels about self, others, activities, institutions or situations. In this study, a likert scale was used. Data on key variables in the self and researcher administered questionnaires was measured on the likert scale (5, 4, 3, 2, 1) for strongly agree, agree, uncertain, disagree and strongly disagree respectively.

CHAPTER FOUR

PRESENTATION, ANALYSIS AND INTERPRETATION OF RESULTS

4.0 Introduction

This chapter comprises of a presentation of results and their interpretation. The presentation in this chapter shows the results as tested according to the objectives of the study. The chapter begins with the demographic characteristics of the respondents such as age, educational level, tenure and gender which were all presented using cross tabulations. The descriptives for the items in the instrument were also presented using means for each item to define the relative opinion of the respondents for that particular item. The results from the Zero Order correlations and the regression analysis results were presented.

4.1 Response Rate

The study took an inquiry into knowing the response rate of the respondents in the study.

Table 3: Response rate of distributed questionnaires

		Frequency	Percent
Valid	Response	202	92.66
	Non-response	16	7.33
	Total	**218**	**100.0**

Source; primary data

Ten (10) key informants were interviewed among the Branch support team, Senior Credit Officers and Branch Loan Officers while 208 questionnaires were distributed to Loan Customers. Therefore the results in Table 3 show that out of the two hundred and eight (208) questionnaires distributed to the respondents, only 192 (one hundred and ninety two) questionnaires were returned. Therefore 192 respondents who had completed and returned the

questionnaires and these comprised the total number of respondents used for testing the hypothesis of the study. This gave a response rate of 92.7%, which according to Mugenda & Mugenda (2010:83) is a very good response rate. This implied that overall majority of respondents participated in the study.

4.2 Demographical Characteristics

To present demographical characteristics, cross tabulations and frequency distributions were used to indicate variations of respondents based on age, educational level, tenure and gender. The sample characteristics were presented basing on the responses from staff and borrowers.

4.2.1 Gender of the respondents

Cross tabulation was used by the researcher to present the Gender and Category of the respondents. Table 4 below presented the results:

Table 4: Gender of the respondents * Category of the respondents Cross tabulation

			Category of the respondents		Total
			Credit officers	**Borrowers**	
Gender of the respondents	**Male**	Count	22	74	96
		Row %	22.9%	77.1%	100.0%
		Column %	100.0%	43.5%	50.0%
		% of Total	11.5%	38.5%	50.0%
	Female	Count	0	96	96
		Row %	.0%	100.0%	100.0%
		Column %	.0%	56.5%	50.0%
		% of Total	.0%	50.0%	50.0%
Total		**Count**	**22**	**170**	**192**
		Row %	**11.5%**	**88.5%**	**100.0%**
		Column %	**100.0%**	**100.0%**	**100.0%**
		% of Total	**11.5%**	**88.5%**	**100.0%**

Source: Primary data

From the results in table 4 above, out of the 192 respondents, (22) 11.9% were credit officers and (170) 88.5% were borrowers, whereas, for the female respondents, (96) 100% were borrowers

while (74) 38.5% were borrowers for the male respondents and (96) 50% were borrowers for the female respondents. From the results, there was relative representation of the gender for the respondents who were borrowers.

4.2.2 Age group and Category of the respondents

Cross tabulation was used by the researcher to present the age group and category of the respondents. Table 5 below presented the results:

Table 5: Age of the respondents * Category of the respondents Crosstabulation

			Category of the respondents		Total
			Credit officers	Borrowers	
Age of the respondents	**18 - 24**	Count	20	0	20
		Row %	100.0%	.0%	100.0%
		Column %	90.9%	.0%	10.4%
		% of Total	10.4%	.0%	10.4%
	25 - 29	Count	2	60	62
		Row %	3.2%	96.8%	100.0%
		Column %	9.1%	35.3%	32.3%
		% of Total	1.0%	31.2%	32.3%
	30 - 34	Count	0	70	70
		Row %	.0%	100.0%	100.0%
		Column %	.0%	41.2%	36.5%
		% of Total	.0%	36.5%	36.5%
	34 - 39	Count	0	35	35
		Row %	.0%	100.0%	100.0%
		Column %	.0%	20.6%	18.2%
		% of Total	.0%	18.2%	18.2%
	Over 40 years	Count	0	5	5
		Row %	.0%	100.0%	100.0%
		Column %	.0%	2.9%	2.6%
		% of Total	.0%	2.6%	2.6%
Total		**Count**	**22**	**170**	**192**
		Row %	**11.5%**	**88.5%**	**100.0%**
		Column %	**100.0%**	**100.0%**	**100.0%**
		% of Total	**11.5%**	**88.5%**	**100.0%**

Source: Primary data

According to the results in table 5 above, 20 (10.4%) of the respondents belonged to the 18-24 years age group, 62 (32.3%) belonged to the 25-29 years age group, (70) 36.5% belonged to the 30-34 years age group, 35 (18.2%) belonged to the 34-39 years age group and (5) 2.6% belonged to the 40 years and above age group. Additionally, 22 (11.5%) of the respondents were credit officers and 170 (88.5%) were borrowers. From the findings, the majority of the respondents belonged to the 34-39 years age group. This implied that the bank employs more of young people in the age range of 18-35 years, thus being a great threat to the credit policy management of the bank because young employees lack experience mostly in handling credit risk. This also implied that most of the respondents were between the ages of 30-39 which is a productive age range and hence the poor loan portfolio performance can't be attributed to the age of the clients.

4.2.3 Level of Education and Category of the respondents

Cross tabulation was used by the researcher to present the level of education and category of the respondents. Table 6 below presented the results:

Table 6: Education of the respondents * Category of the respondents Crosstabulation

			Category of the respondents		Total
			Credit officers	**Borrowers**	
Education of the respondents	**Degree**	Count	22	12	34
		% of Total	11.5%	6.2%	17.7%
	Diploma	Count	0	74	74
		% of Total	.0%	38.5%	38.5%
	Certificate	Count	0	71	71
		% of Total	.0%	37.0%	37.0%
	Masters	Count	0	13	13
		% of Total	.0%	6.8%	6.8%
Total		**Count**	**22**	**170**	**192**
		% of Total	**11.5%**	**88.5%**	**100.0%**

Source: Primary data

From Table 6, 22 (11.5%) of the bank credit officers respondents were degree holders, 74 (38.5%) of the respondents (bank borrowers) were diploma holders, (71) 37.0% of the respondents (bank borrowers) were Certificate holders and lastly, for the master's degree holders, 13 (6.8%) were were borrowers. This implied that the respondents were able the answer the questions presented to them by the researcher.

4.2.4 Working Tenure and Category of the respondents

Frequency tabulation was used by the researcher to present tenure and category of the respondents. Table 7 below presented the results:

Table 7: Working Tenure of the respondents

		Frequency	Valid Percent	Cumulative Percent
Valid	0 - 3 years	62	32.3	32.3
	3- 6 years	72	37.5	69.8
	6 - 9 years	50	26.0	95.8
	Over 9 years	8	4.2	100.0
	Total	**192**	**100.0**	

Source: Primary data

According to the results in table 7 above 62 (32.3%) of both the staff and borrowers had worked with the bank for 0-3 years, 72 (37.5%) had worked for 3-6 years, 50 (26 %) had worked for 6-9 years and 8 (4.2%) had worked for over 9 years. From the results the majority of the respondents had worked for 3-6 years with the bank. The survey revealed that the majority of the respondents had a working relationship with the bank for the period not exceeding years thus indicating that

most lower level staff lacked experience which affected the bank's loan portfolio performance negatively.

