

**CREDIT RISK MANAGEMENT PRACTICES AND LOAN PERFORMANCE OF
COMMERCIAL BANKS IN UGANDA. A CASE STUDY OF
COMMERCIAL BANKS IN MBARARA CITY**

BY

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MAY, 2022

DECLARATION


I, **Agaba Francis**, hereby declare that this research titled “*Credit Risk Management Practices and Loan Performance of commercial Banks in Uganda: Case study of Commercial Banks in Mbarara City*” is my original work and has not been presented in any university or institution of higher learning for any academic award

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
APPROVAL

This is to affirm that this research titled “*Credit Risk Management Practices and Loan Performance of commercial Banks in Uganda: Case study of Commercial Banks in Mbaracity*” has been prepared by Agaba Francis under your supervision and is now approved for further submission to the Faculty of Economics and Management.

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DEDICATION

I wish to dedicate this research work to my family, especially my wife, Tumwebaze Novence, and my children, Agaba Alvin and Atwine Darlen, for their presence and support to me during my studies.

To my academic supervisors, Dr Eton Marus and Assoc Prof Caleb Tamwesigire, for their academic and moral support that got me to where I am today. I also dedicate it to my friends who inspired me in education.

I also dedicate it to my employers Finance Trust Bank for having allowed me to pursue the course.

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Thank you for being there for me, showing me your love and tolerance for the long hours away from home as I pursued my studies.

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LIST OF ABBREVIATIONS

BRAC	Bangladesh Rural Advancement Committee
COVID 19	Corona Virus Diseases
DFCU	Development Finance Cooperative of Uganda
KCB	Kenya Commercial Bank
NPLs	Non-Performing Loans
PAR	Portfolio at Risk
SACCOs	Savings and Credit Cooperatives
UBA	United Bank of Africa
SPSS	Statistical Package for Social Scientists

ABSTRACT

The study was about the relationship between Credit Risk Management Practices and Loan Performance of Commercial Banks in Mbarara City. The study had a problem statement as shown Commercial banks in Uganda have established various credit risk management practices which include credit risk identification, credit assessment, credit monitoring and credit risk control hoping that this would improve Loan Performance (BoU, 2020). However, with all these practices in place, Uganda's banking sector has experienced poor Loan Performance over the years, where both portfolio at risk and bad debts written-off have scaled upwards due to non-performing loans (Bank of Uganda Annual Supervision Reports, 2014-2020). A critical analysis of the Bank of Uganda Annual Supervision Reports (2014-2020) indicate that the asset quality of commercial banks which is measured by Loan Portfolio at Risk (PAT) also referred to as NPL ratio increased from 4.2% in December 2012 to 5.6% in December 2013, reduced marginally to 4.1% in December 2014 and again rose to 5.3% in December 2015. The NPL ratio further increased greatly to 10.7% in December 2016 and reduced to 5.6% in December 2017 and 3.4% in December 2018. NPL ratio then increased to 4.7 percent in December 2019 and further to 6.0% in 2020 (Bank of Uganda Annual Supervision Reports, 2014-2020). The above deteriorating trend has resulted to several bank failures of once leading banks such as Crane Bank in 2016 after incurring a sharp increase in NPLs of 122.9% from Shs19.36bn in 2014 to Shs142.3bn in 2015 (Senyonyi T. , 2017). This resulted to a significant loss of about Shs53.7bn in 2014 to Shs3.1bn in 2015 down from a net profit of Shs50.6bn in 2014 (Aine, 2018). Against the above scenarios, the researcher relates credit risk management and Loan Performance, drawing experience from Uganda's commercial banks. Scanty research has been done to find out the relationship between Credit Risk Management Practices and Loan Performance of commercial banks in the Ugandan context hence the need for the study.

The study was guided by the following objectives: To determine the relationship between Credit Risk Identification and Loan Performance of Commercial banks in Uganda; to find out relationship between Credit Assessment and Loan Performance of Commercial banks in Uganda; to establish the relationship between Credit Monitoring and Loan Performance of Commercial banks in Uganda; and to find out relationship between Credit Risk Control and Loan Performance of Commercial banks in Uganda.

The research also had research design, research design involves a blue print followed to ensure that the research questions are appropriately answered. This includes appropriately selecting the tools for data collection, and data analysis (Kumar, 2011). It sets the boundaries in which the investigation will be confined. The correlational research design which is normally used by scholars to establish relationships between variables (Kowalczyk, 2014). In this study, correlational design will be used to establish the relationship between different credit risk management practices and Loan Performance in selected commercial banks in Mbarara city. Hence, the study used a quantitative approach to collect numeric and categorical data using structured questionnaires to generate inferential statistics (correlations and regressions).

Quantitative method have been used because it produces results that are easy to summarize, compare, generalize and confirm whether the hypotheses hold true or false.

The study comprised 19 commercial banks in Mbarara City out of which the credit and management staff were investigated. A sample size of 115 was selected from a population of 153 people. The study found significant relationships between credit risk identification and loan performance; credit risk assessment and loan performance; credit risk monitoring and loan performance; and credit risk control and loan performance. The study concluded that a strong and significant relationship exists between credit risk management practices and loan performance. The study however, found that some commercial banks do not have experts to accurately predict credit risks nor evaluate the consequences of the decisions taken by loan officers.

Therefore, Commercial banks should have stringent credit risk controls that are likely to register superior loan performance. Stringent credit controls take the form of pledging collateral securities that are equivalent to the loans granted, limiting the ceiling of the loan an individual client can take, and ensuring borrowers have the capacity to pay their loans

Commercial Banks should ensure proper credit risk assessment are done will register superior loan performance. Banks should take time to analyze clients' cash flow statements and other financial records, and make a thorough assessment of the key risks that clients face and the strategies they have put in place to mitigate the risks

Commercial Banks should ensure credit risk monitoring is done on how their clients will use the loans not outside the agreed purpose will recover their loans. Commercial banks should reexamine their clients' profile from time to time, and ensuring that changes in clients' credit quality change from time to time will always stand out of others in terms of performance

Commercial banks should ensure that effectiveness of credit risk controls are done well by looking out for collateral securities from clients before extending loans. Besides collateral securities, ensuring that clients do not take credit that exceeds a certain limit minimizes the level of default.

The study also recommended that Commercial banks should as well consider having in place effective credit standards, credit policy, credit terms and collection policies or procedures as mechanisms to guide their business, since the effectiveness of credit management is important to the successful management of banking institutions; that Commercial banks should as well operate their credit businesses based strictly by the established lending guidelines that outline the business growth priorities of the senior management, as well as the conditions to satisfy in order to qualify for loan approval; and that there should be prior customer evaluation before

loans are granted, and a continuous process of assessment before and during the course of loan repayment. This study's contribution to knowledge is its ability to add to the body of existing knowledge on financial and credit management discipline and bridging. In conclusion therefore the research will help different stakeholders and commercial to improve on areas of credit risks management for better loan performances

CHAPTER ONE: INTRODUCTION

1.1 Background

This study brings out the key concepts: the historical, theoretical, conceptual and contextual overview of the study. The historical background entails the history and nature of the research problem with reference to the existing literature at the global, regional and national levels. The theoretical background demonstrates an understanding of theories related to the study and their relevance to the research problem. Conceptually, the study demonstrates an understanding of the conceptual definitions of credit risk management and loan portfolio. The contextual background on the other hand discusses the context of Commercial Banks in Mbarara City. This gives a direct link to the problem statement.

1.1.1 Historical Background

Worldwide, poor Loan Performance has been at the heart of many commercial banks' failures around the globe and this has seen the collapse of several commercial banks worldwide including Northern Rock Bank in United Kingdom (O'Connell, 2017; Congdon, Eisenbeis, Kaufman, & Llewellyn, 2009), Anglo Irish Bank in Ireland which had NPLs worth €87 million (Carswell, 2013; Chu, 2014), Pioneer Mutual Bank in Scotland (Williams, 2021), Twiga Bancorp in Tanzania (Tanzania Invest, 2018; Kajubi, 2019), Imperial and Chase Banks in Kenya search for competitive advantage across the globe in the 1960s explains the genesis of credit risk management (Brindley, 2004). Back in the 1980s, banking institutions had no risk management departments and only the bank head had the experience and authority to rule on poor and risky transactions (John, 2004). In the 1990s, banks started setting up risk management departments which were charged with measuring risk and not managing it. With all the authority of decision making left to the bank head, this made credit risk management powerless (Economic Intelligence Unit Report, 2009). Credit risk management, however, became a booming industry in the late 1990s which resulted in the volatility of financial markets and derivatives, and financial losses in banks that lacked credit risk management systems (Bofondi & Gobbi, 2003).

In Africa, rising credit risks in commercial banks which began in the early 20th century have seen a threatened the performance of loans in banks across the Sub-Saharan Region (Jean-Philippe, 2016). Likewise, credit risk management has become so prominent in recent years especially after the traumatic events and bank failures caused by rising non-performing loans (Bodo, 2018). A related study shows that 23% of outstanding loans in Nigeria, Angola and Ghana's banking sector were classified as non-performing by 2017 compared to 17% in 2015 (Nsobilla, 2015). In Kenya, NPLs have been cited as the primary cause of bank failures since 2009 (Nasieku, 2014). Recently, the Portfolio at Risk (PAR) of banks in Kenya increased from 12.7 per cent in 2019 to 13.1 per cent in 2020 due to poor credit risk management practices during the COVID-19 period (Central Bank of

Kenya, 2020). When loans become non-performing, banks' portfolio at risk increases which reduces Loan Performance (Bodo, 2018).

In Uganda, many banks have collapsed due to weaknesses in managing credit risk. For example, Greenland bank that collapsed in 1998, failed to observe her lending policy. Around the time, the bank's loan portfolio was classified as non-performing (Bank of Uganda Report, 1999). Since its collapse, several other banks in Uganda have failed due to rising levels of loan defaults. For example, in 2012, the National Bank of Commerce lost her assets to Crane Bank and Bank of Uganda. Notwithstanding her performance in 2012, Crane Bank collapsed in 2016 due to high NPLs that shot from Shs19.36bn in 2014 to Shs142.3bn (122.9%) in 2015 (Senyonyi, 2018).

There are many studies that relate credit risk management and portfolio performance in the banking sector in Nepal (Kattel, 2015), Nigeria (Ogbol & Okallo, 2013), Kenya (Gisemba, 2010; Essendi, 2013; Kalui & Kiawa, 2015; Karugu & Ntoiti, 2015; Kinyuai, 2017; Mbiti, Lugogo, & Koech, 2018; Tanui, Wanyoike, & Ngahu, 2015; Kariuki, 2017; Mutua R. K., 2016; Nyong'o, 2014) and Uganda (Serwadda, 2018). As summarized above, most of the studies have been conducted in Kenya with limited research being conducted in Uganda. The current study relates Credit Risk Management Practices with Loan Performance in Uganda's commercial banks.

1.1.2 Theoretical Background

The study was premised on Asymmetric Information Theory Akerlof (1970) and the Portfolio theory pioneered by Harry Markowitz 1952. The Asymmetric Information theory explains the circumstances where some parties within the banking transaction have more information than others (Ekumah & Essel, 2003). Therefore, Asymmetric information connotes those circumstances when some parties in a transaction process are more informed than others involved in the same transaction process (Binks & Ennew, 1997). In the banking industry, the lender has little information on the borrowers' financial prowess, making it hard for the lender to assess accurately the credit worthiness of the borrower (Auronen, 2003). In order to prevent high default risk, the lender must employ various measures to properly control the risks involved in the lending-borrowing process. In essence, the asymmetric information between the lenders and borrowers must be reduced as much as possible. This theory is therefore applicable in the current study since failure of banks to access full information of the client puts the bank at risk of loan default because in case the borrower fails to pay, it can be difficult for the bank to trace him or her which poses a threat to the Loan Performance of the bank. Likewise, failure of the clients to get full access of the information regarding the loan product and the bank puts the borrower at risk of not being able to afford credit terms and conditions which also results into loan defaults, hence poor loan repayment performance.

The Portfolio Theory on the other hand derives an investment approach that allows investors to ascertain the risks that surround their investment (Wong, 2013). Building onto the portfolio

theory, Markowitz's (1952) Modern Portfolio Theory asserts that the investor needs to explore all the risk exposures likely to be encountered in their investment projects and assess the expected return and assets portfolio using statistical approaches. According to the theory, it is important to bridge portfolio exposures and projected rate of return by diversifying both securities and value actions. The theory therefore calls upon investors to diversify their risks, pool together securities, and decrease exposure. This will inversely shift the prices of the securities with regard to time. Banking institutions, which appropriately handle risk exposures that surround interest rates and market dynamics are likely to improve their loan portfolio performance than those that do not.

1.1.3 Conceptual Background

Coyle (2000) defines a risk as an event that is likely to occur in the future and undermine the attainment of organizational goals and objectives. In some instances, the likelihood that the event will occur are evident already. Extending the definition to credit management, beyond and Gobbi (2003) defined a risk as the probability that a loss due to a decrease in credit quality of borrowers will occur. The loss might as well occur when potential customers turn into loan defaulters over time. According to Bikker and Metz makers (2005) risk management in banks covers all policies and instruments designed by banks to control their financial exposures. The bank must respond to a few questions: What is the risk? How heavy is the risk? And can the risk be controlled? Putting the practices of risk management together, Bashabe, Kalu, & Amu (2017) defined credit risk management as the possibility that borrowers will default from a loan repayment is minimized and controlled.

