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LENDING POLICIES AND LOAN PERFORMANCE IN COMMERCIAL BANKS IN UGANDA

CASE STUDY: POSTBANK UGANDA LIMITED

A dissertation presented to

FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT

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UGANDA MARTYRS UNIVERSITY
SCHOOL OF POSTGRADUATE STUDIES AND RESEARCH

Master's Dissertation

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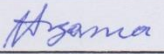
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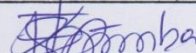
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DEDICATION

This work is dedicated to my Parents Mr. & Mrs. Yiga Stephen and to my daughter Helga Namuddu.

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I owe first a debt of gratitude to the Almighty God who by His Grace has seen me through this MBA program successfully.

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ABSTRACT

The study investigates the effect of Lending Policies on Loan Performance in Commercial Banks in Uganda and uses a case of Post Bank Uganda to pursue this purpose. The study examines three research objectives namely: i) To examine the effect of interest rates Policy on Loan performance in Post Bank Uganda; ii) To examine the effect of Credit Limits policy on Loan Performance in Post Bank Uganda; iii) To assess the effect of Collateral Policies on Loan Performance in Post Bank Uganda. Adopting a descriptive survey design and combining both qualitative and quantitative research approaches as well as utilizing a sample of 80 respondents drawn from the departments and units of Post Bank, the researcher collected both primary and secondary data on all the tenets of lending policies through a questionnaire and an interview guide was entered and analyzed with aid by SPSS and MS Excel.

With a response rate of 96.1% (74/77), the study findings generated by running correlations reveal that Interest Rate Policies is negatively associated with loan Performance with a correlation coefficient of $r = -0.398$; $p < 0.01$, Collateral Policies are also negatively associated with loan performance with a correlation coefficient of $r = -0.283$; $p < 0.01$ and also that Credit Limits Policies are negatively and significantly associated with loan performance with correlation coefficient $r = -0.272$; $p < 0.05$. Relatedly, results of regression analysis reveal that Credit Limits Policy and Collateral policy have a bigger positive contribution on loan performance indicated by a beta value of ($\beta = 0.758$) and $\beta = 0.645$ respectively while Interest Rates Policy contributes a portion to loan performance with beta values of $\beta = 0.028$. Further still, the results of the regression model summary indicate that the dimensions of lending policies account of only 17.8% ($R^2 = 0.178$) of the variation in loan performance and thus there is sufficient evidence to conclude that overall, measures of lending policies are weak in predicting loan performance and as such, the observed feedback appears to be widely spread from the fitted regression line.

Based on the findings, the researcher concludes that the bank registers better Loan performance if staff effort is devoted effectively managing credit limits and defining flexible collateral choices and that Post Bank may only need to establish how it manages the interest rates for competitive loan performance.

The researcher therefore recommends that the bank should devote more efforts in managing credit limits so as mitigate both over and under funding of loan applications as well as their associated consequences. The bank should also define and adopt flexible collateral choices since for stimulated loan performance.

CHAPTER ONE

INTRODUCTION

1.0 Introduction

The study was generally built around Lending Policies (LP) and Loan Performance among Banking Institutions in Uganda and in particular, the study utilized a case study of Post bank Uganda Ltd. The entire research was carried out on two major variables namely; Lending Policies as the independent variable and Loan Performance as the dependent variable. The researcher considered the economic environment within the banking industry as the key moderating variable in the study. This chapter presents the Background to the study, Problem Statement, Purpose of the Study, the Objectives of the Study, research questions and the corresponding hypotheses, the justification of the study, the significance, the scope that the study wishes to draw attention to as well as the conceptual framework among the variables of the study explaining the interrelationships among them.

1.1 Background to the study

The advancement of credit to the public ranks as the biggest asset for all financial institutions the world over (Saunders and Cornet 2008). Because of this catalyst, financial institutions are looked at as the major source and sometimes the only source of financing for particular sectors of the economy whenever the need for financial resources arises (Owino, 2013). However, the success of any banking institution is measured by annual profit and quality of its assets. Therefore, much as banks serve social objectives through priority sectors such as lending, mass branch networks and employment of many people, maintaining a quality loan book and sustained profits are important for the Banks' continuous growth and survival (Freixas and Roche, 2008). As a result, large Financial Institutions (FIs) have acknowledged for some time that taking a more customer

– centric as opposed to a product – centric approach can be a useful strategy for an organization. Thus with the current economic unrest, FIs are looking for ways to improve customer loyalty with the most profitable and yet lowest risk customers (Saunders and Cornet, 2008).

It is important to note that as the banking industry continues to expand the Loan performance in the European Union, America and Afro- Asia has had a peculiar composition over the years. According to the International Monetary Fund (IMF, 2015), there has been an incremental trend in both volume of loan disbursements and Non-performing Loans (NPL) and that NPLs reached one trillion Euros in Europe alone in 2015 which is more than double the amount in 2009. IMF stresses that this issue remains a challenge across the banking sector particularly in economies where NPL ratios as a percentage of gross loans are in double digits.

Down to Africa, many FIs are focusing on account growth and building strategies to implement in the near future (Altunbas et al., 2009). However with the limited pool of qualified candidates and increased competition, it is more important than ever that each and every customer is given the best customer treatment any time they visit their respective banks for service so as to increase response rates, achieve portfolio growth goals as well as building a profitable portfolio according to William, Michael, Joost and Tavneet (2016).

In Uganda, the degree of competition in the banking industry is paving way for increased coverage as well as takeovers (B.O.U 2016). The country boasts of 25 Commercial Banks, 3 Credit Institutions, 4 Micro Deposit – taking Institutions (MDIs) and over a 1,000 Micro Finance Institutions (MFIs) as per the Uganda’s banking sector report of 2016. All these types of

institutions offer both collateralized and non-collateralized loans to the general public and are regulated and supervised by the Bank of Uganda (BOU) with the exception of MFIs.

Information from Bank of Uganda and the Uganda Bankers' Association shows that the majority of the lending institutions have invested in human capital and also devised means to motivate staff by way of providing the necessary logistics required to effectively carry out the lending function of such institutions. As a result, the majority of the institutions have adhered to the ever changing environment in the industry by revising their credit manuals as well as revising the decision protocol to be able to match the market requirements in terms of loan processes.

On the other hand, according to Russell (2012) Lending Policies refers to the Lending Institution's statement of philosophy, standards, and guidelines of a lending institution's lending approach. Russell adds that the institution's employees must comply with this approach in granting or refusing a loan request.

Karen and Sunman, (2014) view lending policies as a set of guidelines and criteria developed by a bank and used by its employees to determine whether an applicant for a loan should be granted or refused the loan. These policies determine which sector of the industry or business will be approved for loans and which will be avoided, and must be based on the country's relevant laws and regulations.

Relatedly, Comptroller's Hand Book (1998) defines a Non-Performing Loan (NPL) as a loan that is in default or close to being in default. Greenidge and Grosvenor (2010) further stresses that many loans become non-performing after 90 days although this depends on the contract terms of the facility. William, *et al* (2016) further argues that the value of a loan portfolio depends not

only on the interest rates earned on the loans, but also on the quality or likelihood that interest and principal will be paid. In this study however, Lending Policies will be limited To Interest Rates Policy, Collateral policy as well as the Credit Limits Policy of Post Bank Uganda while the Non-Performing Loans will refer to volume of written off loans, percentage of loan loss provisions as well as the total Portfolio at Risk in comparison to the entire loan portfolio of the bank.

Records from Bank of Uganda indicate that there has been a growing trend in NPLs over the years. For example, the Bank of Uganda Annual Report of 2016 revealed that NPLs increased from UGX.389 billion in 2014 to UGX.574 in 2015 and finally shot up to UGX.1, 203.2 trillion in 2016. Mugisha, (2017) further observed that Standard Chartered Bank Uganda topped the list of banks with the highest volume of NPLs registering a total of 112 billion shillings in 2016 down from 114 billion shillings in 2015. This was followed by Bank of Baroda whose NPLs shot from 7.1 billion shillings in 2015 to 77.6 billion shillings in 2016 while Barclays bank Uganda came in position three with NPLs of 70.5 billion shillings in 2016 despite an improvement from 96 billion shillings in 2015.

It is also evident that the growing volume of NPLs forced B.O.U to revoke the operating license of Greenland Bank and Cooperative Bank in the 90s while National Bank of Commerce, Global Trust Bank and most recently Crane Bank followed the same route in the recent years. According to records from B.O.U, the collapse of Crane Bank was on the backdrop of high Non-Performing Loans (NPLs) that increased by 122.9% to Shs142.3bn in 2015, up from Shs19.36bn in 2014. This saw the once profitable bank post a whooping loss of Shs3.1bn in 2015, down from a net profit of Shs50.6bn in 2014

Theoretically, the study was guided by the Information Theory that was propounded by Derban, Binner and Mullineux, (2005). The theory recommends that borrowers should be screened especially by banking institutions in form of credit assessment and that the collection of reliable information from prospective borrowers becomes critical in accomplishing effective screening. For the purpose of this research therefore, the Information theory was adopted due to its ability to elucidate relevance of information and its associated benefits on portfolio quality.