4.3 The effect of Credit terms on loan portfolio performance in commercial banks

Regarding the effect of Credit terms on loan portfolio performance in commercial banks, the respondents were asked to provide their views on their welfare and below are the results. The results in the table below were generated using a scale which was coded such that one represents (SA = strongly agree, A = agree, NS = not sure, D disagree SD = strongly disagree), ranging from (5, 4, 3, 2 and 1) respectively. A mean close to 1 or 2 shows Disagreement, while one close to 4 or 5 shows Agreement. Means close to 3 reflect uncertainty with the issue at hand.

Table 8: Respondents' attitude on the effect of Credit terms on loan portfolio performance in commercial banks (N=192)

Credit terms on loan portfolio performance	**Responses in percentages (%)**						
	SD	D	NS	A	SA	**Mean**	**SD**
There is a credit policy at the bank	1.4 % (3)	8.2% (16)	5.5% (11)	57.5% (110)	27.4 % (52)	3.98	.894
The credit policy is revised regularly by the bank	2.7% (5)	2.7% (5)	9.6% (19)	76.7% (147)	8.2% (16)	3.68	.771
Credit terms are determined by the bank managers	1.4% (3)	9.6% (19)	11% (21)	69.9% (134)	8.2% (16)	3.73	.811
Credit terms are determined in consultation with the customers	5.5% (11)	5.5% (11)	16.4 % (31)	52.1% (100)	20.5 % (39)	3.75	1.02
Credit terms are determined in line with Bank of Uganda lending/credit policy.	2.7% (5)	8.2% (16)	16.4 % (31)	60.3% (116)	12.3 % (24)	3.72	.882
Credit terms at Equity bank are favorable and affordable compared to other banks	0	4.1% (8)	13.7 % (26)	69.9% (134)	12.3 % (24)	3.90	.648
Loans are disbursed according to	1.4%	2.7%	5.5%	68.5%	21.9	4.05	.717

the competence of the clients	(3)	(5)	(11)	(132)	% (41)		
Equity bank determines interest rates by looking at the cost of production, inflation rates and loan loss provisions	5.5% (11)	12.3 % (24)	13.7 % (26)	57.5% (110)	11% (21)	3.55	1.03
The credit worthiness of the customer is assessed before giving him or her a loan	6.8% (13)	4.1% (8)	17.8 % (34)	53.4% (103)	17.8 % (34)	3.71	1.02
Equity bank considers the applicant's credit history when approving the loan.	1.4% (3)	11% (21)	11% (21)	65.8% (126)	11 (21)	3.74	.854

Key: Strong Agree (SD), Agree (A), Not sure (NS), Disagree (D), Strongly Disagree (SD)
5 4 3 2 1
Source: Primary data

Table 8 above represents the respondents' attitude on the effect of Credit terms on loan portfolio performance in commercial banks. The study used 10 questions based on a five Likert scale to measure this variable. When the respondents were asked to give their attitudes whether there is a credit policy at the bank, out of the 192 respondents who answered the questionnaire; 52 (27.4%) strongly agreed, 110 (57.5%) agreed, 11 (5.5%) were not sure, (16) 8.2% disagreed and 3 (1.4%) strongly disagreed. This indicated that the there is a credit policy at the bank since the majority, 163 (84.9%) agreed to this.

On whether the credit policy is revised regularly by the bank; 16 (8.2%) strongly agreed, 147 (76.7%) agreed, 19 (9.6%) were not sure, 5 (2.7) disagreed and 5 (2.7) strongly disagreed, which showed that the credit policy is revised regularly by the bank. This implied that overall the bank was performing fairly well is an average response of 2.13, on the whether the bank uses

conservative approach in its loan analysis, being aggressive in its lending approaches, bank not lending to clients with a high payment risk, emphasis in evaluation is put on the quality of assets, bank possesses a credit policy hand book for guidance in giving out loans, and the bank is consistent with its loan analysis approach.

Asked whether Credit terms are determined by the bank managers; 16 (8.2%) strongly agreed, 134 (69.9%) agreed, 21(11%) were not sure, 19 (9.6%) disagreed and 3 (1.4%) strongly disagreed. This implied that Credit terms are determined by the bank managers since 78.1% agreed to this. On whether the Credit terms are determined in line with Bank of Uganda lending/credit policy; 12.3% strongly agreed, 60.3% agreed, 31 (16.4%) were not sure, 16 (8.2%) disagreed, and 5 (2.7%) strongly disagreed. This implied that Credit terms are determined in line with Bank of Uganda lending/credit policy.

On the issue of whether Credit terms at Equity bank are favorable and affordable compared to other banks; (24) 12.3% strongly agreed, 134 (69.9%) agreed, 26 (13.7%) were not sure and 8 (4.1%) disagreed. This meant that Credit terms at Equity bank are favorable and affordable compared to other banks.

On the question of whether Loans are disbursed according to the competence of the clients; 21.9% strongly agreed, 68.5% agreed, 11 (5.5%) were not sure, 5 (2.7%) disagreed, and 3 (1.4%) strongly disagreed. This revealed that Loans are disbursed according to the competence of the clients since 90.4% agreed to this.

On whether Equity bank determines interest rates by looking at the cost of production, inflation rates and loan loss provisions; 34 (17.8%) strongly agreed, 103 (53.4%) agreed, 34 (17.8%) were not sure, 8 (4.1%) disagreed and 6.8% strongly disagreed. This serves to explain that Equity bank determines interest rates by looking at the cost of production, inflation rates and loan loss provisions.

On this issue of whether the credit worthiness of the customer is assessed before giving him or her loan; 21 (11%) strongly agreed, 126 (65.8%) agreed, 21 (11%) were not sure, 21 (11%) disagreed and 3 (1.4%) strongly disagreed. This showed that a good number of respondents agreed that the credit worthiness of the customer is assessed before giving him or her loan since 78.8% agreed to this. This meant that credit standards affects credit terms which implies that if the bank put a lot of emphasis on nurturing borrower relationships, this would enhance Loan portfolio performance

Results of interviews with key informants further established that;

> The lifeblood of each lending institution is its Loan portfolio and the success of the institution depends on how well that portfolio is managed. Therefore any study of a credit institutions loan portfolio must be base on the financial characteristics of the clients and on the financial sector , economic and competitive conditions and commonly used lending practices within the territory served by the institution, (Respondent).

4.3.2 Testing hypothesis 1; Credit terms positively affect loan portfolio performance

These findings were further analyzed using Pearson correlation and later Regression analysis to establish the effect of Credit terms on loan portfolio performance in commercial banks.