The approach to managing and mitigating risk using managerial resources constitutes credit risk management. The control and mitigation measures might include rolling in a second party, minimizing the impact of the risk, and taking insurance credit covers of a particular risk (Regassa, 2015). For efficient and effective credit risk management, credit institutions should consider the nexus between risk and return on investments, so as to allocate resources appropriately (Ogbol & Okallo, 2013; Clark, 2019; Tanui, Wanyoike, & Ngahu, 2015).

Credit risk management is a structured approach to managing uncertainties through identification, assessment, monitoring and control of credit risk arising from the possibility of default from loan repayment (Bashabe, Kalu, & Amu, 2017; Regassa, 2015). From this definition, the study operationalized credit risk management according to its four (4) concepts: credit risk identification, credit risk assessment, credit monitoring and credit risk control.

Credit Risk identification is a process that reveals and determines the possible organizational risks as well as conditions under which these risks arise (Maliisa, 2013). In this study, risk identification was operationalized in terms of getting in-depth information about the client through in-depth interviews, credit reference bureaus (CRBs), stress testing, simulation and expert judgment (Kattel, 2015).

Credit Risk assessment is the analysis conducted on prospective credit customer's information to ascertain whether the customer can meet his obligations according to the terms of trade (Cole, Glenn, & Brent, 2005; Masheta, 2018). In this study, risk assessment was conceptualized in terms of assessment of inspection by branch managers, financial statement analysis, establishing assessment standards, credit scoring, risk rating and analyzing the client's character, capacity, collateral, capital and condition (Gakure, Ngugi, Ndwiga, & Waithaka, 2012).

Credit risk monitoring involves a comprehensive analysis of the entire loan portfolio performed on a regular basis and a detailed analysis of the entire loan portfolio to identify cases of possibility of impaired loans (Onaolapo, 2012). Credit risk monitoring provides relevant information for senior management to make informed judgment about the quality of the loan portfolio (Prakash & Poudel, 2012). In this study, credit monitoring was operationalized in terms of loan supervision, personal visits by loans officers and communication with clients (Prakash & Poudel, 2012).

On the other hand, credit risk control is defined as hedging or neutralizing the financial risks that result from one or a series of transactions (Holton, 2003). This study operationalized credit risk control in terms of collateralization of loans, taking insurance against loans and diversification of loan portfolio since these are the most widely used practices by banks to control credit risks.

On the other hand, loan performance relates to the performance in terms of whether the customer is paying in time or is in default, and more generally in terms of meeting their obligations in terms of principal or interest payment or any other obligations defined in the Loan Contract (agreement)(Taylor, 2019). It also refers to the measurement of the returns on loans issued by financial institutions in form of loan premium repayment, interest repayment as well as other costs and charges (Rukundo, 2018).

1.1.4 Contextual Background

Studies have appreciated the role of commercial banks in any economy. Commercial banks are conduits of financial resources through savings mobilization (Franklin & Elena, 2012). Mbarara city is a home to regional branches of at least 19 major commercial banks in Uganda including Centenary Bank, Stanbic Bank, Absa Bank, Guaranty Trust Bank, Diamond Trust Bank, Finance Trust Bank, Equity Bank, DFCU Bank, Opportunity Bank, Orient Bank, UBA Bank, Cairo Bank, BRAC Uganda Bank, Housing Finance Bank, Bank of Africa Uganda, Bank of Baroda, Tropical Bank, KCB Bank and Post Bank. While these act as regional branches, they serve a wider market share with diverse clients from the rural, urban and peri-urban areas of South Western Uganda. With such a wider and diverse market share, most banks are liable to huge credit risk which, if not well managed, can result to increasing loan defaults and non-performing loans hence affecting Loan Performance.

Due to asymmetric information amongst all parties involved in banking transactions, most commercial banks engage in transactions that put banks at risk of incurring bad debts which if incurred reduces Loan Performance (Selene, 2017). Since the losses incurred on loans directly affect Loan Performance (Ssekiziyivu, Mwesigwa, Joseph, & Nabeta, 2017), commercial banks should devise mechanisms that handle credit risk exposure within the acceptable standards to increase Loan Performance (Serwadda, 2018).

Most commercial banks today are characterized by increasing loan defaults over time which were expected to have increased further during the Covid-19 pandemic of 2020/2021. In the wake of the Covid-19 pandemic that hit Uganda in 2020, most banks have experienced a whopping increase in NPLs, most of which have not been recovered up to now. According to the assessment of credit risk during the post-COVID period, a Bank of Uganda report 2019/2020 revealed that Loan Performance deteriorated over the financial year ended June 2020 partly driven by the economic shocks brought by the COVID-19 pandemic which resulted into an increase in the ratio of Non-performing loans and advances to gross loans increasing from 3.8% in 2019 to 6.0% in 2020 (BoU, 2020). Though there is no current report by Bank of Uganda to verify this, media reports have consistently reported an outcry of banks on the increasing level of bad debts written off and non-performing loans most of which had been restructured which has resulted to poor Loan Performance (Kasemiire, 2021; URN, 2020).

1.2 Problem Statement

Commercial banks in Uganda have established various credit risk management practices which include credit risk identification, credit assessment, credit monitoring and credit risk control hoping that this would improve Loan Performance (BoU, 2020). However, with all these practices in place, Uganda's banking sector has experienced poor Loan Performance over the years, where both portfolio at risk and bad debts written-off have scaled upwards due to non-performing loans (Bank of Uganda Annual Supervision Reports, 2014-2020). A critical analysis of the Bank of Uganda Annual Supervision Reports (2014-2020) indicates that the asset quality of commercial banks which is measured by Loan Portfolio at Risk (PAT), also referred to as NPL ratio, increased from 4.2% in December 2012 to 5.6% in December 2013, reduced marginally to 4.1% in December 2014 and again rose to 5.3% in December 2015. The NPL ratio further increased greatly to 10.7% in December 2016 and reduced to 5.6% in December 2017 and 3.4% in December 2018. NPL ratio then increased to 4.7 percent in December 2019 and further to 6.0% in 2020 (Bank of Uganda Annual Supervision Reports, 2014-2020). The above deteriorating trend has resulted to several bank failures of once leading banks such as Crane Bank in 2016 after incurring a sharp increase in NPLs of 122.9% from Shs19.36bn in 2014 to Shs142.3bn in 2015 (Senyonyi T. , 2017). This resulted to a significant loss of about Shs 53.7bn in 2014 to Shs3.1bn in 2015 down from a net profit of Shs50.6bn in 2014 (Aine, 2018). Against the above scenarios, the researcher related credit risk management and Loan Performance, drawing experience from Uganda's commercial banks. Scanty research had been done to find out

the relationship between Credit Risk Management Practices and Loan Performance of commercial banks in the Ugandan context, hence the need for the study.

1.3 Objectives of the study

1.3.1 General objective

To explore the relationship between Credit Risk Management Practices and Loan Performance of Commercial Banks in Mbarara City

1.3.2 Specific objectives

- i. To assess the relationship between Credit Risk Identification and Loan Performance of Commercial banks in Uganda;
- ii. To explore the relationship between Credit Assessment and Loan Performance of Commercial banks in Uganda;
- iii. To explore the relationship between Credit Monitoring and Loan Performance of Commercial banks in Uganda;
- iv. To assess relationship between Credit Risk Control and Loan Performance of Commercial banks in Uganda.

1.4 Research Hypotheses

H0₁: There is no relationship between Credit Risk Identification and Loan Performance of Commercial banks in Uganda.

H0₂: There is no relationship between Credit Assessment and Loan Performance of Commercial banks in Uganda.

H0₃: There is no relationship between Credit Monitoring and Loan Performance of Commercial banks in Uganda.

H0₄: There is no relationship between Credit Risk Control and Loan Performance of Commercial banks in Uganda.

1.5 Scope of the study

1.5.1 Content Scope

The content scope study was limited to credit risk management practices as the independent variable and Loan Performance as the dependent variable. Credit risk management practices was measured in terms of credit risk identification, credit assessment, credit monitoring, and credit risk control. On the other hand, Loan Performance was measured in terms of loan portfolio growth, amount of NPLs, NPL ratio, and amount of bad debt written off.

1.5.2 Area Scope

The study was conducted from Mbarara city targeting all the 18 commercial banks within the Mbarara city. Mbarara city is located in the south western part of Uganda about 290 kilometres (180 miles) by road, southwest of Kampala, Uganda's capital and oldest city (Globefeed, 2014). The coordinates of the Mbarara central business district are 00 36 48S, 30 39 30E (Latitude:- 0.6132; Longitude: 30.6582).(Google, 2015). With reference to the map of Uganda, Mbarara city borders with Mbarara District to the north and west, Kiruhura District in the East, Isingiro District in the South West and Rwampara District in the South West. Mbarara city was selected because it was the main commercial center of most of south western districts of Uganda and the site of the regional branches of most commercial banks in the southwestern region.

1.5.3 Time Scope

The study was conducted within a time scope of one (1) year from January to December 2021 since it was the time allocated for research by the university. However, for secondary data, the researcher analyzed information within a time scope of five (5) years from 2016 to 2021.

1.6 Significance of the Study

To the commercial banks, the study provides information on the effectiveness of Credit Risk Management Practices in improving the Loan Performance of the bank. The study provides recommendations to the commercial banks on the specific Credit Risk Management Practices they should adopt to improve Loan Performance.

The study benefits policy makers like the Central Bank of Uganda because it is a reference point for designing appropriate policies for commercial banks in Uganda to put in place proper Credit Risk Management Practices to improve return on assets.

The study also benefits the researchers and academicians as it acts as a source of additional literature to the already existing knowledge about Credit Risk Management Practices and Loan Performance in the banking sector.

The study has assisted the researcher to complete his course and graduate since research is one of the requirements of the university for all students of the Faculty of Business and Management Sciences.

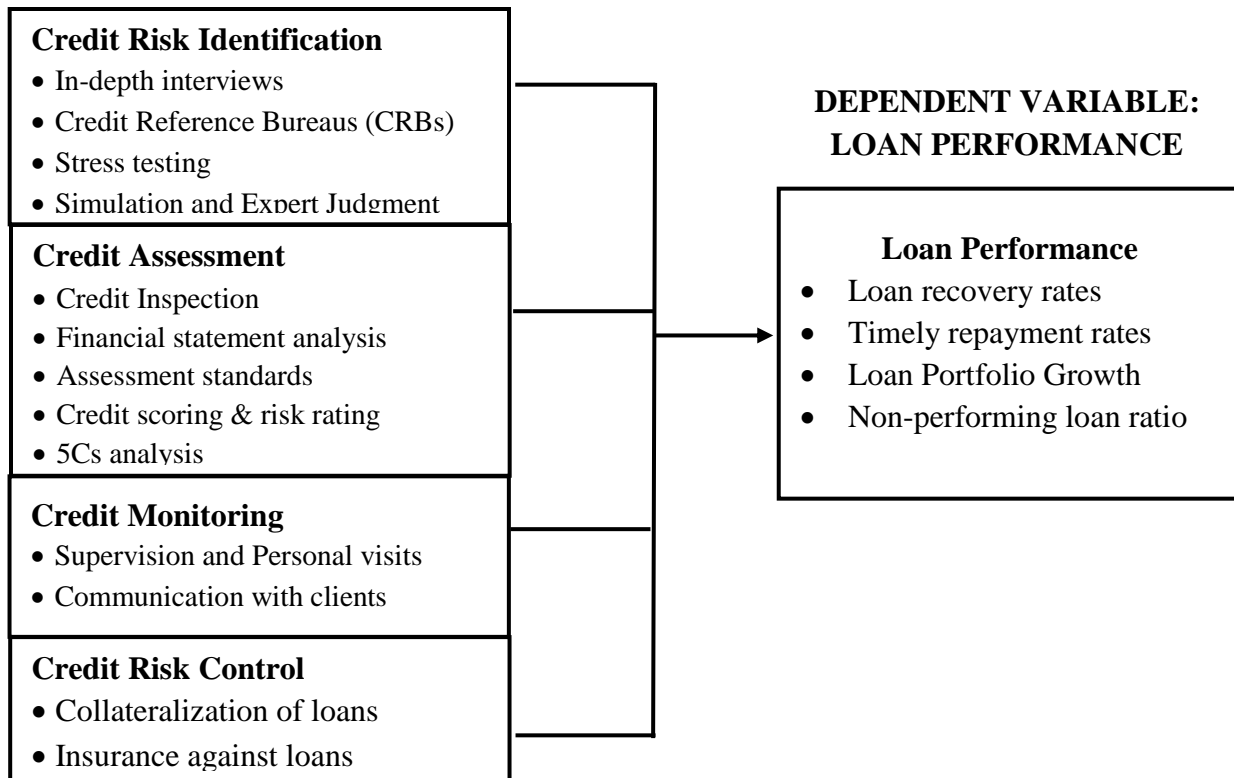
1.7 Justification of the Study

Studies had been undertaken on credit risk management and financial performance in commercial banks in Nepal (Kattel, 2015), Nigeria (Ogbol & Okallo, 2013), Kenya (Gisemba, 2010; Essendi, 2013; Kalui & Kiawa, 2015; Karugu & Ntoiti, 2015; Kinyuai, 2017; Mbiti, Lugogo, & Koech, 2018; Tanui, Wanyoike, & Ngahu, 2015; Kariuki, 2017; Mutua R. K., 2016;

Nyong’o, 2014) and Uganda (Serwadda, 2018). However, there was an information gap in how credit risk management practices such as credit risk identification, credit risk assessment, credit risk monitoring, and credit risk control influence Loan Performance in commercial banks. The gap would be filled by adding more knowledge to the already existing literature and be adopted by various banks to manage credit risks which would in turn increase Loan Performance.