1.1.1 Overview of Post Bank Uganda Limited

Post Bank Uganda has been in existence since 1926. The bank started as a department in the Post Office. It was however incorporated in February, 1998 as a limited liability company to take over the activities/operations of the former Post Office Savings Bank. This was in accordance with the Communications Act of 1997. The Bank is 100% owned by the Government of Uganda and is run by a Board of Directors headed by the Chairman of the Board. The bank as at 31st December, 2016 had 41 operational branches and 13 mobile banking branches spread over 37 districts. The bank's Vision is, *"To be the leading financial institution for the mass market"* while her mission is, *"To empower our customers by offering financial services in a sustainable manner"*. The bank has 35,000 loan customers out of about 400,000 customers in the bank's network. The bank also boasts of a total loan portfolio of about 78 billion Shillings as at 30th December 2016. Post bank has time and again implemented projects like launching new and competitive products, staff training and branch network expansion all aimed at improving performance. However, despite all the measures undertaken to strengthen and maintain performance, the bank's vision and mission are far from materializing, (Auditor General's Report, 2016).

The audit reports of KPMG (2016 and 2017) as well as the report of the Auditor General (OAG, 2016) about Postbank for the years 2016/17 and 2017/18 indicate that PBU is in a huge crisis as regards NPLs. KPMG (2016) points out that 8 out of the 40 branches the bank has have registered losses to a tune of over UGX 750 million each due to the increasing loan write offs while the provision for loan default has been on an incremental trend since 2013.

OAG (2016) submits that in a number of branches, the branch managers override the powers of head office and approve loan volumes way above their limits. The report identifies a case of a particular branch in Northern Uganda where a loan of 1.3billion shillings was approved by the manager without the consent of head office and that the loan went delinquent just after disbursement. It's was thus premised on such practices in the bank's credit function that the researcher wished to explore the effect of lending policies on Loan Performances using Postbank as the case.

1.2 Problem Statement

Commercial banks just like any other Financial Institutions have in place a number of policies and guidelines that facilitate their lending activities. These policies are contained into the various lending manuals and B.O.U guidelines on credit limits, loan tenure, approval limits, interest rates, collateral as well as repayment sources all aimed at a safe and low risk portfolio in terms of volume of loan write offs and provisions for loan loss.

Despite the presence of the aforementioned prevailing policies, commercial banks in Uganda have continuously registered worsening portfolio quality which is reflected in high loan write offs and loan loss provisions, high portfolio at risk (PAR) and stunted portfolio growth. For

example, the audit reports of KPMG (2016 and 2017) as well as the report of the Auditor General (OAG, 2016) about Postbank for the years 2016/17 and 2017/18 indicate that PBU is in a huge crisis as regards NPLs. KPMG (2016) points out that 8 out of the 40 branches the bank have registered losses to a tune of over UGX 750 million each due to the increasing loan write offs while the provision for loan default has been on an incremental trend since 2013.

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1.3 Objectives Of the study

1.3.1General objective

To investigate the effect of Lending Policies on Loan Performance among Commercial Banks in Uganda

1.3.2 Specific objectives

- i.To examine the effect of interest rates Policy on Loan performance in Post Bank Uganda
- ii.To examine the effect of Credit Limits Policy on Loan Performance in Post Bank Uganda
- iii.To assess the effect of Collateral Policies on Loan Performance in Post Bank Uganda

1.4 Research Hypotheses

- a) Interest rates Policy has a positive and significant effect on Loan Performance at Post Bank Uganda
- b) Credit limits policy has a positive and significant effect on Loan Performance at Post Bank Uganda
- c) Collateral policy has a positive and significant effect on Loan Performance at Post Bank Uganda

1.5 Scope of the Study

1.5.1 Content scope

The study was built on Lending Policies and Loan Performance among Ugandan commercial banks, critically to investigate the effect of Lending Policies on loan performance in Post bank Uganda. The study paid particular attention to interest rates policy, credit limits as well collateral policies as the constructs of lending policies on one hand while Value of written off loans, Provision for bad debts as well as the Portfolio at Risk will be examined as the key indicators of loan performance.

1.5.2 Geographical scope

The study was carried out at Post Bank Uganda Limited, a Bank located at Nkrumah Road Plot 4/6 Kampala.

1.5.3 Time Scope

The time scope for the study was 2012-2018. This period was selected because it is the time during which the banking sector in Uganda experienced extensive technological advancement as well as the most recent bank failures leading to closure by the Central Bank. It is also in this scope period that the Credit Reference Bureau (CRB) was launched and implemented. In addition, the main aim of choosing this particular period was to utilize the most recent financial data available from commercial banks in Uganda. In particular however, the study conducted in March – April, 2019.

1.6 Significance of the study

This research aimed at investigating the effect of Lending Policies on Loan performance in Post Bank Uganda. The study was deemed vital considering the ever increasing volumes of loan write offs and bank failures in Uganda. The study was thus thought to provide more understanding of the key policies and factors that influence non-performing loans in post bank Uganda. This is because understanding the dimensions of non- performing loans is paramount to the survival and also useful in sustaining profitability in the dynamic and complete banking industry.

The study was also believed to help the Banks policy makers to focus on creating policies that promote compliance of customers in regard to payment of their loan dues.

The study aims at being used by other scholars to refer to the findings during their research on related topics on lending policies in various Banks.

The study also aims at helping the researcher to boost her knowledge and skills, given the fact that she is directly in practice of finance, a field where lending policies fall.

1.7 Justification of the Study

The rate at which the banking industry is registering NPLs is worrying and needs urgent redress. Never the less, the lending policies are designed to guide the lending function but the quality of the loan portfolio among the banks in Uganda points to a number of flaws that might harbored in the respective lending policies of particular banks in Uganda and thus an inquiry into such a relationship is deemed timely.

The study was justified on grounds that earlier studies such as Kaggwa (2013), studied interest rates and portfolio performance among Ugandan commercial banks while studies of Pasha and Khemraj (2010) and Nkuah (2015) were done in other countries and not Uganda hence the need to carry out this study in Uganda and explore the effect between Lending Policies and Loan Performance among Commercial Banks using Post bank Uganda as a case study.

1.8 Conceptual framework

This is the diagrammatic relationship between the variables of the study. The study was built on Lending Policies as the independent variable which is split into policy on interest rates, policy on collateral and policy on credit limits as the dimensions. The dependent variable of the study was Loan Performance which was broken down into percentage loan recovery rates, Loan loss

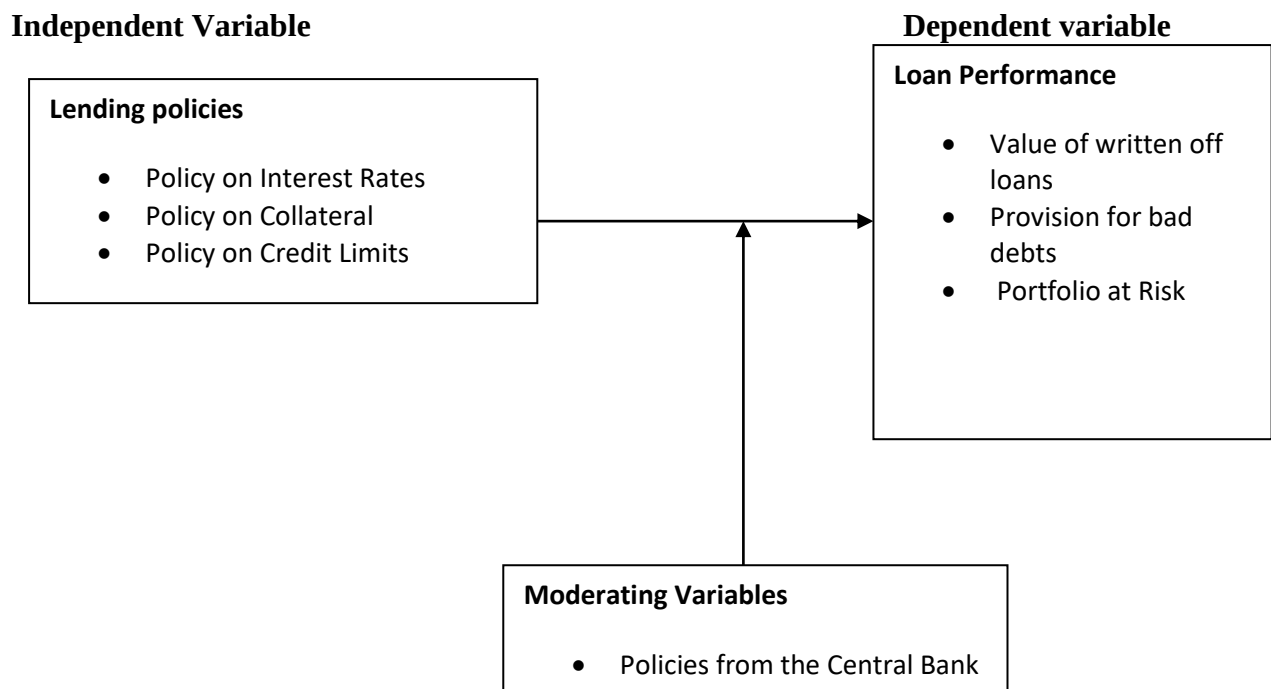
provisions as well as the average Portfolio at Risk of the bank under the time scope of the study. The research took the Central Bank policies as its moderating variable that influences the relationship between the two key variables of the study.