Table 9: Effect of Credit terms on loan portfolio performance in commercial banks

		Credit Terms	Loan Portfolio Performance
Credit Terms	Pearson Correlation	1	.259**
	Sig. (2-tailed)		.000
	N	192	192
Loan Portfolio Performance	Pearson Correlation	.259**	1
	Sig. (2-tailed)	.000	
	N	192	192
***. Correlation is significant at the 0.01 level (2-tailed).*			

Source: Primary data

Correlation results indicated a significant positive relationship between Credit terms and Loan portfolio performance ($r = .259^{**}$, $p<.01$). This is confirmation that borrower values, attitudes, experience and beliefs had a positive effect on the improvement of loan repayment rate, reduction on the arrears rate and portfolio at risk of the bank. The results imply that if credit terms were in favour of the bank's credit terms, this would positively affect Loan portfolio performance.

4.3.3 Regression Analysis

Regression analysis was used to determine the extent to which Credit terms; credit standards predict Loan portfolio performance in Equity bank. The results obtained are shown by table 10 below:

Table 10 A: Effect of Credit Terms to Loan Portfolio Performance in commercial banks

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.037	1	1.037	13.625	.000[a]
	Residual	14.458	190	.076		
	Total	15.495	191			

a. Predictors: (Constant), Credit Terms

b. Dependent Variable: Loan Portfolio Performance

The independent variable, credit terms, was statically significant in affecting loan portfolio performance in commercial banks, f = 13.625 (<0.01) as shown in table above. This implies that there is a meaningful positive relationship between the independent variable credit terms and the dependent variable loan portfolio performance in commercial banks.

Table 10 B: Causal relationship between Credit Terms and Loan Portfolio Performance in commercial banks

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.879	.060		14.595	.000
	Credit Terms	.164	.045	.259	3.691	.000

a. Dependent Variable: Loan Portfolio Performance

The regressions results from the table above shows that a unit change in Credit terms brings about .879 or 87.9 % change in Loan Portfolio Performance in commercial banks. Hence, H_1 which states that Credit terms positively affect loan portfolio performance in commercial banks is supported and accepted.

Table 10 C: Model Summary between Credit Terms and Loan Portfolio Performance in commercial banks

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.259[a]	.067	.062	.27585

a. Predictors: (Constant), Credit Terms

In reference to the above model summary, this shows that Credit terms account for a variation in performance at 62%(Adjusted R square)Hence, H_1 which states that credit terms positively affect loan portfolio performance in commercial banks is supported and accepted.

4.4 The Effect of Credit Standards on Loan Portfolio Performance in commercial banks

The researcher wanted to know whether Credit Standards have an effect on Loan Portfolio Performance in commercial banks. The findings are summarized in the Table 4.8 below. The results in the table below were generated using a scale which was coded such that one represents (SA = strongly agree, A = agree, NS = not sure, D disagree SD = strongly disagree), ranging from (5, 4, 3, 2 and 1) respectively. A mean close to 1 or 2 shows Disagreement, while one close to 4 or 5 shows Agreement. Means close to 3 reflect uncertainty with the issue at hand.

Table 11: Effect of Credit Standards on Loan Portfolio Performance in commercial banks (N=192)

Effect of Credit Standards on Loan Portfolio Performance in commercial banks	**Responses in percentages (%)**						
	SD	D	NS	A	SA	**Mean**	**SD**
Clients are frequently visited by staffs of Equity bank to strengthen monitoring.	1.4 % (3)	8.2% (16)	5.5% (11)	57.5 % (110)	27.4 % (52)	4.29	1.62
Clients provide financial statements in order to be analyzed as regards to the performance trends of their	2.7% (5)	2.7% (5)	9.6% (19)	76.7 % (147)	8.2% (16)	3.71	1.60

business activities							
Equity bank visits clients frequently at their site in order to strengthen monitoring of the loans	1.4% (3)	9.6% (19)	11% (21)	69.9 % (134)	8.2% (16)	4.29	0.89
Credit standards are periodically reviewed to include any updates of the bank	5.5% (11)	5.5% (11)	16.4 % (31)	52.1 % (100)	20.5 % (39)	2.44	1.21
Demonstration of integrity and commitment to honor the repayment of the loan with interest is one of the credit standards.	2.7% (5)	8.2% (16)	16.4 % (31)	60.3 % (116)	12.3 % (24)	3.17	1.17
There is evaluation of collateral of the borrower to justify that its quality and value is adequate to redeem the debt in case the bank has to recover loan from selling the collateral.	0	4.1% (8)	13.7 % (26)	69.9 % (134)	12.3 % (24)	3.50	1.60
Equity bank makes the borrower aware of important instructions relating to the credit disbursement modalities	1.4% (3)	2.7% (5)	5.5% (11)	68.5 % (132)	21.9 % (41)	3.86	0.64
Equity bank sends a credit officer/agent to the client with a disbursement letter which spells out the amounts and currency of disbursement	5.5% (11)	12.3 % (24)	13.7 % (26)	57.5 % (110)	11% (21)	3.07	0.86
The bank suspends disbursement if a clients does not fulfil the conditions specified in the loan agreement	6.8% (13)	4.1% (8)	17.8 % (34)	53.4 % (103)	17.8 % (34)	3.71	1.60
A monitoring mechanism is put in place to ensure that the borrower pays the loan in time	1.4% (3)	11% (21)	11% (21)	65.8 % (126)	11% (21)	3.72	1.60
The bank verifies and satisfies that borrower's activity is progressing in accordance with the business plan.	1.4% (3)	9.6% (19)	11% (21)	69.9 % (134)	8.2% (16)	3.05	0.59

Source: Primary Data

Key: Strong Agree (SD), Agree (A), Not sure (NS), Disagree (D), strongly Disagree (SD)

5 4 3 2 1

The results in the Table 11 present the respondents' attitudes on the effect of credit standards on loan portfolio performance in commercial banks. The respondents were asked whether Clients are frequently visited by staffs of Equity bank to strengthen monitoring, the respondents strongly agreed at a (Mean = 4.29), Clients provide financial statements in order to be analyzed as regards to the performance trends of their business activities at a (Mean = 3.71), Equity bank visits clients frequently at their site in order to strengthen monitoring of the loans at a (Mean = 4.29), however they disagreed that Credit standards are periodically reviewed to include any updates of the bank at a (Mean = 2.44). On the contrast the majority of the respondents agreed that demonstration of integrity and commitment to honour the repayment of the loan with interest is one of the credit standards. at a (Mean = 3.17), there is evaluation of collateral of the borrower to justify that its quality and value is adequate to redeem the debt in case the bank has to recover loan from selling the collateral. at a (Mean = 3.50), Equity bank makes the borrower aware of important instructions relating to the credit disbursement modalities at a (Mean = 3.86), Equity bank sends a credit officer/agent to the client with a disbursement letter which spells out the amounts and currency of disbursement at a (Mean = 3.07), The bank suspends disbursement if a clients does not fulfil the conditions specified in the loan agreement at a (Mean = 3.71), A monitoring mechanism is put in place to ensure that the borrower pays the loan in time at a (Mean = 3.72) and lastly that The bank verifies and satisfies that borrower's activity is progressing in accordance with the business plan at a (Mean = 3.05) respectively. This implied that most of the clients don't provide the financial statements of their businesses implying that the bank is not able to determine the credit worthiness of its clients to make credit decisions hence one of the causes of the poor loan portfolio performance in the bank since client standards

and screening helps to establish whether the loan applicant will afford to service and repay the loan.