1.8 Conceptual Framework

INDEPENDENT VARIABLE: CREDIT RISK MANAGEMENT



Source: Adopted from the literature (Essendi, 2013; Kalui & Kiawa, 2015; Karugu & Ntoiti, 2015; Kinyuai, 2017; Mbiti, Lugogo, & Koech, 2018; Kariuki, 2017; Serwadda, 2018).

Figure 1.8.1: Conceptual Framework

The independent variable was Credit Risk Management Practices whose dimensions included credit risk identification/appraisal, credit assessment (credit reference bureau), and credit monitoring and credit risk control (security against credit). On the other hand, Loan Performance was measured in terms of loan recovery rates, times repayment rates, loan portfolio growth, and NPL ratio. This is because banks thrive on their ability to generate income through their lending activities which depend on the management’s capacity to manage risk well.

Banks, which predict borrowers' unlikelihood to pay their credit meet their credit obligations in the stipulated days are likely to disburse their loans to creditworthy customers. Banks which take time to assess the borrowers' financial position increase their chances of disbursing loans to customers that honor their obligations in the future. Banks, which take time understand the extent to which new clients comply with sector and national laws that govern creditworthiness are likely to disburse their loans to complaint customers. A comprehensive approach to credit risk management is likely to reduce the level of non-performing loans in commercial banks in Uganda.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical and empirical review of theories and past studies on Credit Risk Management Practices and profitability based on the specific objectives. Hence the literature is divided into four (4) specific objectives; relationship between credit risk identification and Loan Performance; credit risk assessment and Loan Performance; credit risk Loan Performance; and, the relationship between credit risk control and Loan Performance of commercial banks.

2.2 Theoretical review

Different theories have been employed to bring clarity to the study. The following are the theories that underpin this study.

Table 2.2.1: Theories underpinning the study

Theory and Authority	Assumptions/ description	Relevance to the study	Limitations/ weaknesses of the theory
Asymmetric Information Theory(Akerlof, 1970)	Assumes that some parties in a transaction may restrict some useful information to the other party for his/her own benefit and this may result to adverse decisions on the party with less information	The theory indicates that if banks can put in place measures to access full information of the client, this will reduce risk of loan default which can improve Loan performance of the bank.	-It deal with highly simplified versions of the markets and may not apply in a real world market (Auronen, 2003). -It only considers asymmetries in one direction/ party.
Modern Portfolio theory Markowitz (1952)	Investors using can project the risk exposure, which is likely to influence their expected return on asset portfolios in order to place appropriate strategies to mitigate and control the risks.	The theory indicates that if banks can make proper projections of the credit risk and put in place proper practices that minimize credit risk, Loan Performance can improve significantly.	-Considers the past performance and does not provide a guarantee for the result that could arise in the future. -Assumption of a normal distribution of the return on an asset within a class of assets is proved to be wrong for individual equities.
Principal-Agent theory/Agency theory(Alchian	It explains the relationship between the principals and the agents where	The theory focuses on resolving problems that can exist in agency	-Simplistic premises concerning nature of actions involved in agency

<p>& Demsetz, 1972; Jensen & Meckling, 1976)</p>	<p>the principals/ shareholders hire agents/ managers to manage the affairs of the organization on their behalf, or perform a task the principal is unable or unwilling to do. It also explains the conflict of interest that exist between the principals (shareholders) and the agents (managers).</p>	<p>relationships due to unaligned goals or different aversion levels to risk. The theory also points at what shareholders can do to improve their relationship with managers and motivate managers to effectively manage credit risks to maximize shareholder returns.</p>	<p>relationships do not cover all the complexities of human actions.</p> <p>-It is applicable only in situations, when there is divergence between shareholders' and managers' interests.</p> <p>-Hinges on relationship between shareholders and managers and ignores other key stakeholders such as employers, members and customers.</p>
<p>Credit risk theory (Macleod, 1889; Thakor, 2016).</p>	<p>The value of credit depends on the obligation of the debtor to pay his debt and right which the creditor acquires to demand payment from the debtor. Banks can choose between a relatively safe loan and a potentially more profitable risky loan, with public observability of the type of loan chosen. The probability of success (repayment) of the loan depends on the realization of the risk associated with the credit.</p>	<p>The theory emphasizes the need for lending institutions to develop a credit risk measurement policy to enable easy identification, assessment, monitoring and control of credit risk to improve loan performance.</p>	<p>The theory was criticized for not systematically distinguishing among the different forms of credit since it could not explain whether the credit supply comprises of paper money, coins, bank notes, bank deposits or indeed material items such as goods and or services.</p> <p>-It is based on trial and error, learning through experiences but does not bring out clearly how banks should prevent credit risk to improve loan performance.</p>

2.2.1 Asymmetric Information Theory

The asymmetric information theory advanced by shows that information asymmetry exists in examining potential bank applicants. The theory explains a condition in the banking practice where some of the parties in the banking transaction have more information than other parties (Ekumah & Essel, 2003). The theory assumes that some agent in a transaction has more information than other parties and may restrict it to the other party for his/her own benefit. In relation to the banking business, lenders have less information on the capability of the borrower

to meet their credit obligation in future. Borrowers disclose little information to the lender, which limits the correct assessment of the creditworthiness of the borrower (Binks & Ennew, 1997). While the lender may use the borrower's credit history as evidence of financial prowess, the information always disclosed is very limited. This makes it difficult for the lender to assess the extent to which the borrower defaults or acts prudently with his loan (Auronen, 2003).

When lenders fail to discretionally select borrowers, the same rate is charged to both the worthy and unworthy borrowers which in turn makes the bank charge worthy borrowers highly to the detriment of unworthy borrowers (Kipyego, 2013). Borrowers who correctly disclose their financial worth to lenders are likely to help the bank make informed credit decisions, which reduces the risks thereof, the level of non-performing assets (Onuko et al., 2015). This theory was therefore applicable in the current study since failure of banks to access full information of the client puts the bank at risk of loan default because in case the borrower fails to pay, it can be difficult for the bank to trace them, which poses a threat to the Loan Performance of the bank (Murigi & Thuo, 2018). Likewise, failure of the clients to get full access of the information regarding the loan product and the bank puts the borrower at risk of not being able to afford credit terms and conditions which also results to loan defaults hence poor loan repayment performance (Onuko, Muganda, & Musiega, 2015).

Although a very useful theory, asymmetric information theory also has its weaknesses. The first potential weakness of this theory is that it deals with highly simplified versions of the markets with few possible types of players or states and cannot easily be mathematically manipulated to explain the complexities present in a real world market (Auronen, 2003). The applications of this theory only consider asymmetries in one direction, in this case the borrower, when actually the lender may also restrict some information to the borrower that may result to default. It may, however, be that there are also information differences in the favor of the other party. The theory assumes that the borrowers always know the factors that may hinder them to pay loans but it may not be true since some factors are such that as uncertainties they cannot be known by the borrower (Auronen, 2003).

2.2.2 Portfolio Theory

The Portfolio Theory often described as modern portfolio theory explains the relationship between the risks on investments and the return on investment, using investment portfolios (Wong, 2013). According to the Modern Portfolio Theory (Markowitz, 1952), investors using statistical approaches can project the risk exposure, which is likely to influence their expected return on asset portfolios. After assessing the risk, they put in place strategies to mitigate and control the risks. Credit, being one of the risky portfolios in banking institutions, this theory asserts that banks implement credit risk management practices that minimize Portfolio at risk which would ultimately increase the Loan Performance. Banks, which diversify financial products are likely to have better Loan Performance than those that do not. Hence, the theory is relevant in studying the relationship between credit risk management and Loan Performance (Wakaria, 2016).

Even though Modern Portfolio Theory is accepted widely all over the world and also applied by different investment institutions, it has also been criticized by different persons particularly by representatives of behavioral economics who challenge the assumptions of the Modern portfolio theory on the parameters of investor rationality and the expectations for the return (Westfall & Kvilhaug, 2021). For example, the theory has been criticized for considering the past performance, yet this does not necessarily provide a guarantee for the result that could arise in the future (Lukomnik & Hawley, 2021). Considering only the past performances sometimes leads to over-passing the newer circumstances, which may not have been there when historical data were considered but could play an important role in making the decision (Obeidat, 2018). This theory also assumes that there is a normal distribution of the return on an asset within a class of assets, which is proved to be wrong for individual equities as the correlations of asset class may change over the period of time (Thakur & Vaidya, 2020).

2.2.3 Principal-Agent theory

Having its origin in Law, accounting, economics, and finance, the ‘Principal-Agent theory’, also called the ‘Agency theory’ was expounded by Alchian and Demsetz (1972) and further developed by Jensen and Meckling (1976). The Agency theory is defined as “the relationship between the principals, such as shareholders and agents such as the company executives and managers” (Drury, 2021). In banks, the principals are the shareholders or the members while the agents are the managers or governing board. Both the managers and the board committee members are charged with the responsibility of ensuring proper management of the affairs of the bank to improve shareholders’ returns and effectively utilize members’ deposits while minimizing risks that may arise from their decisions. In this theory, shareholders who are the owners of the bank, hire the agents who are the managers to carry out the work of credit management on their behalf (Drury, 2021).

Basically, the principal-agent theory explains the conflict of interest that exist between the shareholders, hereby referred to as the principals, and the managers and debt holders, here referred to as the agents (Jensen & Meckling, 1976). Considering the fact that principal-agent relationship is a contract that the principal engages the agent to perform some duties on their behalf, agency conflict may arise when the agents in executing the duties of the principal are affected by their own welfare interest which impairs them from acting at the best interest of the principal. Agency conflict in commercial banks is largely attributed by moral hazard, earnings retention, risk aversion and time horizon and if not controlled, may arise to poor loan performance (Balungi, 2018).

Effective governance structure is therefore imperative in commercial banks to institute balance performance incentives to the managers. Bank managers need to be well remunerated, trained and motivated by the shareholders to effectively manage credit risks. Likewise, shareholders and managers need to create close relationship with debt holders in order to seek full information of their creditworthiness, character, ability and willingness to pay back the loans. This will assist

them to clearly identify, assess, monitor and control credit risks that would have affected the loan performance of the bank (Balungi, 2018).

The theory is applicable because it focuses on resolving problems that can exist in agency relationships due to unaligned goals or different aversion levels to risk. In the present research, the problem of concern is the declining loan performance of the banks. The shareholders of the banks (principals) invest capital, which is the capital structure comprising equity and debt. On the other hand, bank managers (Agents) design credit risk management strategies to improve loan performance and maximize returns on investment (Orichom & Omeke, 2020).

Critics of agency theory and its applications to the issues of credit risk management focus on such problems as unrealistic premises concerning managers' motivations and actions, ineffective recommendations inferred from the theory and dubious legal interpretations of credit risk management being made on its basis (Segrestin & Hatchuel, 2011). Limits of applicability of agency theory are determined mainly by the premises assumed in modelling various agency relationships. Simplistic premises concerning the nature of actions involved in relationships between subjects do not cover all the complexities of human actions. Simplistic premises are very convenient for mathematical modelling, but unrealistic when it comes to description of human behaviour (Kultys, 2016).

Premises of agency theory restrict its universality and make it applicable only in the situations when there is divergence between shareholders' and managers' interests, which can be restricted by adequate monitoring systems and appropriate salary packages (Davis, Schoorman, & Donaldson, 1997). This theory is one-sided, emphasizing some economic factors, and not including political factors, internal problems of governance or the roles of other stakeholders (Mesjasz, 2007). Critics of agency theory have noticed as well that control mechanisms suggested on the basis of agency theory are not only expensive, but also economically ineffective, because mechanisms protecting shareholders' interests may interfere with realization of strategic decisions, may restrict collective actions, distort investment plans and ignore interests of other stakeholders, which may lead to decreasing their commitment to the creation of economic value (Segrestin & Hatchuel, 2011).

Another doubt concerns ownership of a firm. From the legal point of view, shareholders are owners not of a firm, but only of its shares, and therefore they should not be considered the only residual claimants. Shareholders' exclusive rights modify risk undertaken by various stakeholders, because managers controlled by shareholders will opt for strategies leading to relatively safe financial returns, even at the expense of lack of innovative development or of ignoring other goals vital for the firm (Kultys, 2016). Risk may therefore be transferred from shareholders to other groups, such as employees. In addition, managers are not shareholders' agents, and they get their mandate not from them, but from the board of directors, which in turn acts as an autonomous fiduciary (Kultys, 2016).