A survey by Russell (2012) on bank lending conditions in Jamaica intimated that lending policies are related to the economic and strategic factors observing that changes in lending policies for example the alteration of credit limits, collateral conditions and the loan tenure may reflect competitive strategies in the market segments to achieve target market share. Further, the Federal Deposit Insurance Corporation of USA and Karen and Brayden (2014) submit that lending policies should be clearly defined and set forth in such a manner as to provide effective supervision by the directors and senior bank officials. Karen and Brayden, (2014) add that the Board of any bank has a legal responsibility to formulate lending policies and also supervise their implementation. Therefore, banks are encouraged to establish and maintain written up to date lending policies which should be approved by the respective Boards and that the policies should not be static documents but must be revised periodically and reviewed in line with the changing circumstances surrounding the borrowing needs of the customers, the banks' strategic objectives as well as the regulatory guidelines from the respective central banks.

Further, the Federal Deposit Insurance Corporation of USA, Jacobson and Roszback, (2001); Gupta and Sunman,(2012) as well as Karen and Brayden,(2014) assert that the widely divergent circumstances of regional economies and considerable variance in characteristics of individual loans are generally the basis for establishment of standard or universal lending policies. However, they all agree that there are identified general issues of concern that should be addressed in the lending policies of all financial institutions regardless of size and location.

These aspects include; the general fields of lending in which the bank will engage and the kinds of loans in each field; the guidelines on collateral of loans; the guidelines on interest rates to be charged by the bank, the loan limits in various types of loan fields, the credit terms as well as the authority levels of respective officers starting with the loan officers/relationship officers up to the Board of Directors in respect to loan approval powers. The study therefore attempted an investigation into the effect of Lending Policies on Loan Performance in Uganda using a case of Post Bank Uganda Limited

Figure 1: Conceptual framework



Source: Adopted from Russell (2012); Gupta and Sunman (2012) and Karen and Brayden (2014) and modified by the researcher.

The study was based on the conceptual framework above which provides the linkage between Lending Policies (independent variable) and Loan performance (dependent variable) as well as other factors (moderating factors). The researcher utilized policies from the Central Bank as the moderating variable for the study.

In here, the researcher was of the view that the central bank's policy on interest rates guided by the Central Bank Rate has an impact on the interest rates charged by Post bank which in turn influences the performance of its Loan portfolio by influencing both quality and quantity of the loan book. Similarly, the central bank has policy guidelines on collateral that may be accepted by banks as a shield against the risk of loan loss due to default. Therefore, Post bank would always draw its attention to such guidelines concerning collateral during the design of its collateral policies which in turn affects the performance of its loan book both in terms of quality and volume of the portfolio.

In the same way, the credit limit guidelines by the central bank would have a direct impact on the operations of Post bank regarding how much credit it can extend to a single client. For example according to Bank of Uganda, a lending institution may not extend more than 1% of its core capital to single borrower. This therefore affects the size of the portfolio that Post Bank attempts to achieve.

1.9 Definition of terms

1.9.1 Interest Rates

D'Alberto, (2015) describes interest rates as the cost of hiring money. Further, Keynes, (1973) looks at interest as the reward for not hoarding money while, (Wamabari, 2017) contends that interest rate variables include the minimum rediscount rate, lending rates, deposit rates, treasury

rates as well as interbank rates. He adds that in the normal practice of lending, commercial banks will either charge fixed interest rates, prime rates, variable rates as well as amortized rates and that each rate has its best product choice as well as some drawbacks to both the lender and the borrower.

1.9.2 Collateral

This refers to any asset that a bank wishes to take on as a security back up for the money lent out. Examples are Certificates of land titles, Motor vehicles and fixed deposit/ share certificates among others.

1.9.3 Credit Limits

This refers to the maximum amount of credit a financial institution or any other lender will extend to a debtor for a particular credit line.

1.9.4 Loan performance

Generally, Loan portfolio defines the total of all loans held by a commercial bank or a finance company. This is usually listed as an asset on the balance sheet of a lending entity and most importantly the major assets of banks or other lending institutions. The value of loan portfolio depends not only on the interest earned on loans but also on the quality (the likelihood) that both interest and principle will be repaid.

1.9.5 Portfolio at Risk

The loan portfolio at risk is defined as the value of the outstanding balance of all loans in arrears (principal). The Loan Portfolio at Risk is generally expressed as a percentage rate of the total loan portfolio currently outstanding, (Nkuah, 2015). Both in theory and practice, a declining ratio

of PAR is desirable but this should never emanate from increasing volumes of new credit amidst unrecovered existing NPLs and as such a health position should originate from recoveries of existing NPLs, (Kaggwa, 2013; Othieno, 2013; Nkuah, 2015)

1.9.6 Bad loans

Bad loans are those loans of the bank that remain outstanding in both principle and interest for a period longer than the terms and conditions specified in the loan contract, (Berger and Young, 1997; Basu, 1998 in Nkuah, 2015; Fofack, 2005). Conversely, the loans are classified as NPLs since they contravene the loan contract terms. NPLs can be described either qualitatively by basing on the information regarding a customer's financial status and management judgment about a customer's future repayments or quantitatively by analyzing the number of day by which payment of both principal and interest is overdue, (Bloem and Gorter, 2001 cited in Nkuah 2015).

1.10 Conclusion

In conclusion, the chapter has provided an insight on the background of the study by: stating the problem statement, the purpose of the study, the objectives of the study, the scope of the study and the conceptual framework which identified the dependent as well as the independent variable. This chapter thus provided grounds for reviewing existing literature in regard to the study objectives.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter offers an account for and a critical look at the existing published and/or unpublished facts that are significant to the problem the research attempts to investigate. It contains the theoretical framework about the problem, Conceptual framework, Actual literature review of literature on all the study objectives as well as a Summary of the literature reviewed.

2.1 Theoretical Framework

A survey of literature about the theories of credit assessment suggests that theories are commonly grouped according to the nature of relationship between the borrower and lender. This research particularly investigates three theories namely as portfolio theory, credit market theory and information theory.

2.1.1The Modern Portfolio Theory (MPT)

The theory was pioneered by Harry Markowitz in 1952 in his paper “portfolio selection,” that was publishing in journal of finance in the same year. According to this theory, it is possible to construct an efficient frontier of optimal portfolios offering maximum possible expected returns of a given level of risk. Thus the MPT is a theory on how risk- averse investors can construct portfolios to optimize expected returns based on a given level of market risk – emphasizing that risk is an inherent part of higher rewards. The MPT assumes that investors are risk averse and that their expected utility follow demonstrates diminishing marginal utility of wealth. Further still, the theory assumes that risk is estimated on the basis of variability of expected returns. It further assumes that investors are rational who prefer higher returns to lower risk and lower

returns for the same level of risk. The theory has been successfully applied since 1980s by financial institutions and other companies to address market risk. To date, many companies are using value at risk models to manage their interest rate and market risk exposures. However it is disturbing to note that while credit risk remains the largest risk facing most financial institutions, the practice of applying modern portfolio theory to credit risk has stagnated (Margrabe, 2007). Most successful banks recognize how credit concentrations can adversely affect financial performance and as a result, a number of institutions are actively pursuing quantitative approaches to credit risk measurement. The banking industry is also making significant progress toward developing tools that measure credit risk in a portfolio context. Further, Portfolio quality ratios and productivity indicators have been adapted (Kairu, 2009) and a combination of these developments has greatly accelerated progress in managing credit risk in a portfolio context.