Results from individual interviews conducted with key informants did not differ from those discussed above. They noted that credit standards include client screening which involves obtaining information on loan applicants and then using the information to analyze and determine the credit worthiness of the applicant to make credit decisions. Information is obtained from the applicant's financial statements, credit rating reports, trade checking and experience in business.

One of the loan officers noted that;

" this information helps in the analysis of not only credit worthiness and ability of the applicant to meet the minimum standards for qualifying for the loan being applied for but also the probability of bad debts. All this is done so as to take an informed decision as to the extension of any loan."

Key informants reported that the Client screening deals with assessing the credit demand based on the repayment potential of loan applicants. for bank, it basically focuses on the repayment capacity of the applicants based on the analyzed degree of credit worthiness, trust worthiness, type of business engaged in and level of faith that the bank derives from the information given by the applicant

4.4.1 Testing hypothesis Two; credit standards positively affect loan portfolio performance These findings were further analyzed using Pearson correlation and later Regression analysis to establish the effect of credit standards on loan portfolio performance in commercial banks was carried out using Pearson's correlation.

Table 12: Correlation between the effect of Credit Standards on Loan Portfolio Performance in commercial banks

		Credit Standards	Loan Portfolio Performance
Credit Standards	Pearson Correlation	1	.845**
	Sig. (2-tailed)		.000
	N	192	192
Loan Portfolio Performance	Pearson Correlation	.845**	1
	Sig. (2-tailed)	.000	
	N	192	192

***. Correlation is significant at the 0.01 level (2-tailed).*

The results in the Table 12 above reveal that Credit standards had a positive correlation with the Loan Portfolio Performance in commercial banks ($r = 0.845^{**}$ $P < 0.01$). This means that the two variables are positively related. This supports the hypothesis that Credit standards significantly Loan Portfolio Performance in commercial banks since the p value 0.00 is less than 0.01. This implies that the Credit standards positively affect Loan Portfolio Performance in commercial banks.

4.4.2 Regression Analysis

A linear regression model was used to determine the proportion that the independent variable, Credit standards accounts for the Loan Portfolio Performance in commercial banks. The results are summarized in tables below as shown.

Table 13 A: Effect of Credit standards to Loan Portfolio Performance in commercial banks

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.060	1	11.060	473.845	.000[a]
	Residual	4.435	190	.023		
	Total	15.495	191			

a. Predictors: (Constant), Credit Standards

b. Dependent Variable: Loan Portfolio Performance

The independent variable, Credit standards, was statically significant in affecting Loan Portfolio Performance in commercial banks, F = 473.845(<0.01) as shown in table above. This implies that there is a meaningful positive relationship between the independent variable Credit standards and the dependent variable Loan Portfolio Performance in commercial banks.

Table 13 B: Causal relationship between Credit standards and Loan Portfolio Performance in commercial banks

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.261	.040		6.589	.000
	Credit Standards	.739	.034	.845	21.768	.000

a. Dependent Variable: Loan Portfolio Performance

The regressions results from the table above shows that a unit change in Credit standards brings about .261 or 26.1% change in Loan Portfolio Performance in commercial banks. Hence, H_2 which states that Credit standards positively affect loan portfolio performance in commercial banks is supported and accepted.

Table 13 C: Model Summary between Credit standards and Loan Portfolio Performance in commercial banks

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.845[a]	.714	.712	.15278

a. Predictors: (Constant), Credit Standards

In reference to the above model summary, this shows that there is significantly positive relationship between independent variable Credit standards account for a variation in performance at .712%(Adjusted R Square).Hence, H_2 which states that Credit standards positively affect loan portfolio performance in commercial banks is supported and accepted.

4.5 The Relationship between Collection Procedures and Loan Portfolio Performance in commercial banks

The results in the table below were generated using a scale which was coded such that one represents (SA = strongly agree, A = agree, NS = not sure, D disagree SD = strongly disagree), ranging from (5, 4, 3, 2 and 1) respectively.

Table 14 Respondents' attitude on the effect of Collection Procedures and Loan Portfolio Performance in commercial banks

	Responses in percentages (%)				
	SD	D	NS	A	SA
The bank has a loan appraisal process system which is implemented in the collection procedures to influence Loan Portfolio Performance in commercial banks	1.4 % (3)	8.2% (16)	5.5% (11)	57.5 % (110)	27.4 % (52)
The bank has a well set up body to deal with debt collection	2.7% (5)	2.7% (5)	9.6% (19)	76.7 % (147)	8.2% (16)
There is a relationship between Collection Procedures and Loan Portfolio Performance in Equity bank	1.4% (3)	9.6% (19)	11% (21)	69.9 % (134)	8.2% (16)

Rigid approval and collection procedures affects Loan Portfolio Performance in Equity bank	5.5% (11)	5.5% (11)	16.4 % (31)	52.1 % (100)	20.5 % (39)
The bank observes the collection period given to each client.	2.7% (5)	8.2% (16)	16.4 % (31)	60.3 % (116)	12.3 % (24)
There are systematic written down steps in the handling of defaulting customers.	0	4.1% (8)	13.7 % (26)	69.9 % (134)	12.3 % (24)
Loan default rates are as a result of poor collection Procedures in the bank	1.4% (3)	2.7% (5)	5.5% (11)	68.5 % (132)	21.9 % (41)
Clients are encouraged to reconcile their bank statements with the bank	5.5% (11)	12.3 % (24)	13.7 % (26)	57.5 % (110)	11% (21)
The bank usually recovers 100% of the total loan due for collection	6.8% (13)	4.1% (8)	17.8 % (34)	53.4 % (103)	17.8 % (34)

Key: Strong Agree (SD), Agree (A), Not sure (NS), Disagree (D), Strongly Disagree (SD)

5 4 3 2 1

Source: Primary data

In regard to the respondents' attitude on the effect of Collection Procedures and Loan Portfolio Performance in commercial banks**,** responses were as shown in the Table 4.4 above. The study used 10 questions based on a five Likert scale to measure this variable.

When the respondents were asked to give their opinion on whether the bank has a loan appraisal process system which is implemented in the collection procedures to influence Loan Portfolio Performance in commercial banks, out of the 192 respondents who answered the questionnaire; 52 (27.4%) strongly agreed, 110 (57.5%) agreed, 11 (5.5%) were not sure, 16 (8.2%) disagreed and (3)1.4% strongly disagreed. This indicated that the bank has a loan appraisal process system which is implemented in the collection procedures to influence Loan Portfolio Performance in commercial banks since the majority, 84.9% agreed to this.

On whether the bank has a well set up body to deal with debt collection; (16) 8.2% strongly agreed, 147 (76.7%) agreed, 19 (9.6%) were not sure, 5 (2.7%) disagreed and 5 (2.7%) strongly disagreed, which showed that a good number of respondents agreed.