2.2.4 Credit Risk Theory

The study was also be underpinned by the credit risk theory developed by Macleod (1889).The Credit Theory asserts that the value of credit depends on the obligation of the debtor to pay his debt and right which the creditor acquires to demand payment from the debtor (Macleod, 1889).This theory explains the origin of credit default and presents the foundation for efforts by the lenders to identify, assess, monitor and control credit risk exposure (Chatterjee, Corbae, Dempsey, & Ríos-Rull, 2020).However, the theory was later criticized for not systematically distinguishing among the different forms of credit since it could not explain whether the credit supply comprises paper money, coins, bank notes, bank deposits or indeed material items such as goods and or services (Lapavitsas, 1991).

The credit risk theory was further developed by Thakor (2016) who reformulated it as the theory of bank credit risk management. The theory is based on rational learning that leads to revisions in inferences of banking skills in an environment in which skills may or may not matter, depending on a macroeconomic state that could be shaped by investor sentiment or developments in the real sector. Thakor (2016) proposes that banks can choose between a relatively safe loan and a potentially more profitable risky loan, with public observability of the type of loan chosen. The probability of success (repayment) of the loan depends on the realization of the risk associated with the credit. According to this theory, there are two systematic risk regimes: high risk and low risk. In the high risk regime, default risk is deemed to be so high that investors will fund only low-risk loans even if banks are viewed as being highly skilled, whereas in the low-risk regime, riskier loans are funded if the bank is viewed as being skilled enough to manage these risks (Thakor, 2016).

According to the credit risk theory, every lending institution should develop a credit risk measurement policy to enable easy identification, assessment, monitoring and control of credit risk to improve loan performance (Wanjiru, 2017). The limitation of this theory is that it is based on rational learning that leads to revisions in inferences of banking skills to effectively manage credit risk. Hence, it is based on trial and error, learning through experiences but does not bring out clearly how banks should prevent credit risk and improve loan performance.

2.3 Credit Risk Identification and Loan Performance of Commercial Banks

The first critical step of the risk management process includes the identification of risks (Kleindorfer & Saad, 2005). Risk identification aims at discovering all relevant risks at an early stage to decide whether the bank should give out credit or not. Therefore, risk identification needs to follow a holistic approach to identify the credit risk origins and classification of risk (Buhman, Kekre, & Singhal, 2005).Craighead et al. (2007) noted that companies need to develop an ability to predict disruptions early so that risks can be duly assessed and mitigation efforts can take effect. By carefully scanning the environment for early indicators, relevant risks are thus

recognized in time and mitigation actions can be initiated (Craighead, Blackhurst, Rungtusanatham, & Handfield, 2007).

Mazumder and Ahmad (2010) contended that greed and the tendency to take excessive risk have rather been a constant risk source in the financial market. They prevail in good times, in times of turmoil and especially during bubbles leading to defaults in real estate business -- often times risk an outcome of indulgent regulations (Mazumder & Ahmad, 2010). It is important to note that only risks that are identified in the first step can be assessed and managed in the subsequent process. Thus, the quality of the risk identification activities is crucial for the overall credit risk management process (Berg, Knudsen, & Norman, 2008).

Studies have revealed the importance of managing risks in banks effectively (Gakure, Ngugi, Ndwiga, & Waithaka, 2012). The process of credit risk management starts with identifying risks (Kleindorfer & Saad, 2005). Risk identification ensures discovering all relevant risks in the operations. By implication, there is need to decide early enough on whether a risk is relevant or not. The procedures enshrined in risk identification are holistic (Maliisa, 2013).

Studying credit risk identification in commercial banks in Nepal, Kattel (2015) found out that 66.1% frequently use interviews to identify and analyses risks. The author found that only 17.1% of the bank staff take time to identify and analyzed credit risks. However, a greater part of the staff (68.2%) indicated to use Strength, Weaknesses, Opportunities, Threats (SWOT) analysis techniques, while 43.1% used scenario analysis. The scenario method uses historical data to ascertain the factors that are likely to affect the bank. While methods like expert judgment and simulation were explored, Kattel (2015) shows that only 1.1% of the bank officers use simulation to identify credit risks.

A study in Kenya by Kalui and Kiawa (2015) examined the credit risk management practices used in microfinance organizations. Most of the organizations investigated identified risks, monitored risks, and assessed risks in their practices. This study, however, based on microfinance institutions most of which target the rural low income farmers and May not basically apply in commercial banks whose target clients are the institutional and high-income individuals.

A related study in Kenya by Essendi (2013) investigated Credit Risk Management Practices among Saccos and assessed their impact on loans portfolio. The results revealed that risk identification was key among the practices used. The reasons advanced for the popularity of the practice among SACCOs in Kenya derived from its excellence in ranking risks according to their importance, and assisting SACCOs in developing risk management strategies. The most important observation in the study was the positive relationship that existed between credit risk identification and SACCOs' profitability.

Cain (2014) reported that credit assessments assist banks to give loans only to trustworthy and financially able customers, thereby reducing incidences of loan defaults as well as ensuring profitability. While in theory this study sounds true, the findings may not be true if statistical techniques were used to test for the relationship. Since this study was more descriptive in nature, there was no statistical measure of the relationship between credit risk assessment and Loan Performance.

Wambugu (2010) advised that credit risk identification was applied effectively to help organizations grappling with credit risks. The authors indicated that providing the likelihood of risks to occur minimizes loss and maximizes profits. He concluded that organizations that provide accurate, timely, and relevant risk information are likely to be profitable. Despite the positive relationship between credit risk identification and profitability of banks, this study focused on credit risk management in SACCOs which are member-based and managed as compared to commercial banks.

Mutua (2014) postulated that banks which apply modern approaches, especially credit, easily discover mistakes in early stages. However, Gakure, Ngugi, Ndwiga, and Waithaka, (2012) did not find any inferential tests conducted to verify the relationship between risk identification and performance and the study was based on only descriptive analysis. Hence, there was need for a more correlational study to verify this. Kimotho nd Gekara (2016) found a positive association between credit risk identification and financial performance. However, their study looked at financial performance in Kenya, yet in the current study, Loan Performance was looked at.

In Rwanda, Magnifique (2013) found that credit risk identification relates to productivity of commercial banks. However, this study focused on credit risk management and financial performance yet the current study would focus on Loan Performance. In Uganda, Kalu, Shieler, and Amu (2018) found that inadequate financial analysis leads to loan default. This study however was limited to microfinance institutions focusing on financial performance rather than Loan Performance.

Remy an Njeru (2020) analyzed the impact of credit risk identification on the financial performance of commercial banks in Burundi. The study found that the influence of credit risk identification has been a success to the banks in Burundi in the fact of taking care each factor related to its performance where each risk was verified one by one in this study. We found that the effective risk identification helps greatly to reach benefits of the bank and the presence of effective risk tracking system of the risk measurement comes to ensure financial performance in the bank (Remy & Njeru, 2020).

2.4 Credit Risk Assessment and Loan Performance of Commercial Banks

Credit analysis is about assessing the credit quality of borrowers. Basing on the information provided by borrowers, the analyst assesses the position of the counterparty (Holton, 2003). It

revolves around character, collateral capability and capacity. It takes into account various factors like income of the applicants, number of dependents, monthly expenditure, repayment capacity, employment history, number of years of service and other factors which affect credit rating of the borrower (Kithinji, 2010). The assessment of the various risks that can impact on the repayment of a loan is credit appraisal. Depending on the purpose of loan and the quantum, the appraisal process may be simple or elaborate. For small personal loans, credit scoring based on income, lifestyle and existing liabilities may suffice. But for project financing, the process comprises technical, commercial, marketing, financial, managerial appraisals as also implementation schedule and ability. The credit risk appraisal involves measures employed by banks to avoid or minimize the adverse effect of credit risk (Ndyagyenda, 2020).

The main purpose of risk assessment is thus to provide the necessary in-depth information about a risk identified in order to effectively avoid it, reduce its likelihood and impact, accept its occurrence or prepare contingency plans (Maliisa, 2013). From a managerial perspective, the accuracy of credit risk assessment serves two key purposes; first it removes from consideration borrowers who present excessive credit risk. Second, for those borrowers who pass the first screen, it is used to determine how much credit should be extended and what price should be attached to an extension of credit. In this way, credit risk assessment serves the purpose of helping institutions to align expectations of risk and return with constraints on portfolio performance (Cole, Glenn, & Brent, 2005).

Maliisa (2013) asserts that risk assessment provides lenders with in-depth information about a particular risk, and outlines the mechanisms to avoid the risk, reduce its likelihood, or prepare contingency plans to accommodate it. A study by Tanui, Wanyoike and Ngahu (2015) found that SACCOs that have improved credit administration are likely to register improvements in their financial performance. This study however was conducted in SACCOs in Kenya and may not apply in commercial banks in Uganda,

According to Marisit (2018), one way of improving credit risk assessment is to use credit scores. Checking on the credit score helps the bank evaluate its credit and supplier risk, increase collections, and reduce Loan Performance. The author established that a reduction in Loan Performance increases profitability.

Paul and Boden (2008) reported that firms with robust processes to assess risk are likely to lose a sale than sell to customer who is likely to default easily. This suggests that the knowledge and expertise in credit management facilitates the practicality of making decisions on who should take the loan.

Studying MFIs in Vietnam, Ayayi (2011) shows that sound credit risk assessment is a precursor to high return on assets. The author noted that MFIs which implemented sound credit assessment were likely to have low credit risk, decreased loans write-off ratio, and increased

portfolio quality. However, this study focused on Vietnamese microfinance institutions, which creates a contextual gap in Uganda.

Mallisa (2013) confirmed a positive link between Risk assessment and performance of Housing Finance Bank in Uganda. The study suggested that assessing data and classifying credit risks are likely to boost financial performance. The study found out that Housing Finance Bank had undertaken adequate efforts to estimate credit risk by the bank's credit risk analysis and had deployed a reliable information system which provided a rich credit risk data base with potential to assess risk concentration. However, this study concentrated on only one bank, Housing Finance Bank which was not justified to other banks.

2.5 Credit Monitoring and Loan Performance of Commercial Banks

Ongoing active monitoring and management of credit risk positions is an integral part of our credit risk management activities. Monitoring tasks are primarily performed by the divisional credit risk units in close cooperation with the business which acts as first line of defense, dedicated rating analysis teams and our portfolio management function (Deutsche Bank, 2011). Credit counterparties are allocated to credit officers within specified divisional risk units which are aligned to types of counterparty (such as financial institution or corporate) or economic area. The individual credit officers within these divisional risk units have the relevant expertise and experience to manage the credit risks associated with these counterparties and their associated credit-related transactions (Deutsche Bank, 2011).

Credit risk monitoring of borrowers is very important as current and potential exposures change with both the passage of time and the movements in the underlying variables, and also very important in dealing with moral hazard problem (Derban, Binner, & Mullineux, 2005). Monitoring involves frequent contact with borrowers, creating an environment that the bank can be seen as a solver of problems and trusted adviser, develop the culture of being supportive to borrowers whenever they are recognized to be in difficulties and are striving to deal with the situation; monitoring the flow of a borrower's business through the bank's account, regular review of the borrower's reports as well as an on-site visit; updating borrowers credit files and periodically reviewing the borrower's rating assigned at the time the credit was granted (Maliisa, 2013).

Sheehan (2010) equally noted that for activities with a high likelihood of occurring, but where the financial impact of each event is small, the best risk response is to use the firm's management control systems to reduce the potential for loss. For activities that involve a high probability of losses of a large financial magnitude, the best risk response is to avoid the activity (Sheehan, 2010). For activities that have a low probability of occurring, but the financial impact of each event would be of a large magnitude, the best risk response is to transfer a portion or all of the risk to a third party either by purchasing insurance, hedging, outsourcing or entering into

partnerships. By first identifying which events pose the greatest threat to the firm, managers can employ its management control system to its maximum benefit. It allows managers to design the management control system to align the firm's risk exposure with the board of directors risk appetite (Maliisa, 2013).

Mazumder and Ahmad (2010) noted that financial institutions are equally faced with the challenge of credit monitoring in that after the loan is approved and draw down allowed, the loan should be continuously watched over. These include keeping track of borrowers' compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments. This has not been easily observed and achieved in most financial institutions due to lack of adequate resource infrastructures. Siddiqui, Malik and Shah (2012), in their study of NPLs in Pakistan, noted critical challenges of limited resources in loan recovery effort of banks. This necessitates the importance of putting emphasis on recovery of big loans and unless it can be demonstrated very clearly through action that these top defaulters are pursued with success, there would be little incentive for small defaulters to settle their debts.

With reference to credit monitoring, Mazumder and Ahmad (2010) show that after approving loans, most financial institutions fail to observe the loans due to lack of adequate resource infrastructures. Kariuki (2017) stresses that a more stringent credit monitoring procedure would lead to ensuring that only creditworthy customers access loans. Banks should be stringent enough to ensure that their loans do not go to persons who lack the capacity to repay (Kariuki, 2017). The monitoring systems adopted should further ensure that instead of keeping financial performance to a minimum, the banks aim at outstanding performance (Kariuki, 2017).