It is also important to note FIs have taken an asset-by-asset approach to credit risk management and that while each organization's method varies, the approach in general involves periodically evaluating the quality of credit exposures, applying a credit risk rating, and aggregating the results of this analysis to identify a portfolio's expected losses, (Kairu, 2009). Therefore the foundation of the asset-by-asset approach is a sound credit review and internal credit risk rating system by enabling management to identify changes in individual credits, or portfolio trends in a timely manner. Based on the changes identified, credit identification, credit review, and credit risk rating system management is in position to make necessary modifications to portfolio strategies or increase the supervision of credits in a timely manner.

The theory however finds itself limited in a manner that while the asset-by-asset approach is a critical component to managing credit risk, it does not provide a complete view of portfolio credit risk in terms of the possibility that actual losses exceed expected losses and also because of its failure to identify and measure concentration risk. Therefore, to gain greater insight into credit risk, FIs increasingly look to complement the asset-by-asset approach with a quantitative portfolio review using a credit model (Mason and Roger, 1998).

2.1.2 Information Theory

Derban, Binner and Mullineux (2005) recommended that borrowers should be screened especially by banking institutions in form of credit assessment. Thus, collection of reliable information from prospective borrowers becomes critical in accomplishing effective screening as indicated by symmetric information theory.

Qualitative and quantitative techniques can be used in assessing the borrowers although one major challenge of using qualitative models is their subjective nature. However according to Derban et al (2005), borrowers attributes assessed through qualitative models can be assigned numbers with the sum of the values compared to a threshold. This technique minimizes processing costs, reduces subjective judgments and possible biases. The rating system becomes important if it indicates changes in expected level of loan loss. Brown (1998) concluded that quantitative models make it possible to numerically establish which factors are important in explaining default risk, evaluating the relative degree of importance of the factors, improving the pricing of default risk, screening out bad loan applicants and calculating any reserve needed to meet expected future loan losses.

A close look at the two theories indicates that the MPT comes out clearly on the constructs of developing a profitable portfolio but falls short on the key information needed to select the potential borrowers and as such this gap is addressed by the information theory. Therefore the study utilized all the two theories because of their ability to single out pertinent issues that are vital in performing the lending function by banks.

2.2 Overview of lending policies

According to Saurina (2005), lending policies relate to a lending institution's statement of philosophy, standards, and the guidelines that its employees must observe in granting or rejecting a loan request. Mukisa (2007) adds that loan committees need to take full responsibility of overseeing the loan acquisition process and report on the portfolio progress as a measure of careful monitoring of the loan portfolio performance in the bank.

Bank of Uganda has time and again issued policy guidelines with attention to general principles that are prepared for governing the implementation of more detailed lending procedures and practices within the banks. This is aimed at enabling banks achieve a health portfolio while maximizing their sales and satisfying customer interests, B.O.U (2015). As a result, it is mandatory for a bank to prepare Credit Policy Guidelines (CPG) for making investment and lending decisions and which reflect the banks' tolerance for credit risk. Prior to consent to a credit facility, the bank should make an assessment of risk profile of its customers, such as of their business, and which can be done through the credit procedure. Benedikt et al., (2007) studied the credit risk management policies for ten banks in the United States and found that advanced credit risk management techniques help the banks to achieve a better portfolio quality.

Further, Private Banks are more serious on implementing effective credit risk management practices than state owned banks. A study conducted by Kuo and Enders (2004) on credit risk

management policies for state banks in China found that given the mushrooming of the private FIs, the state owned commercial banks in China faced unprecedented challenges and tough competition with foreign banks unless they made some thoughtful changes. Among the thought after changes, the reform of credit risk management was deemed a major step in determining whether the state owned commercial banks in China would survive the challenges or not. However research disagrees with some of the credit risk management policies that are being propagated arguing that the broad framework and detailed guidance for credit risk assessment and management provided by the Basel New Capital Accord and widely followed internationally poses huge challenges to credit operations (Campbell, 2007). As a result a significant number of countries is contemplating suspending execution of Basel Accord or decide on simple approaches for determining credit risk (Campbell, 2007).

Chernykh and Theodossiou (2011) investigated the determinants of long-term lending by banks to firms in an emerging market using bank-level information from 881 banks in the former USSR. The variables of concern included bank size, capitalization, liability structure, risk taking, ownership type, managerial expertise and location of individual banks. The findings reveal that the size of the bank (measured by assets) and the bank capitalization are the only determinants of not only loans expended to businesses but also long-term loans. This is attributed to the fact that bigger and well capitalized banks can withstand the risks emanating from long-term lending. The study thus demonstrates that there are supply-side constraints to credit expansion, although it did not consider the role of collateral on bank lending levels.

Ewert et al. (2000) studied the determinants of bank lending performance in Germany using credit file information of 260 medium-sized firm borrowers for the period 1992-1998. The study aimed at testing the several theories relating collateral to interest rate premiums and therefore

lending performance, using a random effects model on panel data analysis to eliminate the borrower and time-specific effects. Two models were estimated with interest rate premiums and probability of distress as the two predicted variables. Interest rate premium was set to be predicted in a random effects model by collateral, bank relationships, bank firm rating, firm characteristic and firm size. The highlights of the study finding were that interest rate premium increased with rise in the collateral pledged. This was contrary to the signaling and firm characteristics theories above, where we would expect higher interest rate premium for firms pledging little or no collateral. However, estimation of distress probabilities of the same firms revealed that more collateral and covenant in credit contracts lead to lower distress probabilities. Combining the above results, the study gives controversial finding that riskier credit contracts are assigned lower interest rate premiums by banks.

2.2.1 Interest Rate Policy

According to Interest rate is the amount charged, expressed as a percentage of principal, by a lender to a borrower for the use of assets. Interest rates are typically noted on an annual basis, known as the annual percentage rate (APR). Consequently, interest rate policy refers to the guidelines that the lending institutions put in place to regulate the amount of interest chargeable as well the forms of calculating interest upon which the banks' products are priced. This could be in form of the flat rate, reducing balance approach, the variable interest rates as well as fixed interest rates among others.

Interest rate is main tool of monetary policy and an important macroeconomic variable, which is positively linked with country's economic growth. Commonly, interest rate is said to be the cost of capital which means the price paid for money used over a certain time period.

(Investopedia.com). Banks as financial intermediary play a vital role in operations of economic development and their efficiency can also influence the economic advancement. The financial services provided by banks are quite different from other financial institutions and in return banks charge interest. Relatedly, Depositors provide maximum amount of the funds and they receive interest in return.

Further still, according to the Keynesian economists, Interest margin is the excess of the interest earned to the interest paid. If banks' interest margin increases the banks are in direct benefits but it will have negative impact on the lenders and borrowers. Throughout the last decade increasing trend in interest margin has been observed, (Mwangi and Wambari, 2017). To this, Wambari cites Lack of desirable amount of the possible opportunities for financial institutions as a key factor that further aggravated the impact of spread.

It is important to note that changes in interest rate not only affect the cost of using money (cost of capital) as a result of the decision to invest but also influence the consumption level of an individual. When there is an increase in interest rates, it will affect the investment because the cost of capital will increase. On the contrary, when there is decrease in interest rate it will decrease the rates to depositors and suppress the savings. For this reason, serious repercussions are observed on the economy due to the interest rate changes (D' Alberto, 2015).

Unlike other institutions, banks responsiveness to the interest rate changes is quite large and the impact of changes in the interest rates on the profits of banks has remained a momentous issue. These realities provide an impetus to focus on the current situation of banks profitability. They exert great deal of influence on the efficient and effective handling of banks of their portfolios like assets and liabilities. They also influence the identification of unexplored areas where banks

can have possible opportunities to increase their profitability. Too much fluctuation in interest rate has a great impact on the economy as well as individual and corporate level decision making. The variation of interest rate has immense influence on savings and investments decisions, (D' Alberto, 2015;Mwangi&Wambari, 2017).

Khan and Sattar (2014) examined the impact of interest rate changes on the profitability of commercial banks operating in Pakistan during 2008-2012. According to study, for the couple of previous years interest rate spread is growing, by which savings and investment are discouraged and on the other hand it ensures the efficient bank lending. For the purpose of discovering the relationship between interest rate and profitability, they used Pearson Correlation method. In their study they took profitability as dependent variable and interest rate as independent variable. They individually analyzed the impact of interest increase and interest decrease on the bank's profitability. The results showed that interest rate and commercial bank's profitability are strongly and negatively correlated. The result differs from the literature review because there is huge banking spread in Pakistan which absorbs the changes in interest rates.

Therefore, while setting the interest rates policy; commercial banks put into account the CBR of the central bank and also the level of activity in the economy, the extent of competition within the banking industry and the extent of demand for credit products among others.