Asked whether there is a relationship between Collection Procedures and Loan Portfolio Performance in Equity bank; 8.2% strongly agreed, 69.9% agreed, 11% were not sure, 9.6% disagreed and 1.4% strongly disagreed. This implied that there is a relationship between Collection Procedures and Loan Portfolio Performance in Equity bank since 78.1% agreed to this.

On whether rigid approval and collection procedures affects Loan Portfolio Performance in Equity bank; 12.3% strongly agreed, 60.3% agreed, 16.4% were not sure, 8.2% disagreed, and 2.7% strongly disagreed. This implies that a rigid approval and collection procedures affects Loan Portfolio Performance in Equity bank. Therefore a credit policy forms part of bank performance since this attributed by most scholars who have analyzed credit policy but little has been done on analyzing the relationship between credit policy and performance in banks. This relationship is vital since developmental institutions are now being run mostly on commercial principles rather than as relief, their customers must know from the onset that he or she has to pay up the money borrowed or risk the undesirable consequences of defaulting.

4.5.1 Testing hypothesis Three; Collection Procedures positively affect loan portfolio performance

These findings were further analyzed using Pearson correlation and later Regression analysis to establish the effect of Collection Procedures and Loan Portfolio Performance in commercial banks was carried out using Pearson's correlation.

Table 15: Correlation between the effect of Collection Procedures on Loan Portfolio Performance in commercial banks

		Collection Procedures	Loan Portfolio Performance
Collection Procedures	Pearson Correlation	1	.169**
	Sig. (2-tailed)		.019
	N	192	192
Loan Portfolio Performance	Pearson Correlation	.169**	1
	Sig. (2-tailed)	.019	
	N	192	192

**. Correlation is significant at the 0.01 level (2-tailed).

The results in the Table 15 above reveal that Collection Procedures had a positive correlation with the Loan Portfolio Performance in commercial banks($r = 0.169$** $P< 0.01$). This means that the two variables are positively related. This supports the hypothesis that Collection Procedures significantly Loan Portfolio Performance in commercial banks. This implies that the Collection Procedures positively affect Loan Portfolio Performance in commercial banks. The relationship is however weak and not significant since the p.value of 0.019 is greater than 0.01

4.5.2 Regression Analysis

A linear regression model was used to determine the proportion that the independent variable, Collection Procedures accounts for the Loan Portfolio Performance in commercial banks. The results are summarized in tables below as shown.

Table 16 A: Effect of Collection Procedures to Loan Portfolio Performance in commercial banks

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.758	1	.758	5.556	.019[a]
	Residual	25.909	190	.136		
	Total	26.667	191			

a. Predictors: (Constant), Collection Procedures

b. Dependent Variable: Loan Portfolio Performance

The independent variable, Collection Procedures, was statically significant in affecting Loan Portfolio Performance in commercial banks, F = 1.556 (<0.01) as shown in table above. This implies that there is a meaningful positive relationship between the independent variable Collection Procedures and the dependent variable Loan Portfolio Performance in commercial banks.

Table 16 B: Causal relationship between Collection Procedures and Loan Portfolio Performance in commercial banks

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.920	.108		8.538	.000
	Collection Procedures	.227	.096	.169	2.357	.019

a. Dependent Variable: Loan Portfolio Performance

The regressions results from the table above shows that a unit change in Collection Procedures brings about .920 or 92% change in Loan Portfolio Performance in commercial banks. Hence, H_3

which states that Collection Procedures positively affect loan portfolio performance in commercial banks is supported and accepted.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.169[a]	.028	.023	.36927

a. Predictors: (Constant), Collection Procedures

In reference to the above model summary, this shows that independent variable credit standards account for a variation of 2.3% on the dependent variable loan portfolio performance. Hence, H_3 which states that Credit standards positively affect loan portfolio performance in commercial banks is supported and accepted.

4.7: Dependent Variable (Loan Portfolio Performance)

Table 20: The minimum and maximum range and mean results of respondents rating on Loan Portfolio Performance in Equity

Loan Portfolio Performance	**Min.**	**Max.**	**Mean**
Loan Loss Rate is one of the ways of determining Loan Portfolio Performance in the bank	1.00	5.00	3.71
In Equity Portfolio at Risk indicates loan Portfolio Performance	1.00	5.00	4.29
Client Affordability to Repay exists in Equity bank	1.00	5.00	3.86
Number of out Standing Loans increases Portfolio Performance in Equity bank	1.00	5.00	3.79
Loan recoveries reduces Portfolio Performance in Equity bank	1.00	5.00	3.50

Source; Primary Data

In regard to Loan Portfolio Performance in Equity bank, response was as shown in Table 20 above. Results showed that Loan Loss Rate is one of the ways of determining Loan Portfolio Performance in the bank at a (Mean = 3.71), In Equity Portfolio at Risk indicates loan Portfolio Performance (Mean = 4.29), Loan recoveries reduces Portfolio Performance in Equity bank (Mean= 3.50), Client Affordability to Repay exists in Equity bank at a (Mean 3.86) and that the number of out Standing Loans increases Portfolio Performance in Equity bank at a (Mean = 3.79) respectively. This implies that good loan portfolio managers have to concentrate most of their effort on prudently approving loans and carefully monitoring loan performance. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, such as those associated with oil and gas lending, agricultural lending, and commercial real estate lending, has made it clear that portfolio managers should do more.

One of the managers who was affected in this way, had this to say;

> *"*Despite all efforts by Equity Bank to improve its asset quality, the quality of the corporate loan portfolio has consistently remained as low as 12% for the last three years. According to the Annual Report (2008), loan portfolio has grown from 144 billion in 2005 to 193 in 2007 (which is only 30%). It is thus upon such reports on setbacks suffered in the corporate loan portfolio that the study seeks to focus on improving corporate loan portfolio quality in Equity Bank.*"*

4.8 Summary of Correlations

Table 21: correlation between Credit terms, Credit standards and Collection procedures on loan portfolio performance

		Credit Terms	Credit Standards	Collection Procedures	Loan Portfolio Performance
Credit Terms	Pearson Correlation	1	.845**	.169**	.259**
	Sig. (2-tailed)		.000	.019	.000
	N	192	192	192	192
Credit Standards	Pearson Correlation	.845**	1	.111	.567**
	Sig. (2-tailed)	.000		.000	.000
	N	192	192	192	192
Collection Procedures	Pearson Correlation	.169**	.111	1	.169*
	Sig. (2-tailed)	.019	.000		.019
	N	192	192	192	192
Loan Portfolio Performance	Pearson Correlation	.259**	.567**	.169*	1
	Sig. (2-tailed)	.000	.000	.019	
	N	192	192	192	192
**. Correlation is significant at the 0.01 level (2-tailed).					
*. Correlation is significant at the 0.05 level (2-tailed).					