Karugu and Ntoiti (2015) found that credit monitoring accounts for 47.8 percent of the changes in profitability. Regarding credit risk monitoring, Cain (2014) advises executive managers to exercise risk tolerance. This helps the bank management to suggest possible strategies for reducing such a high risk which prevents non-performing loans and bad debts, thereby reducing profitability. Marisit (2018) identifies potential clients may become risky. A reduction in revenue losses implies that net income will increase which increases profitability.

According to Nyong'o (2014), credit risk monitoring increases return on assets as well as profitability. Banks which minimize the level of non-performing loans perform better than those which do not. The author, however, does not show how these two factors increase non-performing loans. Wambugu (2009) argues that establishing will provide essential, and clear information; which if delivered timely can improve the profit levels of the bank. Addae-Korankye (2014) found that in order to reduce loan default and increase Loan Performance, SACCOs must conduct regular monitoring of clients.

A study on financial performance in Kenya by Gatuhu (2011) found that credit monitoring has a strong effect on financial performance. In practice, microfinance institutions which vary their

credit monitoring systems are likely to register positive changes in their financial performance. In this regard, SACCOs which practice credit monitoring show strong changes in their financial performance (Mutua, 2016). However, the strength in the performance is mostly due to mitigations in SACCOs' credit policies.

According to Nyawera (2013), banks need to communicate with the borrowers' customers, vendors and other current and former lending institutions if they want to accurately describe a client's banking practices in the past. The bank ought to make arrangements with the client, his current banker or other bankers to make an informed assessment and judgment of the latter's credit history. This ensures that the bank deals only with trusted people who can act in good faith at all times – in good times and in bad -- so that if things go wrong, that client was there. Walsh (2010) adds that SACCOs whose clients have delinquency problems must ensure to give a reminder, especially when the repayment time is drawing nigh. The zero-tolerance concept, if properly communicated to new clients, might work better.

Nguyen (2016) highlights the factors that enhance loan review. These include analyzing debtors' financial statements, and the ability to repay, a thorough analysis of debtors' documentation, a thorough analysis of the borrowers' compliance with the written loan policy and regulation, the borrowers' profitability and collateral value. The author recommends a separation of duties of staff that handle loans. In particular, loan employees should be different from loan officers to ensure objectivity and independency in the reviewing process.

Drawing examples from Uganda, Kalu, Shieler, and Amu (2018) reported that frequent, timely, accurate and informative reports can enhance monitoring actions, especially when they are distributed to appropriate individuals. Suggestively, effective risk monitoring systems should ensure that reporting and review structures allow for effective identification and assessment controls.

2.6 Credit Risk Control and Loan Performance of Commercial Banks

Credit control is the system used by a business to make sure that it gives credit only to customers who are able to pay, and that customers pay on time. Credit control is part of the financial controls that are employed by businesses particularly in manufacturing to ensure that once sales are made, they are realized as cash or liquid resources (Dasah, 2012). Taking into consideration the complex and extensive nature of the banking business, it is essential to note that credit control embraces all the factors related to credit quality, credit extension, and recurrent cyclical patterns and sequences. Moreover, disciplined and strong credit control represents the foundation of credit risk management since it guides all the credit and ending decisions (Ndyagyenda, 2020).

According to Ogilo (2012), impact of credit risk controls, reliability and timeliness of client information is critical to managing the credit process. If timely and useful information is available, management is much better equipped to direct and control prudent credit processes.

With a credit application, the creditor should be sure the client provides the company's legal name and entity type, as well as the names of principals. If the business structure shields the company's owners from liability, you may want to extract a personal guarantee (Ogilo, 2012). Ask for the contact information such as telephone and fax numbers and e-mail and home addresses for the principals, as well as for the person who will probably be your main contact: the accounts payable manager. Ask for trade references, ideally in your industry, who can speak to completed transactions with the prospect. Seek bank account information and contacts. Some lawyers recommend including a form that authorizes a bank to release the client's records. Include the terms and conditions, written so that the client has to acknowledge agreeing to them and require a dated signature (Matunda, 2016).

Credit risk control makes use of the data collected in the identification step to address potential risks with the right countermeasures. This includes classic mitigation strategies (before the risk event), risk monitoring and contingency plans (after the risk event). For each relevant risk, an appropriate Credit risk control strategy needs to be developed and executed. Credit risk control includes the development as well as the evaluation of diverse mitigation strategies towards their potential value and required investments (Kleindorfer & Saad, 2005). Credit risk control also needs to be supported from various functions within the firm. This requires support from senior executives, enabling holistic thinking, joint decision making and fast implementation activities (Berg et al., 2008). While the previous steps of the risk management process contribute to better risk control, only suitable and well-executed risk control activities can directly contribute to risk performance in the form of lower probabilities for specific risks or a reduced impact of occurred risks affecting the performance of an organization (Maliisa, 2013).

It has always been assumed that collateral could serve to secure the loan that on default, the collateral is converted for the outstanding loan balance. Thus, collateral is used mainly as a loss-mitigating tool for financiers thereby countering loan losses arising from default (De Laurentis & Mattei, 2009). Commercial banks usually take into consideration the use of loan loss provision and research on the determinants of loan-loss provisioning distinguishes between non-discretionary and the discretionary components of loan loss provisioning (Pinho & Martins, 2009). Perez, Salas-Fumas and Saurina (2008) noted that general provisions usually rise during an economic upturn, as banks give out more loans and the demand for credit is high during this period. During a downturn, loans to riskier companies would incur larger loan losses as risks materialize, and therefore higher specific loan-loss provisions follow (Perez, Salas-Fumas, & Saurina, 2008).

According to Essendi (2013), credit risk control involves policies that guide the credit staff in risk appraisal and monitoring to ensure that only those clients who are potentially able to pay back and with a good credit history are given credit. This reduces risks of bad debts and non-performing loans, thereby improving profitability. Gasemba (2010) looks at credit risk control as the capacity to use collateral security and borrower screening to analyze the risk of credit, and to

reduce and manage credit risks. SACCOs that research into the different ways of controlling risks such as minimizing loan defaulters and cash losses perform better than those, which do not, especially in terms of in terms of return on assets.

Nyawera (2013) also revealed that collateral is important because it acts as a secondary source of repayment of the loan which increases financial performance. The findings therefore agree with all the existing literature. Moti, Masinde, Mugenda & Sindani (2012), and Justus, Dickson and Harrison (2016), focusing on documentation, show that signing covenants with customers has a positive effect on loan performance. This might include diversifying loans and rating the credit worthiness of customers. While the above studies were taken from Kenya, and due to differences in cultural context of clients, credit risk controls in Kenya may be different from Uganda (Dexiang & Desheng, 2021).

Sheehan (2010) also recommends the use of management control systems to reduce firm loss, especially when the likelihood of the event to occur has small financial impacts. Otherwise, firms should better avoid those activities which involve a likelihood of losses and a large magnitude of occurring. On the other hand, activities that are least likely to occur, yet bear significant impacts on the firms finances should be managed by transferring part of the risk to a third party. This might take the form of: buying insurance cover, signing partnerships or outsourcing (Maliisa, 2013). Mallisa (2013), in Uganda, found that the use of credit limits, collateral, use of credit risk to determine interest and credit review committees in the bank's credit risk control practices in Housing Finance Bank had not been effective in mitigating credit risk.

Mbiti, Lugogo and Koech (2018) show that commercial banks that have collaterals and credit protection, profitability increases controlling credit losses register improvements in their profitability. The authors revealed that Credit Risk Management Practice strategies like collateral and credit protection significantly affect financial stability compared to credit rationing and contract evaluation. Credit protection in particular, remains the best technique for handling risks of clients who operate in diverse client-risk scenarios.

Kenton (2019) advises that credit risk control should assess and prepare for any potentials for disasters that may physically or figuratively affect the goals and objectives of an organization. Risk control helps firms to take actions that eliminate potential threats. They help companies to manage losses and incomes. Kalu, Shieler, and Amu (2018) show that diversification is primary in controlling credit risk and improving financial performance. The technique is most appropriate in situations where the loan portfolio can be diversified to sectors of the economy which have much benefits compared to others.

2.7 Summary of literature and Literature gaps

Literature clearly indicated that credit management strategies including: credit risk identification, credit risk assessment, and credit risk monitoring and credit risk control are positively related

with performance of financial institutions. However, few studies had focused on Loan Performance. Likewise, most of the literature is on studies conducted from other countries with the greatest percentage being on studies conducted in Kenya while Uganda has received scanty research. It has also been observed that most of the literature has been conducted in microfinance institutions and SACCOs whose way of managing credit risks may differ from the way commercial banks manage credit risks. Some of the ideal studies in Uganda have focused on single bank. Other studies have been based on descriptive analysis which may not accurately give the magnitude and direction of the relationship. Against the above research gaps, this study designed instruments that sought information on credit risk identification, credit risk assessment, credit risk monitoring, and credit risk control.

CHAPTER THREE: METHODOLOGY

3.1 Introduction

This chapter presents a detailed analysis of the methodology designed for investigating credit risk management practices and Loan Performance. The chapter provides an outlay of the research design, the population, and the data collection extents. The chapter provides details on quality control and ethical concerns.

3.2 Research Design

A research design involves a blue print followed to ensure that the research questions are appropriately answered. This includes appropriately selecting the tools for data collection, and data analysis (Kumar, 2011). It sets the boundaries in which the investigation will be confined. The correlational research design is normally used by scholars to establish relationships between variables (Kowalczyk, 2014). In this study, correlational design was used to establish the relationship between different credit risk management practices and Loan Performance in selected commercial banks in Mbarara city. Hence, the study used a quantitative approach to collect numeric and categorical data using structured questionnaires to generate inferential statistics (correlations and regressions). Quantitative method was used because it produces results that are easy to summarize, compare, generalize and confirm whether the hypotheses hold true or false.

3.3 Study Population

A study population refers to a well-defined collection of individuals or objects known to have similar binding characteristics or trait (Kumar, 2011). The unit of analysis comprised 19 commercial banks in Mbarara Town while the unit of inquiry included the credit staff and management in each selected bank. This was because they were the ones who had basic knowledge on credit risk management and Loan Performance in the banks. In each of the 19 banks in Mbarara, the researcher purposively selected 1 branch manager and 1 credit manager while loans officers/credit officers were selected randomly after being subjected to sampling. The population size was 153 people who comprised 19 branch managers, 19 branch credit managers and 115 credit staff of commercial banks in Mbarara city. These were apportioned as follows:

Table 3.3.1: Study population

NO.	Bank	Branch manager	Credit manager	Credit officers	Total
1	Centenary bank	1	1	13	15
2	Stanbic bank	1	1	11	13

3	Absa Bank	1	1	8	10
4	Guaranty Trust Bank	1	1	5	7
5	Diamond Trust Bank	1	1	5	7
6	Finance Trust Bank	1	1	6	8
7	Equity bank	1	1	5	7
8	DFCU bank	1	1	6	8
9	Opportunity bank	1	1	5	7
10	Orient bank	1	1	4	6
11	UBA bank	1	1	5	7
12	Cairo bank	1	1	3	5
13	Brac Uganda Bank	1	1	12	14
14	Housing Finance Bank	1	1	7	9
15	Bank of Africa Uganda	1	1	6	8
16	Bank of Baroda	1	1	4	6
17	Tropical bank	1	1	3	5
18	KCB bank	1	1	3	5
19	Post bank	1	1	4	6
	Total	19	19	115	153

Source: 2021 Employee reports of commercial banks in Mbarara city

3.4 Sample Size

A sample is a portion of the population that is selected for study purposes. The number of units to be investigated was determined by Yamane (1967);

$$n = \frac{N}{1 + N(e)^2}$$

Where N= Total population=153
n = required sample size
e= Margin of error estimated as 5% at 95% level of confidence

$$n = \frac{153}{1 + 153(0.05)^2}$$

n=110 respondents

The sampling frame was be as follows;

Table 3.4.1: Sampling frame

NO.	Bank	Study Population				Sample Size			
		Brch Mngr	Crdtm ngr	Crdt Officers	Total	Brch Mngr	BrchCr dtMngr	Crdt Officers	Total
1	Centenary bank	1	1	13	15	1	1	8	10
2	Stanbic bank	1	1	11	13	1	1	7	9

3	Absa Bank	1	1	8	10	1	1	5	7
4	Guaranty Trust Bank	1	1	5	7	1	1	3	5
5	Diamond Trust Bank	1	1	5	7	1	1	3	5
6	Finance Trust Bank	1	1	6	8	1	1	4	6
7	Equity bank	1	1	5	7	1	1	3	5
8	DFCU bank	1	1	6	8	1	1	4	6
9	Opportunity bank	1	1	5	7	1	1	3	5
10	Orient bank	1	1	4	6	1	1	2	4
11	UBA bank	1	1	5	7	1	1	3	5
12	Cairo bank	1	1	3	5	1	1	2	4
13	BRAC Uganda Bank	1	1	12	14	1	1	7	9
14	Housing Finance Bank	1	1	7	9	1	1	4	6
15	Bank of Africa Uganda	1	1	6	8	1	1	4	6
16	Bank of Baroda	1	1	4	6	1	1	3	5
17	Tropical bank	1	1	3	5	1	1	2	4
18	KCB bank	1	1	3	5	1	1	2	4
19	Post bank	1	1	4	6	1	1	3	5
	Total	19	19	115	153	19	19	72	110

Source: 2021 Employee reports of commercial banks in Mbarara city

3.5 Sampling techniques

Two sampling techniques were used as follows;

3.5.1 Stratified Sampling Technique

The study used stratified sampling technique to categorize the population into different categories. Stratified sampling is a type of sampling method in which the total population is divided into smaller groups or strata to complete the sampling process. The strata are formed based on some common characteristics in the population data (Thomas, 2020). In a stratified sampling, the researcher divided the population into homogeneous sub-populations called strata based on the bank name. Every member of the population was in exactly one stratum and each stratum was then sampled using another probability sampling method, specifically simple random sampling. The researcher relied on stratified sampling to ensure that every characteristic was properly represented in the sample since the population's characteristics were diverse.