2.2.2 Collateral policy

It relates to the deliberate guidelines on property or other asset that a borrower offers as a way for a lender to secure the loan. If the borrower stops making the promised loan payments, the lender can seize the collateral to recoup its losses. A lender's claim to a borrower's collateral is

called a lien. The banks can take hold of certificates of land title, Motor vehicle Logbooks, land sales agreements as well as household chattels among others.

Collateral usually represents the ability of the borrower to pledge specific assets to secure a loan. According to the provisions of Central Bank, all loans offered by banks must be secured to protect the customer deposits against the risk of loss by defaulting borrowers. As a result, the Mortgage Act of 2012 as well as the Bank of Uganda guidelines on collateralization of loans empowers the respective lenders to seize and sell off assets pledged as securities for recovery of loans in the event of default. The value of the security should be ascertained and title documents charged to the loan which should not exceed 2/3 of the value of the securities.

Capital or the money personally invested into the business by the loanee and is an indication of how much the borrower has at risk should the business fail. Other forms of collateral that may be accepted are Certificates of title, motor vehicle logbooks, Household chattels, fixed deposits, personal guarantees and letters of undertaking in the case of loans granted to salaried employees. Interested lenders and investors will expect the loanee to have contributed from their own assets and to have undertaken personal financial risk to establish the business before advancing any credit (George and Simonson, 2000 cited in Owino, 2013).

Assessing the collateral of the borrower usually is embedded in the credit appraisal process of the bank which pays vast attention to the 5Cs of credit namely Character, capacity, capital collateral and conditions. The purpose of credit analysis is to assess the likelihood that a borrower will default on a given loan. Credit analysis consists of evaluating a borrower's needs and financial conditions which includes: Character or the person's traits such as honesty, ethical

considerations, integrity among others. This is usually based on the borrower's past behavior in both banking and repayments of loans borrowed earlier.

Similarly, capacity of the borrower focuses on whether the borrower has the ability to generate sufficient funds to liquidate the loan and still stay financially healthy. This will include assessing the manager's ability, policy documents of the firm, investment policies, strategic plans, credit statements, etc. as well as judge the market potential of the institution. The judgment should be both on liquidity as well as solvency of the institution

2.2.3 Credit Limits Policy

A credit limit is the maximum amount of credit that a financial institution or other lender will extend to a debtor for a particular line of credit (sometimes called a credit line, line of credit, or a trade line. Conversely, credit limits policy is a set of guidelines that are used to determine which customers are extended credit and billed, sets the payment terms for parties to whom credit is extended, defines the limits to be set on outstanding credit accounts and also outlines the steps or procedures used to deal with delinquent accounts.

Usually the credit limit guidelines by the central bank will have a direct impact on the operations of Post bank regarding how much credit it can extend to a single client. For example according to Bank of Uganda, a lending institution may not extend more than 25% of its core capital to single borrower, (Bank of Uganda Statutory Instrument No. 44 of 2005). This therefore will affect the size of the portfolio that Post Bank attempts to achieve.

Wozniak et al (2014) argue that banks use various credit risk management methods such as credit limits, taking collateral, diversification, loan selling, syndicated loans, credit insurance, and securitization and credit derivatives.

According to Tetteh (2012), sound credit-giving is one of the most essential principles which strengthen financial institutions in their financial standing. This researcher stressed that, sound credit giving establishes credit limits as well as develop credit granting process for approving new credits. Credit plays a very vital part in the economic growth and development of a country. These roles credit plays can be categorized into two: it enables the transfer of funds to where it will be most effectively and efficiently used and secondly, credit economizes the use of currency or coin money as granting of credit has a multiplier effect on the volume of currency or coin in circulation (Nwanna and Oguezie, 2017). According to Pasha and Mintesinot, (2017) credit management means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. Sahlemichael (2009) notes that, in banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, and recovery of non-performing loans

2.3 Overview of Loan Performance

Comptroller's hand book, (1998:6) defines a Non – performing loan (NPL) as a loan that is in default or close to being in default. Greenidge and Grosvenor (2010) further stress that many loans become default after 90 days although this depends on the contract terms of the facility. William, *et al* (2016) further consents that the value of a loan portfolio depends not only on the interest rates earned on the loans, but also on the quality or like hood that interest and principal will be paid. Therefore effective management of the loan portfolio and the credit function is

fundamental to a bank's safety and soundness. Loan portfolio management (LPM) is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the LPM process is so important, it is a primary supervisory activity. Assessing LPM involves evaluating the steps bank management takes to identify and control risk throughout the credit process. The assessment focuses on what management does to identify issues before they become problems. This is because the identification and management of risk among groups of loans is equally important as is the risk inherent in individual loans (Chodechai, 2004).

For decades, good loan portfolio managers have concentrated most of their effort on prudently approving loans and carefully monitoring loan performance. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, such as those associated with agricultural lending as well as commercial real estate lending in the has made it clear that portfolio managers should do more.

Traditional practices rely too much on trailing indicators of credit quality such as delinquency, non-accrual, and risk rating trends. On a contrary these indicators do not provide sufficient lead time for corrective action when there is a systemic increase in risk (Sanchez, 2009).

Effective loan portfolio management begins with oversight of the risk in individual loans implying that prudent risk selection is vital to maintaining favorable loan quality. As a result, the historical emphasis on controlling the quality of individual loan approvals and managing the Loan performance continues to be essential. This task gets even better since technology and information systems have opened the door to better management methods since technology enables portfolio managers to obtain early indications of increasing risk by taking a more comprehensive view of the loan portfolio, Hirtle (2008).

Therefore, to manage their portfolios, bankers must understand not only the risk posed by each credit but also how the risks of individual loans and portfolios are interrelated. These interrelationships can multiply risk many times beyond what it would be if the risks were not related. It's important to note until recently, few banks used modern portfolio management concepts to control credit risk. However, many banks now view the loan portfolio in its segments and as a whole and consider the relationships among portfolio segments as well as among loans since the practices provide management with a more complete picture of the bank's credit risk profile and with more tools to analyze and control the risk, Gonzalez (2010).

2.3.1 Portfolio at Risk

Loan portfolio at risk is a measure of the proportion of overdue loans in the gross loans portfolio outstanding at any particular time, (Nkuah, 2015). Both in theory and practice, a declining ratio of PAR is desirable but this should never emanate from increasing volumes of new credit amidst unrecovered existing NPLs and as such a health position should originate from recoveries of existing NPLs, (Kaggwa, 2013; Othieno, 2013; Nkuah, 2015).

The value of a loan portfolio depends not only on the interest rates earned on the loans, but also on the quality or likelihood that interest and principal will be repaid. One of the principal activities of commercial banks is to grant loans to borrowers. Loans are among the highest yielding assets a bank can add to its balance sheet, and they provide the largest portion of operating revenue.

In this respect, the banks are faced with liquidity risk since loans are advanced from funds deposited by customers. Hamisu, (2011) notes that credit creation involves huge risks to both the lender and the borrower. The risk of the counterparty not fulfilling his or her obligation as per the

contract on due date or anytime can greatly jeopardize the smooth functioning of bank's business. On the other hand, a bank with high credit risk has high bankruptcy risk that puts depositors' funds in jeopardy.

In a particular study, Owojori et al., (2011) highlighted that available statistics from liquidated banks in Nigeria clearly showed that inability to collect loans and advances extended to customers was a major contributor to the distress of liquidated banks

At the height of the distress in 1995, when 60 out of the 115 operating banks were distressed, the ratio of the distressed bank's non-performing loans and leases to their total loans and leases was 67%. The ratio deteriorated to 79% in 1996; to 82% in 1997; and by December 2002, the licenses of 35 of the distressed banks had been revoked. At the time, the banking licenses were revoked, some of the banks had ratios of performing loans that were less than 10% of loan portfolios (Hamisu, 2011)

2.3.2 Volume of written off loans

This represents the sum total of all irrecoverable loans that the banks register in the loan book. When written off, such become expenses to the bank and trade by reducing the bank profits.

Usually, banks write off bad debts that are declared non collectable (such as a loan on a defunct business, or a credit card due that is in default), removing them completely from their balance sheets which affects the overall profits. When recovered, such amounts are treated as miscellaneous incomes.

Bad loans can be restricted by ensuring that loans are made to only borrowers who are likely to be able to repay, and who are unlikely to become insolvent. Credit analysis of potential

borrowers should be carried out in order to judge the credit risk with the borrower and to reach a lending decision. Loan repayments should be monitored and whenever a customer defaults action should be taken. Thus banks should avoid loans to risky customers, monitor loan repayments and renegotiate loans when customers get into difficulties (Kay Associates Limited, 2005 cited in Nkuah, 2013).

2.3.3 Provisions for bad debts

The provision for doubtful debts is the estimated amount of bad debt that will arise from accounts receivable that have been issued but not yet collected. It is identical to the allowance for doubtful accounts. Usually provisions increase the cost of doing business and eventually result into bad debts written off.