Source; Primary Data

4.8.1 The relationship between Credit terms and loan portfolio performance

From table 21 above results indicate that the Pearson product moment correlation index obtained is positive at r = .259. This result indicates that there is a positive and significant relationship between Credit terms and loan portfolio performance of commercial banks. This implies that that borrower values, attitudes, experience and beliefs had a positive effect on the improvement of loan repayment rate, reduction on the arrears rate and portfolio at risk of the bank. The results imply that if credit terms were in favour of the bank's credit terms, this would positively affect Loan portfolio performance.

4.8.2 The relationship between credit standards and finance Performance

Credit standards had a positive correlation with the Loan Portfolio Performance in commercial banks (r = 0.845** P< 0.01). This meant that the two variables are positively related, implying that tight credit standards make a firm lose a big number of customers and when credit are loose the firm gets an increased number of clients but at a risk of loss through bad debts. A loose credit policy may not necessarily mean an increase in loan portfolio performance because the increased number of customers may lead to increased costs in terms of loan administration and bad debts recovery.

4.3.3 The relationship between Collection Procedures and loan portfolio performance

The results in the Table 15 above reveal that Collection Procedures had a positive correlation with the Loan Portfolio Performance in commercial banks(r = 0.169** P< 0.01). This means that the two variables are positively related. This implies that collection policy establishes a set of procedures used to collect accounts receivables which was getting overdue. Methods used could include letters, telephone calls, visits by the firm's officials for face to face reminders to pay and legal enforcements. The rationale is that not all clients meet their obligations, some just take it for granted, others simply forget while others just don't have a culture of paying until persuaded to do so.

A multiple regression analysis was conducted to address the purpose of the study which was to establish the relationship between credit management policies and loan portfolio performance in commercial banks in Uganda focusing on Equity Bank Adjumani Branch as the case study and the results below were obtained:

Table 22: Results of the Multiple Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant) Credit terms	.514	.310		1.658	.099
	Credit Standards	.581	.068	.443	8.514	.000
	Collection Procedures	.250	.043	.303	5.815	.000
a. Dependent Variable: loan portfolio performance						
R	.630					
R Square	.397					
Adjusted R Square	.392					
F Statistic	87.430					
Sig. F Statistic	.000					

Source: Primary Data

Results from Table 22 above indicate that credit management policies in terms credit terms, credit standards and Collection Procedures explain 39.7% of the variance in the loan portfolio performance (Adjusted R Square = .392). Results further indicate that Credit Standards (Beta = .443, sig. < .01) are a better predictor of loan portfolio performance than the Collection Procedures (Beta = .303, sig. < .01). The regression model was significant at the 99% confidence level. Finally, Credit management policies variable also have a constant relation with loan portfolio performance in Equity bank, it is every 1 unit increase in Credit management policies with incur the raise of 0.630 units in loan portfolio performance. The highest beta indicates the independent variable is the most significant variable toward it dependent variable. From the table above, the independent variable of Credit standards has the highest positive beta of 0.392, this mean that the independent variable of Credit standards has contributed the most and has stronger effect toward loan portfolio performance in Equity bank if compared to other independent variable.

CHAPTER FIVE

SUMMARY, DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the study, discussions of the findings, conclusions and recommendations made. It also presents proposed areas for further research. The discussions, conclusions, and recommendations are presented according to the objectives of the study.

5.2 Summary of findings

5.2.1 The effect of Credit terms on loan portfolio performance

It was found out that Credit terms had a positive correlation with the loan portfolio performance (r = .259**, p<.01). This means that the two variables are positively related at a rate of 25.9 %. A unit improvement in Credit terms by Equity bank could bring about .879 or 87.9 % changes in loan portfolio performance. The study revealed that overall the bank was performing fairly well is an average response of 2.13 or 21.3 %, on the whether the bank uses conservative approach in its loan analysis, being aggressive in its lending approaches, bank not lending to clients with a high payment risk, emphasis in evaluation is put on the quality of assets, bank possesses a credit terms hand book for guidance in giving out loans, and the bank is consistent with its loan analysis approach.

The average response on credit terms was 2.25 or 22.5%, meaning in all aspects of credit terms, most of the responses agreed. However, results showed respondents not agreeing with the fact that its advantageous to give loans to clients with outstanding loans, with a means response of 3.27 and credit rating of customers being effectively done, 2.87 or 28.7%.

5.2.2 The effect of credit standards on loan portfolio performance

It was established that credit standards had a positive correlation with the loan portfolio performance (r = 0.845** P< 0.01).This meant that the two variables were positively related or 84.5%. A unit change in credit standards brings about .261 or 26.1% changes in loan portfolio performance. This implies a positive relationship between the two variables. The findings established that credit standards, was statically significant in affecting loan portfolio performance, F = 473.845(<0.01) which implied that there was a meaningful positive relationship between credit standards and loan portfolio performance.

On appraisal, findings showed that on average, the response mean was 2.32. It is clear that the bank appraisal process is bureaucratic, bank credit officers visit clients business before approving loans and the appraisal process carried out is relevant to the loan applications. On communication process, some clients receive financial advice from their loan officers with a mean response of 2.43, Clients are rarely educated on the dangers of loan diversion to purposes it was not intended for, with a mean response of 2.51 and most of the respondents didn't believe that bank process is a comprehensive communication network that caters for customer inquiries with a mean response of 2.51.

5.2.3 The relationship between collection procedures and loan portfolio performance

This was established that collection procedures had a positive correlation with the loan portfolio performance (r = 0.169** P< 0.01). This meant that the two variables are positively related at a rate of 16.9%. Collection procedures, was statically significant in affecting loan portfolio performance, F = 1.556 (<0.01) while R square was 0.28 or 28 %. These findings implied that up to 51.6% of the variations in loan portfolio performance were explained by the collection

procedures. Other factors could explain for the variance in loan portfolio performance in Equity bank.

5.3 Discussion

5.3.1 Credit terms and Loan portfolio Performance

The findings revealed a significant positive relationship between credit terms and loan portfolio performance which implied that if the credit terms were in favour of the bank's credit terms such that the borrowers complied with them then this would affect loan portfolio performance. This is in agreement with Berger, Miller, Petersen, Rajan & Stein (2005) assertions that the behaviour of the borrower was sensitive to ethics, consequences of alternative actions including inaction, and the response of parties concerned to the borrower. Lending in low-income countries is notoriously difficult. Clients typically lack adequate collateral and lenders often have limited information about the profitability of their customers. Information asymmetries coupled with costly enforcement of repayment severely limits the profitability of lenders. The problem is particularly acute in agriculture because the nature of production precludes the use of many of the mechanisms used in microfinance (Berger & Udell, 2002). In addition, all farmers need cash at the same time, so allowing some farmers to borrow only after others have repaid their loans is problematic because some farmers would end up receiving credit when they do not need it (Berger & Udell, 2006). Even if all clients were allowed to borrow at the same time, joint liability may be ineffective if most production shocks are covariate.