3.5.2 Purpose sampling

Purposive sampling was used to select managers (branch manager, credit manager) from each cluster/bank. Purposive sampling is the non-probability sampling where the researcher dictates on who should provide information to the study. Purpose sampling was used to select

management with more knowledge on credit risk management and Loan Performance. In this case, the study targeted Credit managers and branch manager.

3.5.3 Simple random sampling

Simple random sampling involves selecting individuals into the study by giving equal opportunities to all units in the population. This technique assumes that population is finite and the units thereof are known. This method was used to select only credit officers since this was a homogeneous group possessing similar information.

3.6 Sources of data

Data was collected from both primary and secondary sources. These are explained as follows.

3.6.1 Primary Sources

These are sources that provide primary data collected using questionnaires. Primary data is that data collected for the specific purpose of a study either by the researcher or by someone else. This source provides first hand/primary data directly from respondents through questionnaires (Kumar, 2011). Much of the conclusion was based on this source because it provided raw and rich data directly from the targeted respondents.

3.6.2 Secondary Sources

This provided secondary data which is any information that had been collected or written for other bank purposes but was found relevant to the study. Secondary sources provided supplementary data to the primary source and this mainly included documented data from the financial records of the selected banks, published annual reports and other relevant documents that were found in the banks in order for the researcher to draw valid conclusions and recommendations.

3.7 Data Collection Methods

This researcher used quantitative methods. Hence, a questionnaire method was used to collect data, based on a questionnaire. A questionnaire is a document containing the list of questions that were administered to respondents. Respondents were to comprehend the questions and provide written answers. To ensure this, questions had to be self-administered. The method was used in this study because of its enormous benefits: enhancing anonymity, no researcher-bias, minimal finances, and time. This method was used to collect data from all credit staff and management of the selected commercial banks (Kumar, 2011).

3.8 Data Collection Instruments

This was a structured questionnaire based on close-ended questions. The questions were designed on a 5-point likert scale. Both credit risk management practices and Loan Performance were measured as follows:

Strongly Agree = 5, Agree = 4, Not sure = 3, disagree = 2, and strongly disagree = 1. These forms of questions were standardized and easy to analyze.

3.9 Validity and Reliability

3.9.1 Validity

Validity relates to the accuracy of measurement. An instrument is valid if it accurately measures what it is intended to measure. Validity of the instruments was measured by determining the relevance of questions through expert judgment method. The questionnaire was pre-tested among three (3) research experts before the actual time of data collection to give an opinion of whether the items in the questionnaire were relevant to the study variables and if they could be used to answer the specific objectives. The researcher then computed the content validity index (CVI) by calculating the ratio of total items marked relevant (R) by judges to total items in the instrument as shown below:

$$CVI = \frac{\text{Number of items declared valid by judges}}{\text{total number of items}} = \frac{30}{38} = .789$$

From the expert judgment, the instruments were considered valid when the generated coefficient was found to be greater than 0.70 as recommended by Amin (2005).

3.9.2 Reliability

Reliability relates to consistency of results over time, drawn from a population with similar characteristics. In this study, the research instrument was pretested among five (5) credit staff of any one bank in Mbarara city after which this data was analyzed using SPSS Version 20.0. Using the same software, the Cronbach's (1951) alpha co-efficient was generated to test for internal consistency. The instrument was considered reliable if the alpha value was found to be greater than 0.70. However, if the alpha value was less than 0.70, the researcher checked the Cronbach's Alpha values for individual items on each section to see whether the original Cronbach Alpha would increase above 0.70 if one or some items would be deleted. The researcher made necessary corrections to the instrument and then went for actual data collection.

Reliability Statistics

Variable list	Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
Credit risk identification	.672	.669	7
Credit risk assessment	.542	.555	4

Credit risk monitoring	.786	.799	12
Credit risk controls	.839	.843	7
Overall	0.71	0.717	30

Source: Field data, 2021

The overall Cronbach' alpha coefficient ($\alpha = .717$) was above the acceptable 0.7. This therefore means that the items used in this study were internally stable and consistent.

3.10 Research procedure

The researcher obtained a letter from the University to introduce the researcher to the managers of the selected commercial banks to seek permission to conduct research from the bank. Upon being given permission, the researcher interacted with field respondents by distributing questionnaires to them. The questionnaires were left with the bank and the researcher agreed with each respondent when to collect the answered questionnaire for analysis.

3.11 Ethical considerations

To be ethical, a letter from the Kabale University was obtained to introduce the researcher to respondents in order to give them a clear picture regarding the purpose of the study being conducted. Additionally, the researcher first asked for permission from the bank managers so as to allow research be conducted in the selected banks. Confidentiality was assured by not revealing the names of the respondents anywhere in the report. After data analysis, the names of the banks were indicated anywhere in the report. Instead, identical initials or letters were assigned to each bank so that they were not recognized. The data collected from each bank was aggregated and presented as a whole picture, not to a specific bank.

3.12 Data presentation, analysis and interpretation

Data from questionnaires was validated before entering into Statistical Package for Social Scientists (SPSS) to produce quantitative information which was presented in frequency tables and charts for bio data of the respondents. To answer research hypotheses, the researcher run correlation and regression tests to analyze the relationships and effects of Credit risk management and Loan Performance of commercial banks in Mbarara city.

3.13 Measurement of variables

The researcher measured Credit risk management and Loan Performance using an ordinal scale based on the 5-point Likert scale rating, from Strongly Agree (5), to strongly disagree (1). This form of questions is standardized and easy to analyze. For the case of bio-data of the respondents, a nominal scale was used to quantify gender of the respondents and position held in the bank. An interval scale was used to quantify age of the respondent and period spent in the

bank while an ordinal scale was used to quantify highest level of education of the respondent. On all nominal, ordinal or interval scales, a numeric whole number was assigned to each variable label during data analysis to make it easy to generate descriptive statistics such as mean, standard deviation and run inferential statistics such as correlations and multiple regressions.

3.14 Limitations of the Study

The researcher used SPSS program me in data analysis, thus the results on the reliability tests, correlations and regressions were all based on the data set in the system. Hence, an error in the data input may have adverse effects the accuracy of the output. The researcher was however keen enough in data entry and analysis to ensure that actual data collected was the one coded and analyzed.

Self-reporting might limit the dependability of the data. However, the researcher screened the data for correctness and truthfulness before adopting it for analysis. Despite the possibility of false reporting, the researcher encouraged respondents to be sincere and truthful in their responses.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.1 Introduction

This chapter presents the background to the study, descriptive and inferential statistics of the research problem and the hypotheses.

4.2 Background characteristics

Table 4.2.1: Background characteristics

Variable list	Categories	Frequency	Percent
Gender	Male	49	54.4
	Female	41	45.6
	Total	90	100
Age bracket	18 – 35	36	40
	36 – 50	46	51.1
	Above 50	8	8.9
	Total	90	100
Level of education	Diploma	21	23.3
	Bachelors	51	56.7
	Masters	14	15.6
	Others	4	4.4
	Total	90	100
Position held in the bank	Manager	15	16.7
	Credit Officer	27	30
	Credit Supervisor	17	18.9
	Any other	31	34.4
	Total	90	100
Years in the bank	Less than one year	9	10
	1 - 5 years	27	30
	6 - 10 years	23	25.6
	10 years and above	31	34.4
	Total	90	100

Source: Field data, 2021

The findings indicate that majority of the participants were men (54.4%) compared to women (45.6%). This was because men can ride frequently the motorcycles to field, men are hardliners when it comes to riding the motorcycles for loan appraisals, recovery and monitoring. The greatest number of participants fell among adults of age range 36 – 50 years. This was because most experienced credit staff belong to that category and the manager as well credit

manage/supervisor go through the hierarchy of credit officer and credit manager mentorship of not less than two years on each before being appointed credit manager and branch manager. Most of the participants indicated Bachelors' degree as their highest level of education (56.7%). This shows that banks recruits degree holders at entry level high level of skills to do the job of credit officer that helps to perform well.

In terms of the position held in the bank, 34.4% indicated any other, and were the majority. This shows that others play significant roles on loan performance especially account opening and customer care experience. When asked about the years participants worked with the current bank, 34.4% of the participants had worked with their banks for more than 10 years. This shows that the most staff had experience to handle their duties of credit.

4.3 Descriptive analysis

This type of analysis allowed the researcher to summarize the attributes and nature of data on credit risk management and loan performance. The technique revolved around mean (central tendency) and standard deviation (dispersion). The researcher used mean to measure the extent to which participants' opinions on credit risk management and loan performance clustered. Standard deviation measured the extent to which participants' opinions differed from one participant to the other.

4.3.1 Credit Risk Management

Credit risk management was measured in terms of credit risk identification, credit risk assessment, credit risk monitoring, and credit risk controls, which were anchored on a five-point Likert scale. The study used the descriptive statistical procedure of SPSS to run the mean of the responses for each item on the questionnaire. As a guide to interpreting the mean score, 0 to 2.49 was interpreted as 'poorly practiced', 2.50 to 3.49 was interpreted as 'moderately practiced' while 3.50 to 5.00 was interpreted as 'strongly practiced'. Table 4.3.1 summarizes the internal control systems.

Table 4.3.1: Credit risk management

Variable List	Mean	Std. Deviation
Credit Risk Identification		
1. We periodically analyze and identify the different situations and scenarios that may either increase or reduce the probability of recovering all the loans and their interests	3.956	1.080
2. In this bank, we have a written standard procedure that is followed by all loan officers during credit risk identification	3.944	1.032
3. We usually conduct a SWOT analysis to identify out bank's strength, weaknesses, opportunities and threats regarding issue and collection of loans to clients	3.933	0.859
4. Whenever a client delays to repay the loan, our bank's loans officers usually make	3.911	0.967

research to identify the cause of delay		
5. In this bank, we have a checklist of all debtors showing all the loan details and client details	3.878	0.970
6. In this bank, we conduct a thorough interview with the client to identify any credit risk before giving out credit	3.756	0.812
7. We have credit experts who usually predict the occurrence of credit risks and consequences of certain decisions by loans officers regarding the credit risk identification	3.444	1.255
Average	3.832	0.996
Credit Risk Assessment		
1. We ensure that clients present their cash flow statements and other financial records of the business which are analyzed by our bank staff to assess the level of credit risk	4.456	0.837
2. We usually make a thorough assessment of the key risks facing the client and whether the client has some strategies put in place to mitigate these risks	4.278	0.848
3. Our bank's executive management team conducts monitoring of credit risk to understand which potential clients may come at too high a risk and above its pre-identified risk tolerance	4.089	1.056
4. In this bank, we use credit scores to analyze the risk potential that different customers pose so that we take necessary actions to prevent loan defaults	3.833	1.144
Average	4.164	0.971
Credit Risk Monitoring		
1. Our loans officer examines the use of loan according to loan agreement to make sure that the borrower does not spend the credit for wrong purposes	4.200	1.062
2. We regularly a re-analysis of the customer's credit profile to evaluate the ability to re-pay and detect changes in credit quality from time to time	4.078	0.890
3. In this bank, all loans advanced to customers are monitored by our loan officers to ensure that they are paid in time	3.878	1.140
4. In this bank, we communicate with the borrowers' customers, vendors and other current and former lending institutions to determine how the client has handled his/her/its banking arrangements in the past	3.478	1.083
5. We remind our clients who have had recent delinquency problems that their repayment day is approaching.	3.367	1.231
6. We have set up an independent department for loan reviewing and supervision	2.878	1.675
Average	3.646	1.180
Credit Risk Controls		
1. We ensure that customers present collateral security as a secondary source of repayment in case they fail to pay	4.333	0.960
2. My organization has a credit limit beyond which we cannot grant credit to the client in order to control risk of default	4.256	0.801
3. My bank ensures that borrowers have the capacity to service their debts at least 1.2 times the principal loan	4.233	1.071
4. This bank has policy manuals that guide the credit staff in risk monitoring to ensure that only those clients who are potentially able to pay back and with a good credit history are given credit	4.167	0.903
5. In this bank, the committee and the manager receive and evaluate the loan performance on an ongoing basis	3.989	1.055
6. Our bank only grants loans to people that we can trust to act in good faith at all times rather than defaulting adamantly	3.500	1.448

Average	4.080	1.039
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Source: Field data, 2021

Credit risk identification (mean = 3.832; std. = .996) was strongly practiced. Most of the participants pointed to periodic analysis of situations that reduce loan recoveries (mean = 3.956; std. = 1.080) as evidence of credit risk identification. The presence of experts who predict the occurrence of credit risks was contested (mean = 3.444; std. = 1.255). An analysis of the standard deviation, however, shows that participants were consistent in their assertions on conducting thorough interviews with clients to identify any credit risks before giving out credit (mean = 3.756; std. = .812). The statistics provide some evidence that most of the banks investigated identify credit risks through conducting thorough interviews with their clients prior to disbursing loans. This shows that good loans are booked which reduces on non-performing loans.