Historically, the emergence of receivables is associated with the development of commercial lending caused by a lack of available cash assets. To increase the company's revenues the enterprises were forced to ship the products on the transfer conditions of payment at a later date "on the pledge of the word" of the buyer. However, this situation can lead to the occurrence of the so-called "bad" debtors causing doubt about the repayment of their debts, (Guaya et al., 2010; Peechera et al., 2013).

For these purposes the allowances of doubtful debts is established for reducing of the amount of receivables reflected in the financial statements (Dosamantes, 2013). However, at present there are no specific methods of the said allowance formation in the existing laws and regulations on accounting. The idea of an allowance for doubtful debts formation came first to the bankers. Thus, part of the Bank Medici policy which was one of the oldest Florentine banks operating in

the XII-XIV centuries, was the establishing of such allowances to act as preceding distribution of profits. The idea of the allowance creating was implemented in other countries. Thus, J. Peel in the book "Paths to Perfection" published in England in 1569 suggested separating the doubtful debts of the debtors in the accounting, so that the owner could know about it (Kovalev and Kovalev, 2009).

At present, in accordance with international financial reporting standards receivables are treated as a financial asset (Zhang, 2008; Nobesa and Stadler, 2013). Under the IAS 39, each financial asset is subject to impairment test, which is related to the excess of the carrying value of the asset over its estimated recoverable amount. As of the reporting date the company should assess the evidence of the objective data for possible impairment of the financial asset (Beauchamp and Hurt, 2008).

The identified probable failure to obtain the principal debt and the interest by the receivable necessitates the calculation of allowances for the impairment. The allowance volume reduces the carrying amount of the financial asset to its estimated recoverable amount (Loboc et al., 2009). Thus, international standards oblige organizations to form an allowance for doubtful debts in the event of any impairment indications (Bushman and Williams, 2012). In this case, the allowance is formed basing on operational data of debts payment, as well as on the basis of: the probability of the debt recovery; repayment of the past debts depending on the term of the debt; possibility of repayment judging from the data of the client (Kulikova and Goshunova, 2014).

Relatedly, US accounting standards (US GAAP) stipulate basically two methods of determining doubtful debts during the reporting period for calculation of the cost value for bad debts:

percentage of net sales method and accounts receivable aging method. According to the second method the accountancy department fulfills ranking of accounts by terms of their repayment, each group of accounts is determined by the forecasted percentage of doubtful debts. This approach helps the management of the company to determine the policies of the loan provision and all settlement operations (Kulikova and Gafieva, 2014).

2.4 Interest rates policy and Loan Performance

According to Devereux and Yetman (2002), an interest rate refers to the price a borrower pays for the use of money he acquires from a lender to compensate him for the sacrifices the lender makes in deferring his consumption by lending to the borrower. Interest is usually expressed as a percentage of the principle taken over the period of one year, Devereux and Yetman (2002) and important to note is that lending interest rates often change as a result of the inflation and Government policies through the Central bank. Further, the Central Bank uses interest rates as tool keep an eye on any major currency fluctuation. An increase in lending rates is necessary to stabilize the exchange rate depreciation and to curb the inflationary pressure which in turn helps to avoid many adverse economic consequences.

Prior to the implementation of the Structural Adjustment programme (SAP) in 1987, IMF guidelines of 1997 as well as the liberalization of the banking sector, the financial sector in Uganda suffered from severe repression. Lending rates were maintained below the market rates and direct control of credit was the primary monetary control instrument of the authorities, World Bank (2007). As a result uncompetitive banking systems, inadequate regulatory framework and borrowers that are insensitive to interest rates undermined the efficiency of market based credit allocation.

It is widely believed that fluctuations of market lending rates have a significant influence on the performance of commercial banks. According to Samuelson(1945) and B.O.U(2013), under general conditions, bank profits increase with rising lending rates .B.O.U further argues that the banking system as a whole is immeasurably helped rather than hindered by an increase in interest rates citing the period 2010 – 2012 when banks registered abnormal profits due to rise in interest rates. A more accurate measurement of how fluctuations in market interest rates affect banking firms largely depends on the sensitivity of banks' assets and liabilities. When interest rates fluctuate as result of changes in monetary policy or general economic conditions, commercial banks usually encounter a comparative change in the rate of return they earn on their assets. This occurs because banks hold many assets of relatively short maturity and the rates booked on short period loans fluctuate quickly when lending rates fluctuate. Unfortunately, continuously increasing interest rates are likely to trigger high default rates as the volume of economic activity slows down resulting from constrained purchasing power of the masses in an economy.

Further, Banks' investment portfolio components such as mortgage rates, business term loans, rates on bank credit card loans, and real estate rates encounter rapidly falling yields when lending interest rates decrease. Consequently, even the longer period components of a bank's assets portfolio are susceptible to yield declines when market rates fall, although their yields fall more gradually than short period yields. In the short run, however, as general market lending rates descend, the market value of longer assets with fixed contractual terms will rise.

2.5 Collateral Policies and Performance of Loans

According to William, Michael, Joost and Tavneet (2016), collateral is any tangible and valuable asset that a borrower can surrender to the lender as a backup in exchange of a loan. Financial institutions usually require their borrowers to deposit with valuable properties such as certificates of land titles, Motor vehicles as well share certificates prior to the advancement of credit to them.

While FIs often portray their loans as being for investment, there has been debate about the extent to which they actually are used for investment as opposed for financing consumption Banerjee et al, (2015). Asset-collateralized loans might potentially be more likely to flow towards investment, since lenders making collateralized loans presumably have stronger incentives to ensure that borrowers actually obtain the assets than lenders making un-collateralized loans. Some institutions go ahead to finance assets as collateral for their borrowers such as Motorcycles, Motor vehicles and even mortgages since lack of collateral for loans affects greatly credit uptake especially in developing countries.

A study by Ewert et al. (2000) was conducted on the determinants of bank lending performance in Germany using credit file information of 260 medium-sized firm borrowers for the period 1992-1998. The study aimed at testing the several theories relating collateral to interest rate premiums and therefore lending performance, using a random effects model on panel data analysis to eliminate the borrower and time-specific effects. Two models were estimated with interest rate premiums and probability of distress as the two predicted variables. Interest rate premium was set to be predicted in a random effects model by collateral, bank relationships, bank firm rating, firm characteristic and firm size. The highlights of the study finding were that interest rate premium increased with rise in the collateral pledged. This was contrary to the signaling and firm characteristics theories above, where we would expect higher interest rate

premium for firms pledging little or no collateral. However, estimation of distress probabilities of the same firms revealed that more collateral and covenant in credit contracts lead to lower distress probabilities. Combining the above results, the study gives controversial finding that riskier credit contracts are assigned lower interest rate premiums by banks.

Further evidence by B.O.U (2015) revealed that the default increased with unsecured loans over the years as compared to fully secured facilities. Overall, the sector registered a 3.5% growth in loan volume between 2012 and 2015 while portfolio quality declined over the same period. Between 2014 and 2015 alone, non – performing loans grew from UGX 389billion to UGX 574 billion, (B.O.U, (2015).

2.6 Credit limits policy and Performance of loans

For the mitigation and hence avoidance of credit concentration risk, Bank of Uganda continuously has put policies in place barring institutions against lending more than 25% of their core capital to a single borrower(Bank of Uganda Statutory Instrument No. 44 of 2005). This policy calls for both portfolio and risk diversification so that the total loan book is spread across various segments of the market. According to B.O.U (2015), the risk of credit loss increased significantly with very micro loans and also with selected macro loans while on average the SME loans performed well via repayments.

Aside from regulation, the banks internally have policies on loan approval processes and the approval limits. However, bureaucratic loan processes and policy limitations as well high degree of risk aversion negatively affect both portfolio quality and quantity. Ledgerwood (1999) stresses that, responsive and non-bureaucratic approaches throughout the loan process impacts on customer loyalty and respect of their obligations with the financier. She gives an example of the

Grameen bank in Bangladesh to explain her argument urging that the bank is well known throughout the village population for her swift loan processes. As a result the bank has registered numerous achievements and a large quality portfolio, she explains. For this reason, other microfinance institutions have adopted the Grameen lending model. Brown and Reilly (2009) argue that most managers are risk averse which affects their lending decisions

2.7 Summary of the Literature Review

Going by the literature reviewed, it is clear that numerous research works have been done so as to come up with various determinants that affect the portfolio quality of commercial banks and hence their profitability across the world. Most studies conducted have studied overall banks financial performances in general and no study has particularly focused on lending policies and Non – Performing Loans in Uganda at large and Post Bank in particular. Still no satisfactory inquiry has been carried out particularly pegging interest rates and performance of loans, collateral and Loan performance as well as credit limits and loan performance. This study therefore investigated lending policies and Loan performance in Ugandan commercial banks taking Post Bank Uganda as the case study with a goal of investigating the relationship between the two prime variables of the study.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter describes the research methodology that was employed during the execution of study to guide achievement of the study objectives by clearly elaborating on the various phases that were followed in completing the study. The chapter thus describes the research design, study area, the target population, sample size and sampling procedure, data collection and underlying tools to be used, data analysis tools as well as the validity and reliability of the data collection tools, ethical considerations as well as the limitations to the study.