5.3.2 Relationship Credit standards and Loan portfolio Performance

The findings showed a significant and positive relationship between relationship credit standards and loan portfolio performance which implied that if the bank put a lot of emphasis on nurturing

borrower relationships; this would enhance loan portfolio performance by 35.6%. The findings are supported by Elsas (2005) and Ongena and Smith (2000) who posit that the theoretical foundations of relationship banking are found in the modern literature of financial intermediation that acknowledges the special role of banks in alleviating the informational asymmetries in the credit markets. Early works of Degryse & Cayseele (2000) stress the information production function of banks. Screening and monitoring procedures give an information advantage to banks that allow them to overcome information and incentive problems between the bank and the borrower. Therefore, the main benefit attributed to bank financing with respect to other sources of finance is that banks help overcome problems of asymmetric information by producing and analyzing information and by designing loan contracts that improve borrowers' incentives.

Elsas (2005) explored the determinants of self assessments of German universal banks with respect to their house bank status, and found that duration of the bank-borrower relationship is not related to house bank status. Another issue is that many studies find that the duration of the bank-borrower relationship is highly correlated with form age (e.g. Berger and Udell 1995, Cole 1998). The length of the relationship reflects private information obtained by the lender whereas age reflects public information on the reputation and survival of the form. Consequently, the studies that do not control for age and examine the effect of length are susceptible to biased results. Finally, the length of the relationship is right censored, meaning that it measures the past history between the bank and the form. Credit standards relationship has to do with the future expectation to deal with the same customer, and therefore, duration may be undervaluing the strength of relatively new relationships.

5.3.3 Collection procedures and Loan portfolio performance

According to the findings, a significant and positive relationship between collection procedures and loan portfolio performance was observed which implied that a unit positive change in collection procedures would enhance the quality of lending relationships by 28%. This is in line with the assertions made by Elsas & Krahnen (2000) that when the borrowers positively behave towards the collection procedures of the bank, this would improve the quality of the lending relationships between the borrowers and the bank. This is in agreement with existing literature which postulates that long-term ties between main banks and their clients generate value and increase economic efficiency. Little is known, though, on how this value is divided among the stakeholders involved in such relationships. In the course of building the relationship, the lender accumulates borrower specific information which gives him significant benefits (Boot, 2000). To the extent that the lender passes these benefits to the borrower, relationships will also be valuable from the borrower's point of view. The modern literature on financial intermediation has long emphasized the value creation function of lending relationships. In a context of asymmetric information in credit markets, lending relationships facilitate the information exchange between the borrower and the lender through repeated interaction over the duration of the relationship and through the provision of multiple financial services.

The literature on loan portfolio performance has identified many benefits and some costs of such relationships. Elsas & Krahnen (2000) provides a very detailed explanation of each of them with their implications. In the following two subsections we summarize the main insights in Han (2008) and complement them with some recent contributions. Loan portfolio performance adds value through various channels. Loan portfolio performance facilitates the information exchange

between the borrower and the lender. Lenders invest in generating information from their client firms and borrowers are more inclined to disclose information because of the preservation of certain confidentiality (Kon & Storey, 2003). The lower informational asymmetries make it possible to overcome problems of moral hazard and adverse selection otherwise inherent in credit markets. For instance, they ameliorate the project-choice moral hazard (Diamond 1991) and solve agency problems of managerial behavior (Lown & Morgan, 2003).

5.4 Conclusions

5.4.1 Credit terms and Loan portfolio Performance

The study sought to investigate the relationship between credit terms, credit standards and loan portfolio performance. Therefore it was concluded that Credit terms and Loan portfolio performance were correlated at a rate where (r = .259**, p<.01). This was confirmation that borrower values, attitudes, experience and beliefs had a positive effect on the improvement of loan repayment rate, reduction on the arrears rate and portfolio at risk of the bank while the regressions results revealed that a unit change in Credit terms brings about .879 or 87.9 % change in Loan Portfolio Performance in commercial banks. Also on a full analysis, it was clear that some areas of loan recovery, recuperation of loans, loan portfolio management, and loan monitoring were lacking strict measures.

5.4.2 Credit standards and Loan portfolio Performance

The results revealed that there was a significant positive correlation between credit terms , credit standards and loan portfolio performance which implied that the way borrowers behaved during credit accessibility or after acquiring credit from the bank, had a lot of effect on determining the relationship that is formed during the lending process which would in turn affect effectiveness

and efficiency of credit repayment. Therefore, the study concluded that the bank lacked credit evaluation procedures in place that aim at ascertaining the behaviour of the borrower and along with the loan portfolio period, monitor closely the behaviour of the borrower while ensuring that the required lending relationship is not compromised in the process.

5.4.3 Collection procedures and Loan portfolio performance

From the regression results, it was clear that credit terms and credit standards were strong predictors of loan portfolio performance; therefore, the management of the bank should put a lot of emphasis on development of well nurtured relationships with borrowers so as to smoothen the lending process. Therefore, the study concluded that the never carries out a lot of awareness to the borrowers through training, workshops and dialogue so as to sensitize them on how best to invest the money and be able to pay back their debt without straining hard.

5.5 Recommendations

In light of the research findings, the following recommendations are made:

5.5.1 Credit terms and Loan portfolio Performance

The loan screening process was noted to be long and tedious. A loan could take up to one week. Most customers were unhappy with the turnaround time for the facility; hence look for alternative sources of credit. The study recommends that Equity bank should review its loan scoring process with a view of shortening it.

5.5.2 Relationship Credit standards and Loan portfolio Performance

The costs associated with obtaining a loan, that are often incurred prior to disbursement affects both projected cash flow and the borrowers' morale regarding settlement of the facility. The study recommends that Equity bank desist from charging full amount of commitment fee on loan amount every time a new facility is sanctioned to a previous borrower. Where a previous limit is increased upon renewal, only the difference should be charged.

On the other hand, Equity bank lacked credible sources of information on borrowers. It relied on information provided by customers about their previous borrowing. Such information was hard to validate because most customers did not disclose all their existing borrowings in other financial institutions considering that some financial institutions like Savings and credit co-operative societies are not enrolled on Credit Reference Bureau. The study recommends that Equity bank should pool together possibly under the auspices of the Uganda Bankers' Association (UBA) and establish a Credit Reference Bureau (CRB) to which reference can be made before a loan is disbursement.

5.5.3 Collection procedures and Loan portfolio performance

It was noted from the study that Equity bank does not do frequent checks and follow-ups on customers that had borrowed. The study therefore recommends that the credit department be properly resourced and facilitated to visit the customers regularly. Reminders in form of text messages to customers' mobile phones and reminder letters are encouraged.

5.6 Areas for further study

a) Future research should attempt to collect data from other industries such as academic institutions, government ministries to see whether other services are the same and could therefore benefit from this study.

b) The study concentrated on credit terms, credit standards, collection procedures and loan portfolio performance in regard to Equity bank. However, a similar research can be carried out in other banks.

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APPENDIX 1

QUESTIONNAIRE FOR EMPLOYEES AND CUSTOMERS OF EQUITY BANK, ADJUMANI BRANCH

Dear Respondent

The researcher is a student of Uganda Management Institute pursuing a master's degree in Business Administration. She is conducting an academic research study on the topic: "***Credit Management Policies and Loan Portfolio Performance in Commercial Banks: a Case Study of Equity Bank, Adjumani Branch.*** You have been scientifically selected to be one of the respondents to this study. You are kindly requested to take part in this study by filling in this questionnaire. The information you will provide shall be purely for academic purposes and was treated confidentially. We do not require you to indicate your name. We request you kindly to provide objective responses.