Credit risk assessment (mean = 4.164; std. = .971) was very strongly practiced. Most of the participants pointed to analyzing clients' cash flow statements and other financial records (mean = 4.456; std. = .837) as evidence of credit risk assessment. However, the use of credit scores to analyze the risk potential that different customers pose (mean = 3.833; std. = 1.144) was contested among participants. This is because credit score that not involve major parameters of risk assessment. An analysis of the standard deviations did not reveal significant differences in opinions on the claims raised by the researcher. These statistics provide some evidence that analyzing clients' cash flow statements and assessing the extent to which clients mitigate potential risks are dominant practices in credit risk assessment in the banks investigated. This is because cash flow assessment determines the capacity of the customer and ability of how much to afford in paying back the credit.

Credit risk monitoring (mean = 3.646; std. = 1.180) was strongly practiced. Most of the participants pointed to examining the use of loans as presented by the borrowers (mean = 4.200; std. = 1.062) as the strongest evidence of credit risk monitoring. However, participants seemed to disagree on the presence of an independent department for loan reviewing and supervision (mean = 2.878; std. = 1.675). This is because there is key fact of Know your customer and credit clients do not always reveal information pertaining their credit to people they are not used to. An analysis of the standard deviations shows that participants held consistent opinions on the practice of re-analyzing clients' profiles for their ability to re-pay the loans from time to time (mean = 4.078; std. = .890). These statistics provide some evidence that the banking institutions that were investigated regularly follow up their clients to ensure that their ability to pay the loans are sustained and maintained. Loan monitoring helps to reduce the rate of loan diversion and knowing the trend of customers' purpose and status of business/ source of income.

Credit risk controls (mean = 4.080; std. = 1.039) was found to be strongly practiced. Most of the participants pointed to submission of collateral securities as a backup in case of failure to pay the loans (mean = 4.333; std. = .960). Participants, however, contested the view that their banks

always grant loans to only trusted people, who will act faithfully all the time instead of defaulting (mean = 3.500; std. = 1.448). This is because trusted people have willingness to pay are very collaborative. A close analysis of the standard deviations reveals that participants held consistent opinions on the fact that their banks have a credit limit beyond which they cannot grant credit to the client (mean = 4.256; std. = .801). The statistics provide some evidence that the banks investigated practice credit controls through limiting the amount of loan a client can obtain, and asking for collateral securities in case of failure. This is because the banks try to avoid overfunding and collateral is the fallback position of the bank if customer fails to pay, it liquidates the collateral.

Generally, given the four credit management practices, this study established that credit risk assessment is strongly practiced by the banks while credit risk monitoring is least practiced.

When banks have access to the most recent, precise data of the borrower and internal resources, they receive a comprehensive analysis of the loan in question.

Continuously monitoring these factors helps banks and be proactive in how they need to interact with a borrower or manage their reserves. Banks should be aware of the factors that can limit the effectiveness of these programs, including:

- Inefficient data management – your information is only as valuable as it is relevant. Data storage solutions should be secure, organized and updated in real-time.
- Limited infrastructure – robust stress-cycling that spans the entire credit life cycle ensures an accurate risk assessment.
- Poor reporting and visualization – data should be organized in a way that clearly identifies the strengths and weaknesses of a loan without being weighed down by irrelevant information.

4.3.2 Loan performance

The researcher used a set of statements to indicate loan performance in selected banking institutions. The study, using the descriptive statistical procedure of SPSS ran the mean of the responses for each item on the questionnaire. As a guide to interpreting the mean score, 0 to 2.49 was interpreted as ‘low’, 2.50 to 3.49 was interpreted as ‘moderate’ while 3.50 to 5.00 was interpreted as ‘high’. Table 4.3.2 summarizes the financial performance.

Table 4.3.2: Loan performance

Variable List	Mean	Std. Deviation
1. For the last five years, we have been able to efficiently collect all our loans and advances in time.	4.356	0.852
2. The amount of bad debts written off has been reducing for the last 5 years	4.256	0.743
3. The amount of interest income earned on loans and advances to customers has been increasing for the last five years	4.244	0.839
4. In this bank, the amount of non-performing loans has been reducing for the last years	4.233	0.925
5. The recovery rate of loans in this bank since the last years has been as high as above 95%	4.156	0.792
6. In this bank, the loan portfolio has been increasing for the last five years	4.089	0.932
7. The value of portfolio at risk (PAT) of this bank has been below 3% for the last five years	3.989	0.868
Average	4.189	0.850

Source: Field data, 2021

The level of loan performance (mean = 4.189; std. = .850) was high. Most of the high loan performance derived from efficient collection of loans and advances on time (mean = 4.356; std. = .852). While participants appeared to disagree on the claim of the value of their portfolio at risk (mean = 3.989; std. = .868), their views on loan performance were generally consistent. The statistics therefore provide some evidence that loan performance among the banks investigated was generally high, evidenced mostly in efficient loan collection and the reduced bad debts for the last five years. Without sufficient funds, banks might not be able to lend to other individuals, which can reduce the net profits, as well as the portfolio of the bank. Timely debt collection can lead to improved cash flow, which will help the banks to reduce the risks of incurring losses, and free up their resources.

The researcher used correlation to test for the relationship between credit risk management and loan performance. Regression was used to establish the effect of credit risk management on loan performance. Finally, hypothesis testing was used to verify all the hypotheses that were developed in the introductory chapter of this project.

Correlation tests

This study used the correlation coefficient to establish the degree of the relationship between credit risk management and loan performance. The correlation coefficient, which ranges from zero to one shows the nature and strength of the relationship. Strong correlation coefficients tend towards one while weak correlation coefficients tend towards zero. Table 4.4.1 shows the correlation output.

Table 4.3.3: Correlations

Credit Risk Identification	Credit Risk Assessment	Credit Risk	Credit Risk Control	Loan Performance
----------------------------	------------------------	-------------	---------------------	------------------

Monitoring						
Credit Risk Identification	Pearson Correlation	1				
	Sig. (2-tailed)					
Credit Risk Assessment	Pearson Correlation	.568(**)	1			
	Sig. (2-tailed)	.000				
Credit Risk Monitoring	Pearson Correlation	.604(**)	.382(**)	1		
	Sig. (2-tailed)	.000	.000			
Credit Risk Control	Pearson Correlation	.536(**)	.532(**)	.624(**)	1	
	Sig. (2-tailed)	.000	.000	.000		
Loan Performance	Pearson Correlation	.601(**)	.635(**)	.673(**)	.684(**)	1
	Sig. (2-tailed)	.000	.000	.000	.000	

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

From the table above, there is a positive strong relationship between credit risk identification and loan performance ($r = .601$; sig. $<.05$). The significant value, which is less than 0.05 further suggests that credit risk identification and loan performance are linearly related. This means that the more banking institutions identify potential risks the higher they are likely to register performing loans. This might take the form of better credit risk management which presents an opportunity to greatly improve overall performance and secure competitive advantage.

The relationship between credit risk assessment and loan performance ($r = .635$; sig. $<.05$) was strong and positive. The significant value which was less than 0.005 suggests that credit risk assessment and loan performance are linearly related. The statistics imply that banking institutions that carry out credit risk assessment are likely to register performing loans. This might take the form of analysis performed by a credit analyst to determine a borrower's ability to meet their debt obligations. The purpose of credit analysis is to determine the creditworthiness of borrowers by quantifying the risk of loss that the lender is exposed to.

The relationship between credit risk monitoring and loan performance ($r = .673$; sig. $<.05$) is strong and positive. The significant value, which is less than 0.05 suggests that credit risk monitoring and loan performance are linearly related. The statistics imply that the more banking institutions vary their credit risk monitoring practices, the higher the chances of registering performing loans. Credit risk monitoring takes the form of staying on top of your credit history by getting notified about any unusual changes as well as any unusual transactions that may have happened through any of your customers.

The relationship between credit risk control and loan performance ($r = .684$; sig. $<.05$) is strong and positive. A variation in credit risk control is associated to a strong and positive variation in loan performance. The significant value, which is less than 0.05 suggests that credit risk control and loan performance are linearly related. The statistics imply that banking institutions that pay attention to their credit risk controls are likely to register superior loan performance than those that do not. For superior loan performance, credit risk controls should be able to determine

creditworthiness. Accurately judging the creditworthiness of potential borrowers is far more effective than chasing late payment after the fact, Know Your Customer, Conducting due diligence, Leveraging expertise and Setting accurate credit limits.

4.3.3 Regression tests

Regression analysis gives a mathematical relationship between the independent and the dependent variables. This study set credit risk management as the independent variable and loan performance as the dependent variable. The beta coefficients show the proportion of the dependent variable explained by each of the predictor variables. Given the current study, credit risk identification, credit risk assessment, credit risk monitoring, and credit risk controls were used as the predictor variables. Table 4.4.2 shows the regression output.

Table 4.3.4: Coefficients(a)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.570	.303		1.881	.063
	Credit Risk Identification	.072	.094	.070	.774	.441
	Credit Risk Assessment	.312	.078	.326	3.971	.000
	Credit Risk Monitoring	.287	.074	.346	3.868	.000
	Credit Risk Control	.245	.085	.257	2.883	.005
R = .811; R Square = .657; Error = .33421						

a Dependent Variable: Loan Performance

The researcher found a strong and positive relationship between credit risk management and loan performance ($r = .811$; sig. $<.05$). This means that any changes in credit risk management as employed by banking institutions will be associated to positive and strong changes in loan performance. According to (R Square = .657), credit risk management accounts for 65.7% of the variations in loan performance. This is a very strong contribution of credit risk management to loan performance, though some factors external to the current study are likely to account for 34.3% of the variations in loan performance.

From the specific predictors of loan performance, the researcher found that a unit-change in credit risk identification (Beta = .070; sig. $>.05$) accounts for about 7% of the variations in loan performance. However, the effect is not significant. Credit risk identification might fail to explain significant changes in loan performance due to not confined to tile risk that borrowers are unable to pay; it also includes tile risk of payments being delayed, which can also cause problems

A unit change in credit risk assessment (Beta = .326; sig. <.05) accounts for 32.6% of the variations in loan performance. Moreover, the effect is significant. A unit change in credit risk monitoring (Beta = .346; sig. <.05) accounts for 34.6% of the variations in loan performance. This effect is significant. A unit change in credit risk controls (Beta = .257; sig. <.05) accounts for 25.7% of the variations in loan performance and this effect is significant. These statistics generally suggest that banking institutions that adhere to credit risk assessments, credit risk monitoring, and credit risk controls are likely to register superior loan performance than those which do not.

Given the three credit risk management practices that have shown significant effects on loan performance, credit risk monitoring presents the greatest effect on loan performance. The popularity of credit risk monitoring over credit risk assessment and credit risk controls is due to the form of staying on top of your credit history by getting notified about any unusual changes as well as any unusual transactions that may have happened through any of your customers.

4.3.4 Hypothesis tests

The study used the **significance value approach** to test the hypotheses designed in the introductory chapter of this study. In this approach, the test statistic is compared with the sample statistic to verify the hypothetical claims. In social sciences, the test statistic is normally set at 95% ($\alpha = .05$). If the sample statistic is less than 0.05, the null hypothesis is rejected and the alternative hypothesis is accepted. On the other hand, if the sample statistic is greater than 0.05, the null hypothesis is accepted and the alternative hypothesis is rejected.

Table 4.3.5: Decision strategy

Hypothetical Statements	Criterion	Alpha	Decision
1. There is no relationship between Credit Risk Identification and Loan Performance of Commercial banks in Uganda.	0.05	.000	Reject
2. There is no relationship between Credit Assessment and Loan Performance of Commercial banks in Uganda	0.05	.000	Reject
3. There is no relationship between Credit Monitoring and Loan Performance of Commercial banks in Uganda	0.05	.000	Reject
4. There is no relationship between Credit Risk Control and Loan Performance of Commercial banks in Uganda.	0.05	.000	Reject

Source: Field data, 2021

From the table above, the null hypotheses that there is no relationship between credit risk identification and loan performance was rejected. This study rejected the null hypothesis that there is no relationship between Credit Assessment and Loan Performance of Commercial banks in Uganda. The study rejected the null hypothesis that there is no relationship between Credit

Monitoring and Loan Performance of Commercial banks in Uganda. Similarly, the study rejected the null hypothesis that there is no relationship between Credit Risk Control and Loan Performance of Commercial banks in Uganda. For any 100 employees that took part in the study, over 95% were more likely to assert that credit risk identification, credit risk assessment, credit risk monitoring, and credit risk controls are related to loan performance.

4.4 Chapter summary

The chapter has presented the findings on the extents of credit risk management and loan performance. The credit risk management practices have significant relationships with loan performance as observed among the selected banking section.

CHAPTER FIVE

DISCUSSION OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a discussion of the findings. The researcher cross-examined the findings in the context of previous studies.