3.1 Research Design

The study employed a descriptive survey design. According to Polit and Beck (2003), descriptive researches are those studies which are concerned with describing the characteristics of a particular individual, or of a group or the frequency with which certain phenomena occur. The design was chosen because of its ability to address the objective of the study in investigating the relationship between the variables of the study. The design takes into consideration aspects like the size of sample in relation to the target population, the variables under the study, the approaches to the research, and the methods employed in data collection.

Relatedly, the study adopted both quantitative and qualitative research approaches. The quantitative approach was used to numerical facts about the case being investigated while the qualitative approach was employed to attach means and digest the views emanating from the quantitative approach.

3.2 Study area

The study was carried out Post Bank Uganda limited situated on Plot 4 – 6 Nkrumah Road, P.O.BOX, 7189. Started around 1998, the bank has 41 fixed branches spread across Uganda with 10 branches located in Kampala and also boasts of 17 mobile banking branches that were designed with an aim of harnessing financial inclusion in the country. In particular however, attention was paid to Kampala based branches for convenience in data collection.

3.3 Target Population

According to Ngechu (2004), a population is a well-defined set of people, services, elements, and events, group of things or households that are being investigated. The target population of the study therefore comprised of all the credit staff under the banks credit department, internal audit staff, risk and compliance staff as well as branch managers across the banks' network. This target population was believed to have significant interaction with the lending policies of the bank since such policies define the core operations of the aforementioned staff. The Human Resource report of 2017 indicated that the 41 branch managers, 41 credit supervisors, 140 credit officers, 5 credit managers, 9 credit analysts, 5 recovery officers, 4 risk officers as well as 7 staff in the internal audit department making a total of 254 target respondents. However, going by the Kampala based branches, the study targeted a population of 100 members of staff who are associated with credit risk in their operations as summarized in table 3.1

Table 3.1: Study Population

S/N	Category	Population (N)
1	Branch Managers	8
2	Credit Supervisors	8
3	Credit Officers	60
4	Credit Analysts	4
5	Recovery officers	4
6	Internal Audit staff	6
7	Credit Managers	5
8	Risk Officers	5
	Total	100

Source: HR Records (2018)

3.4 Sample Size and Selection

The study utilized a sample size of 80 respondents who were drawn from a population of 100 staff members in the various units associated with credit risk at Post Bank in Kampala district. The sample size was based on Morgan and Krejcie (1970) Tables for sample size determination. Thus with a population of 100 staff, a sample of 80 is sufficient to yield objective representation of the study population.

Table 3.2 Sample size determination

S/N	Category	Population (N)	Sample(n)	Sampling Method
1	Branch Managers	8	7	Purposive sampling
2	Credit Supervisors	8	5	Purposive sampling
3	Credit Officers	60	48	Random Sampling
4	Credit Analysts	4	4	Random Sampling
5	Recovery officers	4	3	Random Sampling
6	Internal Audit staff	6	5	Random Sampling
7	Credit Managers	5	4	Purposive Sampling
8	Risk Officers	5	4	Purposive Sampling
	Total	100	80	

Basing on the contents of table 3.2, out of the 100 respondents as the target population, 80 respondents were picked for the study as indicated. The sample size corresponding to each target population was determined using the following formula below.

$$\text{Sample size} = \frac{\text{target population in each category of the population}}{\text{Total target population}} \times \text{total sample size}$$

3.4.1 Sampling Techniques

The 80 respondents were selected using a two stage sampling approach when purposive sampling was used in singling out Kampala branches and other units to be included in the study. This was because these branches offer convenience with regards to data collection. Random sampling was then applied to the staff in the respective branches and other departments/units of the bank associated with credit risk so as to arrive at the preferred sample size.

3.5 Data Collection Sources

3.5.1 Primary data

Kothari (2004) describes primary data as those which are collected afresh and for the first time, and thus happen to be original in character. Morrison et al. (2007) adds that primary data are those items that are original to the problem under study. Primary data was collected from the defined sample sizes.

3.5.2 Secondary data

Secondary data is the data that have been already collected by and readily available from other sources (Morrison et al., 2007). Secondary data was obtained from the financial reports of the

bank for the period under review, annual supervisory reports of B.O.U, and financial journals as wells library searches. This was achieved generally through literature review.

3.6 Data Collection Tools

3.6.1 Self-Administered Questionnaires (SAQs)

Quantitative data was collected with help of SAQs that were distributed to the 77 selected respondents who were chosen through both random sampling and purposive sampling techniques. This instrument was chosen due to its ability to collect a large volume of data from reasonably a large sample in a short time period in an efficient manner. Thus structured/close ended questions were drafted in the questionnaires aimed at obtaining specific responses from the respondents.

3.6.2 Interview Guide

Qualitative data aimed at obtaining a more explained view on the situation surrounding Loan performance at Post Bank was sought from the 2 heads of departments and one senior manager using an Interview guide. The participants were believed to have a comprehensive understanding of both the key lending policies employed by the bank as well as the extent of loan performance at Post Bank for the period under review. Similarly, an interview guide was deemed relevant for the current purpose of the study given its ability to collect information that digs deep into the problem being investigated.

3.7 Measurement of the study variables

The researcher employed a Likert scale to assess the different attributes in the data collection tools. A scale of 1 to 5 was used where **1 represents strongly disagree, 2 = Disagree, 3 =**

Neutral, 4 = Agree while 5 = Strongly Agree. Similarly, regression analysis was used in finding out whether a control variable predicts a given dependent variable and hence determines the relative importance of each control variable in influencing the dependent variable. For this reason, a regression analysis model below applied;

$$Y = A + B_1X_1 + B_2X_2 + B_3X_3 + \varepsilon, \text{ where,}$$

Y = Volume of nonperforming loans in post bank in a particular period

X_1 = Lending Interest Rate –This is measured as the rate charged by banks on loans to prime customers.

X_2 = collateral mortgaged to secure a loan – This is measured by dividing the total debt by the total value collateral.

X_3 = Credit limits in the bank – This is measured as the loan sizes approved by the various levels of authority

A = value of the intercept

B_i = the coefficient of the explanatory variables which measures the sensitivity of Y changes in i

ε = Error term

3.8 Quality Control

3.8.1 Reliability of the Research Tools

The reliability of the data was ensured through testing the data collection instrument for the reliability of values (Alpha values) for each variable under study as recommended by (Cronbach, 1946). Further, Sekaran, (2003) suggested that Alpha values for each variable under study should not be less than 0.7 for the statements in the instruments to be deemed reliable.

Consequently, all the statements under each variable were subjected to this test and only those proven to be above 0.7 were included.

Table 3.3: Reliability of the data tools

No.	Variable	Number of items	Cronbach Alpha(α)
1	Interest rates policy	10	0.901
2	Collateral Policy	10	0.861
3	Credit Limits Policy	07	0.819
4	Loan Performance	11	0.765

Source: Primary data (2019)

3.8.2 Validity of the instruments

On the other, the validity of the data collection instruments was done with the help of experts to edit the questionnaire. The researcher forwarded the structured questionnaire to the supervisors for reviewing and fine tuning to ensure that the key aspects concerning the study variables are captured. Thus the researcher used the formula below to compute content validity index;

$$\text{Content validity index (CVI)} = \frac{\text{No. of items declared valid}}{\text{Total No. of items in the instrument}} = 32/37 = \mathbf{86.9\%}$$

The results of the CVI agree with Amin (2005) who observed that if the overall Content Validity Index of the instrument is greater or equal to 0.7, then the instrument was accepted as valid.

3.9 Data Management and Processing

The research process started by the researcher obtaining a letter of introduction from the Faculty of Business Administration and Management at Uganda Martyrs University which was presented to the authorities at Post Bank for permission to collect data. Following sanctioning by the bank, the researcher took questionnaires to the respondents to collect relevant data. Upon retrieval,

each questionnaire returned was checked for completeness and thereafter assigned an identification number to ease tracking of the respondents' views during data entry. All items were assigned numerical codes that were used to enter data into the entry and processing software.