SECTION A: PERSONAL INFORMATION

Tick the most appropriate box

Personal Particulars

1 **Age**

18- 25 ☐ 36 - 40 ☐

26- 30 ☐ 40 - 45 ☐

30- 35 ☐ 46 - 50 ☐

50+ ☐ ☐

2 **Gender** ☐

Male ☐ Female ☐

3 **Education level**

Secondary ☐ Degree ☐

Certificate ☐ Masters ☐

Diploma ☐ Others ☐

☐ ☐

4. Working experience

Less than 2 years ☐

3-5 years ☐

More than 5 years ☐

SECTION: B Objective One; The effect of Credit terms on loan portfolio performance in commercial banks

Please read the following statements carefully and rate on a scale of 1-5 for each of the categories. Circle the appropriate box against each statement to indicate your rating, where; 5=Strongly Agree, 4=Agree, 3=Not sure, 2= Disagree, 1=Strongly Disagree

Credit terms on loan portfolio performance						
5	There is a credit policy at the bank	5	4	3	2	1
6	The credit policy is revised regularly by the bank	5	4	3	2	1
7	Credit terms are determined by the bank managers	5	4	3	2	1
8	Credit terms are determined in consultation with the customers	5	4	3	2	1
9	Credit terms are determined in line with Bank of Uganda lending/credit policy.	5	4	3	2	1
10	Credit terms at Equity bank are favorable and affordable compared to other banks	5	4	3	2	1
11	Loans are disbursed according to the competence of the clients	5	4	3	2	1
12	Equity bank determines interest rates by looking at the cost of production, inflation rates and loan loss provisions	5	4	3	2	1
13	The credit worthiness of the customer is assessed before giving him or her a loan	5	4	3	2	1
14	Equity bank considers the applicant's credit history when approving the loan.	5	4	3	2	1

Objective Two: The Effect of Credit Standards on Loan Portfolio Performance in commercial banks

Please read the following statements carefully and rate on a scale of 1-5 for each of the categories. Circle the appropriate box against each statement to indicate your rating, where; 5=Strongly Agree, 4=Agree, 3=Not sure, 2= Disagree, 1=Strongly Disagree

Credit Standards on Loan Portfolio Performance						
15	Clients are frequently visited by staffs of Equity bank to strengthen monitoring.	5	4	3	2	1
16	Clients provide financial statements in order to be analyzed as regards to the performance trends of their business activities	5	4	3	2	1
17	Equity bank visits clients frequently at their site in order to strengthen monitoring of the loans	5	4	3	2	1
18	Credit standards are periodically reviewed to include any updates of the bank	5	4	3	2	1
19	Demonstration of integrity and commitment to honor the repayment of the loan with interest is one of the credit standards.	5	4	3	2	1
20	There is evaluation of collateral of the borrower to justify that its quality and value is adequate to redeem the debt in case the bank has to recover loan from selling the collateral.	5	4	3	2	1
21	Equity bank makes the borrower aware of important instructions relating to the credit disbursement modalities	5	4	3	2	1
22	Equity bank sends a credit officer/agent to the client with a disbursement letter which spells out the amounts and currency of disbursement	5	4	3	2	1
23	The bank suspends disbursement if a clients does not fulfil the conditions specified in the	5	4	3	2	1

	loan agreement					
24	A monitoring mechanism is put in place to ensure that the borrower pays the loan in time	5	4	3	2	1
25	The bank verifies and satisfies that borrower's activity is progressing in accordance with the business plan.	5	4	3	2	1

Objective three: The Relationship between Collection Procedures and Loan Portfolio Performance in commercial banks

Please read the following statements carefully and rate on a scale of 1-5 for each of the categories. Circle the appropriate box against each statement to indicate your rating, where; 5=Strongly Agree, 4=Agree, 3=Not sure, 2= Disagree, 1=Strongly Disagree

Collection Procedures						
26	The bank has a loan appraisal process system which is implemented in the collection procedures to influence Loan Portfolio Performance in commercial banks	5	4	3	2	1
27	The bank has a well set up body to deal with debt collection	5	4	3	2	1
28	There is a relationship between Collection Procedures and Loan Portfolio Performance in Equity bank	5	4	3	2	1
29	Rigid approval and collection procedures affects Loan Portfolio Performance in Equity bank	5	4	3	2	1
30	The bank observes the collection period given to each client.	5	4	3	2	1
31	There are systematic written down steps in the handling of defaulting customers.	5	4	3	2	1
32	Loan default rates are as a result of poor collection Procedures in the bank	5	4	3	2	1
33	Clients are encouraged to reconcile their bank statements with the bank	5	4	3	2	1
34	The bank usually recovers 100% of the total loan due for collection	5	4	3	2	1

SECTION C: DEPENDENT VARIABLE (LOAN PORTFOLIO PERFORMANCE)

Please read the following statements carefully and rate on a scale of 1-5 for each of the categories. Place a tick in the appropriate box against each statement to indicate your rating, where;5=Strongly Agree, 4=Agree, 3=Not sure, 2= Disagree, 1=Strongly Disagree

Loan Portfolio Performance						
35	Loan Loss Rate is one of the ways of determining Loan Portfolio Performance in the bank	5	4	3	2	1
36	In Equity Portfolio at Risk indicates loan Portfolio Performance	5	4	3	2	1
37	Client Affordability to Repay exists in Equity bank	5	4	3	2	1
38	Number of out Standing Loans increases Portfolio Performance in Equity bank	5	4	3	2	1
39	Loan recoveries reduces Portfolio Performance in Equity bank	5	4	3	2	1

‘‘Thanks for your co-operation’’

APPENDIX II

INTERVIEW GUIDE FOR THE KEY INFORMANTS

Dear Respondent

The researcher is a student of Uganda Management Institute pursuing a master's degree in Business Administration. She is conducting an academic research study on the topic: "***Credit Management Policies and Loan Portfolio Performance in Commercial Banks: a Case Study of Equity Bank, Adjumani Branch.*** You have been selected to be one of the respondents to this study. The information you will provide shall be purely for academic purposes and wastreated with confidentially. You are kindly requested to take part in this study by answering the following questions.

SECTION A: Respondent's Bio data

- How long have you worked with bank?
- What is your designation?
- **SECTION B:**

  What is the effect of Credit terms on loan portfolio performance in Equity Bank Adjumani Branch?
- **SECTION C:**

  What is the effect of credit standards on loan portfolio performance in Equity Bank Adjumani Branch?
- **SECTION D:**

  What is the relationship between collection procedures and loan portfolio performance in Equity Bank Adjumani Branch?

THANK YOU

APPENDIX III

TABLE FOR DETERMINING SAMPLE SIZE FROM A GIVEN POPULATION

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

Note: "N" is population size

"S" is sample size.

Krejcie, Robert V., Morgan, Daryle W., "Determining Sample Size for Research Activities", Educational and Psychological Measurement, 1970.