5.2 Credit risk identification and loan performance

The study established a strong and significant relationship between credit risk identification and loan performance. Banking institutions that have stringent credit risk identifications are likely to register superior loan performance than those banks whose credit risk identification is not stringent. Stringent credit identification takes the form of pledging collateral securities that are equivalent to the loans granted, limiting the ceiling of the loan an individual client can take, and ensuring borrowers have the capacity to pay their loans if the collateral requirements set by the banks in Uganda are too high for the clients to manage. This hinders many clients from applying for loans to boost their businesses.

5.3 Credit risk assessment and loan performance

The study established a strong and significant relationship between credit risk assessment and loan performance. Banks that ensure credit risk assessment will most likely register superior loan performance. This study found that the banks take time to analyze clients' cash flow statements and other financial records, and make a thorough assessment of the key risks that clients face and the strategies they have put in place to mitigate the risks. The findings agree with Ayayi (2011) who shows that sound credit risk assessment is a precursor to high return on assets in MFIs in Vietnam. The significant relationship between credit risk assessment and loan performance agree with Mallisa (2013) who confirmed a positive link between risk assessment and performance of Housing Finance Bank in Uganda. The study suggested that assessing data and classifying credit risks are likely to impact financial performance.

5.4 Credit risk monitoring and loan performance

The study established a positive and significant relationship between credit monitoring and loan performance. Banking institutions that ensure credit risk monitoring are likely to register superior loan performance. Banks that have taken a stride in credit risk monitoring examine the ways how their clients will use the loans not outside the agreed purpose will recover their loans than those that do it but with laxity. Secondly, banks that re-examine their clients' profile from time to time, and ensuring that changes in clients' credit quality change from time to time will always stand out of others in terms of performance.

The findings support Mazumder and Ahmad (2010) who show that after approving loans most financial institutions fail to observe the loans due to lack of adequate resource infrastructures. The success of loan performance rests on field operations. Loan officers ought to move to the field to check on the persons to whom loans were disbursed. This helps the bank to ensure that loans are used for none other than the purposes for which they were secured. In Uganda, it has been observed severally, even among large borrowers, for one to use loaned money for luxurious purchases other than boosting their businesses. This increases the chances of defaulting and low recovery.

5.5 Credit risk controls and loan performance

The study established a positive and significant relationship between credit risk controls and loan performance. Banking institutions that have stringent credit risk controls are likely to register superior loan performance than those banks whose credit risk controls are not stringent. Stringent credit controls take the form of pledging collateral securities that are equivalent to the loans granted, limiting the ceiling of the loan an individual client can take, and ensuring borrowers have the capacity to pay their loans.

The findings agree with Sheehan (2010) who recommends the use of management control systems to reduce firm loss, especially when the likelihood of the event to occur has small financial impacts. Firms should better avoid those activities, which involve a likelihood of losses and a large magnitude of occurring. Similarly, Mbiti, Lugogo and Koech (2018) found that commercial banks that ask for collaterals and credit protection increase their profitability through controlling credit losses. Credit risk management practices strategies like collateral and credit protection have significant effects on financial stability.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.7 Introduction

This chapter presents the summary of findings, conclusion and recommendations. The chapter also outlines the areas for future study

5.8 Summary of findings

The relationship between credit risk identification and loan performance ($r = .601$; sig. $<.05$) is significant and strong. The relationship between credit risk assessment and loan performance ($r = .635$; sig. $<.05$) is significant and strong. The relationship between credit risk monitoring and loan performance ($r = .673$; sig. $<.05$) is significant and strong. The relationship between credit risk control and loan performance ($r = .684$; sig. $<.05$) is significant and strong. Overall, the relationship between credit risk management and loan performance ($r = .811$; sig. $<.05$) is very significant and strong.

5.9 Conclusion

The study was about the relationship between credit risk management and loan performance of commercial banks in Mbarara city. Basing on 90 respondents, this study found a significant and strong relationship between credit risk management and loan performance in commercial banks in Mbarara city. In generality, commercial banks in Uganda that adhere to proper credit risk management have better loan performance than those which do not. Findings on credit risk identification, credit risk assessment, credit risk monitoring, and credit risk control as credit risk management practices all confirm to loan performance and improve with proper implementation of credit risk management.

Credit risk identification significantly affects loan performance in commercial banks. Commercial banks that periodically analyze such situations reduce the probability of recovering the loans and their interests have performing loans. Besides analyzing the scenarios that may reduce credit recovery, few banks have experts in place that rightly predict the occurrence of credit risks. This might put the bank at a credit risk.

Credit risk assessment significantly affects loan performance in commercial banks. Commercial banks in Mbarara city which assess the cash flow statements, financial records, and the mitigation strategies of their clients against risks have performing loans. However, few banks use credit scores to analyze their customers' actions that are likely to prevent loan defaults.

Credit risk monitoring significantly affects loan performance in commercial banks. Specifically, commercial banks which examine how clients will use their loans or spend their credit have performing loans. Besides examining how clients might use or spend the loans, commercial banks that routinely evaluate their clients' profiles for ability to repay the loans have performing loans. However, few commercial banks have independent departments to review their clients' profiles.

Credit risk controls significantly affect loan performance in commercial banks. The effectiveness of credit risk controls comes when the banks can look out for collateral securities from clients before extending loans. Besides collateral securities, ensuring that clients do not take credit that exceeds a certain limit minimizes the level of default. However, banks tend to bend these controls and extend credit to people that are merely trusted on grounds of their faithfulness over time.

5.10 Recommendations

Commercial banks should have stringent credit risk controls that are likely to register superior loan performance. Stringent credit controls take the form of pledging collateral securities that are equivalent to the loans granted, limiting the ceiling of the loan an individual client can take, and ensuring borrowers have the capacity to pay their loans.

Commercial banks should ensure proper credit risk assessments are done so as to register superior loan performance. Banks should take time to analyze clients' cash flow statements and other financial records, and make a thorough assessment of the key risks that clients face and the strategies they have put in place to mitigate the risks.

Commercial banks should ensure credit risk monitoring is done on how their clients will use the loans not outside the agreed purpose will recover their loans. Commercial banks should re-examine their clients' profiles from time to time, and ensuring that changes in clients' credit quality change from time to time will always stand out of others in terms of performance

Commercial banks should ensure that effectiveness of credit risk controls are done well by looking out for collateral securities from clients before extending loans. Besides collateral securities, banks that ensure that clients do not take credit that exceeds a certain limit minimize the level of default.

5.11 Areas for future research

We need to know how different clients respond to the different credit risk management practices. Therefore, a qualitative study to assess clients' perception of the credit management practices in commercial banks should be conducted.

We need to know the extent to which clients approved on faithfulness and trust compromise the strength of the credit controls. Therefore, there is need for a study on the effectiveness of trust and faithfulness in assessing the creditworthiness of credit clients in commercial banks.

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APPENDICES

Appendix 1: Questionnaire for bank credit staff and management

Dear Respondent,

I am **Agaba Francis**, a student of Kabale University offering Masters of Business Administration. I am carrying out my research on *“Credit Risk Management Practices and Loan Performance of Commercial Banks in Uganda: Evidence from Commercial Banks in Mbarara City”*. Your opinions are so important to this study and the information you give me will be treated with utmost confidentiality; being strictly for academic purposes.

Thank you for your cooperation

SECTION A: Background information of the respondent

Instructions: Tick the correct option

1. Gender

- (1) Male
- (2) Female

2. Age

- (1) 18-24 years
- (2) 25-34 years
- (3) 35-44 years
- (4) 45 years and above

3. Highest Level of Education

- (1) Diploma
- (2) Bachelor
- (3) Masters
- (4) Others, specify.....

4. Position held in the Bank

- 1) Manager
- 2) Credit officer
- 3) Credit supervisor
- 4) Any other (please specify).....

5. Period spent in the Bank

- (1) < 1 Year
- (2) 1-2 years
- (3) 3-4 Years
- (4) 5 years and above

SECTION B: Credit Risk Management Practices

In the following section, you are required to tick on either agree or disagree for every opinion statement provided. The statements describe the four (4) dimensions of Credit Risk Management Practices which include credit risk identification, credit assessment, credit monitoring and credit risk control.

NO.	Credit Risk Management Practices	SA (5)	A (4)	NS (3)	D (2)	SD (1)
CRI	<i>Credit Risk Identification</i>					
CRI₁	In this bank, we conduct a thorough interview with the client to identify any credit risk before giving out credit					
CRI₂	Whenever a client delays to repay the loan, our bank's loans officers usually make research to identify the cause of delay					
CRI₃	In this bank, we have a checklist of all debtors showing all the loan details and client details					
CRI₄	We usually conduct a SWOT analysis to identify our bank's strength, weaknesses, opportunities and threats regarding issue and collection of loans to clients					
CRI₅	We periodically analyse and identify the different situations and scenarios that may either increase or reduce the probability of recovering all the loans and their interests					
CRI₆	We have credit experts who usually predict the occurrence of credit risks and consequences of certain decisions by loans officers regarding the credit risk identification					
CRI₇	In this bank, we have a written standard procedure that is followed by all loan officers during credit risk identification					

NO.	Credit Risk Management Practices	SA (5)	A (4)	NS (3)	D (2)	SD (1)
CRA	<i>Credit Risk Assessment</i>					
CRA₁	In this bank, we use credit scores to analyze the risk potential that different customers pose so that we take necessary actions to prevent loan defaults					
CRA₂	Our bank’s executive management team conducts monitoring of credit risk to understand which potential clients may come at too high a risk and above its pre-identified risk tolerance					
CRA₃	We usually make a through assessment of the key risks facing the client and whether the client has some strategies put in place to mitigate these risks					
CRA₄	We ensure that clients present their cash flow statements and other financial records of the business which are analyzed by our bank staff to assess the level of credit risk					
CRM	<i>Credit Risk Monitoring</i>					
CRM₁	In this bank, all loans advanced to customers are monitored by our loan officersto ensure that they are paid in time					
CRM₂	In this bank, we communicate with the borrowers’ customers, vendors and other current and former lending institutions to determine how the client has handled his/her/its banking arrangements in the past					
CRM₃	We remind our clients who have had recent delinquency problems that their repayment day is approaching.					
CRM₄	We regularly a re-analysis of the customer’s credit profile to evaluate the ability to re-pay and detect changes in credit quality from time to time					
CRM₃	Our loans officer examines the use of loan according to loan agreement to make sure that the borrower does not spend the credit for wrong purposes					
CRM₄	We have set up an independent department for loan reviewing and supervision					

NO.	Credit Risk Management Practices (continued)	SA (5)	A (4)	NS (3)	D (2)	SD (1)
CRC	<i>Credit Risk Control</i>					
CRC4	In this bank, the committee and the manager receive and evaluate the loan performance on an ongoing basis					
CRC3	This bank has policy manuals that guide the credit staff in risk monitoring to ensure that only those clients who are potentially able to pay back and with a good credit history are given credit					
CRC4	My bank ensures that borrowers have the capacity to service their debts at least 1.2 times the principal loan					
CRC4	My organization has a credit limit beyond which we cannot grant credit to the client in order to control risk of default					
CRC3	We ensure that customers present collateral security as a secondary source of repayment in case they fail to pay					
CRC4	Our bank only grants loans to people that we can trust to act in good faith at all times rather than defaulting adamantly					

Section B: Loan Performance of Commercial Banks in Mbarara City

In the following section, you are required to tick on either agree or disagree for every opinion statement provided as regards to the determinants of Loan Performance in your bank.

NO.	Loan Performance	SA (5)	A (4)	NS (3)	D (2)	SD (1)
LPP1	In this bank, the amount of non-performing loans has been reducing for the last 5years					
LPP2	The recovery rate of loans in this bank since the last 5years has been as high as above 95%					
LPP3	The amount of bad debts written off has been reducing for the last 5 years					
LPP4	The amount of interest income earned on loans and advances to customers has been increasing for the last five years					
LPP5	For the last five years, we have been able to efficiently collect all our loans and advances in time.					
LPP6	In this bank, the loan portfolio has been increasing for the last five years					
LPP7	The value of portfolio at risk (PAT) of this bank has been below 3% for the last five years					

Thank you for your cooperation

Appendix 2: Research Work Plan

Activity	April 2021	May 2021	June 2021	July 2021	August 2021	September 2021	October, 2021
Selection of research topic							
Preparation of the proposal							
Submission of proposal							
Pilot / Pre-testing questionnaire							
Data collection and entry							
Data Analysis							
Dissertation Writing							
Dissertation review\corrections							
Dissertation Submission							

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DIRECTORATE OF POSTGRADUATE TRAINING

October 25th, 2021

To whom it may concern

This is to certify that *Mr. Agaba Francis Reg. No. 2019/A/MBA/010/W* is a postgraduate student of Kabale University studying for a *Masters of Business Management* in the department of *Business Studies*.

He has successfully defended his Research Proposal for a study entitled,

“Credit Risk Management Practices and Loans Performance of Commercial Bank in Mbarara City.”

The student is now ready for field work to collect data for his study. Please give the student any assistance you can to enable him accomplish the task.

Thanking you for your assistance,

Yours sincerely,



Dr. Sekiwu Denis
DIRECTOR, POSTGRADUATE TRAINING