3.10 Data analysis and presentation

3.10.1 Quantitative data Analysis

Quantitative data was entered and analyzed using Statistical Package for Social Scientists (SPSS) software and presented in frequency Tables, graphs and charts as well as descriptive statistics tables. Linear regression was utilized in determining the effect of Lending policies on Loan performance. The results obtained and the corresponding models are presented in Chapter 4 to aid in the analysis after which the inferential statistics were drawn.

3.10.2 Qualitative Data Analysis

Qualitative data was analyzed through the thematic approach. The researcher then consolidated the outcomes of quantitative data with qualitative data analysis to ensure more elaborate meaning is drawn from the findings.

3.11 Ethical Considerations

According to Resnik (2011), there are several reasons for the adhering to ethical norms in research. Norms promote the aims of research, such as knowledge, falsifying or misrepresenting research data, promote the truth and avoid error. The following issues were considered; the process commenced by the researcher obtaining a letter of introduction from the School of Postgraduate Studies of UMU which was consequently presented to the authorities at Postbank

for permission to conduct the study at the institution. Upon clearance, the researcher delivered questionnaires to the respondents to collect relevant data for the study purpose. Upon retrieval, each questionnaire returned was checked for completeness and thereafter assigned an identification number to ease tracking the respondents' views during data entry.

The respondents made their decisions to participate based on their adequate knowledge of study. The researcher sought an informed consent to carry out the study from all the respondents. As a primary goal of ethics in research, the researcher ensured that no one is harmed or faces adverse consequences from research activities. Secrecy was observed. The researcher observed extreme confidentiality while handling information from respondents. The researcher undertook the following to avoid infringement on the rights of respondents by ensuring that participants are selected without bias, informing the respondents about the rationale of the research, informing the participants that consent is sought from the management of the bank before commencement of this study and assuring respondents that their names would not appear in the report.

3.12 Limitations of the Study

This study had the following limitations;

- a) The researcher found a host of challenges in obtaining responses for the study participants owing to their busy working schedule as well as hesitation to provide feedback. This was however overcome by building rapport and defining flexible schedules for obtaining the desired information.

b) Study area

The study was limited to lending policies and Loan Performance at Postbank Uganda limited and as such other banks and financial institutions are left out. Thus investigations into other classifications of institutions such as commercial banks and Microfinance institutions may yield seemingly different results because of the various differences in executing the credit function.

c) Choice of the variables (dimensions)

Further, the study conceptualized lending policies to only mean policy on collateral, policy on interest rates and policy on credit limits. However, there are other key considerations that influence the lending at the bank. On the other hand, loan performance was only limited to Value of written off loans, Provision for bad debts as well as portfolio at Risk

3.13 Conclusion

The research followed a descriptive survey design employing both qualitative and quantitative approaches and covered a target population of 100 staff members in Post Bank's Kampala based branches from whom a sample of 80 was drawn. Sampling techniques were a combination of purposive sampling as well as random sampling. SAQs and Interview guides were employed as data collection tools whose reliability and validity was ensured through the pretesting approach. Data entry, analysis and presentation were done through SPSS and Excel as well as tables and graphs. The entire process of data collection commenced only after the researcher had been cleared by the Uganda Martyrs University and consequently by the respective authorities at Post Bank Uganda Limited.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS

4.0 Introduction

The chapter presents study findings as generated from the field under the themes/objectives that guide the study as well as a summary of the basic characteristics of the study respondents. Similarly, the chapter also presents an analysis and discussion of the study findings with a view of farming a basis for conclusions as well as formulating salient recommendations that would drive the banking industry to greater heights. The study investigated the effect of lending policies on loan portfolio performance at Post Bank Uganda Limited under three study objectives namely; i) To examine the effect of interest rates Policy on Loan performance in Post bank Uganda; ii) To examine the effect of Credit limits policy on Loan Performance in Post Bank Uganda as well as iii) To assess the effect of Collateral policies on Loan Performance in Post Bank Uganda. Employing a sample of 80 respondents drawn from the bank's credit risk associated departments; the findings are as presented in the subsequent subsections of this chapter below.

4.1 Response Rate

The study sought to collect data from a sample of 80 respondents who were bank employees and subsequently administered a total of 80 questionnaires. However a total of 74 questionnaires were received back as fully/completely answered by the respondents indicating a response rate of 92.5% (74/80). This is deemed sufficient response according to Mugenda and Mugenda (2003) who posit that a response rate of 60% or more is adequate for paper based questionnaires.

The findings are also in agreement with Babbie (2004) submitting that return rates of at least 60% are acceptable to analyze and publish the findings from a particular inquiry.

4.2 Basic Characteristics of Respondents

The study examined various characteristics of respondents with intent of establishing how such characteristics affect the main variables of the study. In particular, the study examined gender, age, level of education, position held at the bank, department of the respondent as well as the years a particular staff has been in the service of post bank and the findings from them are presented hereunder.

4.2.1: Gender of Respondents

The findings in Table 4.1 indicate that majority of the respondents (58.1%) were males while 41.9% were females. This could be attributed to Post Bank Uganda employing more male than females in her credit related operations aimed at achieving better levels of loan portfolio performance. This may be due to the fact that males are very aggressive than women and can also work for extended hours as opposed to female officers.

Table 4.1 Gender of respondents

	Frequency	Percent (%)
Male	43	58.1
Female	31	41.9
Total	74	100.0

Source: Primary data (2019)

The results are also presented on figure 2 below to provide visual basis interpretation.

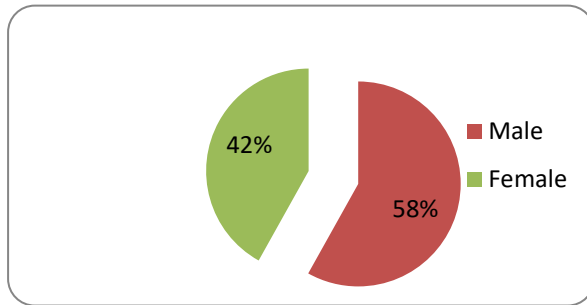


Figure 2: Gender of respondents

4.2.2 Age of Respondents

Regarding the age of respondents, the study findings contained in Table 4.2 indicate that majority of the respondents (50%) were aged between 25 – 34 followed by those aged between 35 – 44 with 36.5% while those below 25 years trailed with 13.5% and that there were no respondents aged above 44 years. The results indicate that the bank employs physically competent and well matured staff capable of making the right decisions which can foster a better quality of its loan portfolio. It may also imply that by the bank rarely employing employees above 44 years is to have a more energetic labor force

Table 4.2 : Age of respondents

	Frequency	Percent (%)
Less than 25	10	14.0
25 – 34	37	50.0
35-44	27	36.0
Total	74	100.0

Source: Primary data (2019)

For visual interpretation, the researcher went ahead to present the results of Table 4.2 on the Figure 3 below to help those readers who may have challenges interpreting the data contained in the above table.

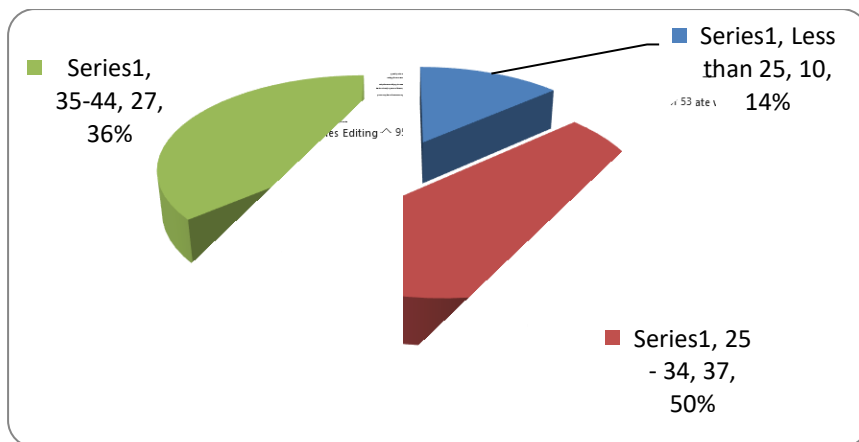


Figure 3: Age of respondents

4.2.3 Academic Qualifications of respondents

The results contained in Table 4.3 indicate that majority (92%) of the employees of the bank are graduates with 77% having only a bachelor's degree with 15% have advanced up a master's degree. On the other hand, only 8% hold diplomas and there were no staff with PhDs other qualifications. The results indicate that employees of the bank have the desired academic training which is sufficient in guiding the roles as regards the lending function for improved loan performance.

Table 4.3: Academic qualifications of respondents

	Frequency	Percent
Diploma	6	8.1
Bachelor's Degree	57	77.0
Master's Degree	11	14.9
Total	74	100.0

Source: Primary Data (2019)

In a similar manner, the above results are presented in Figure 4 below so as to aid visual basic analysis so that even those who have hardships in understanding numbers can make sense of figures.

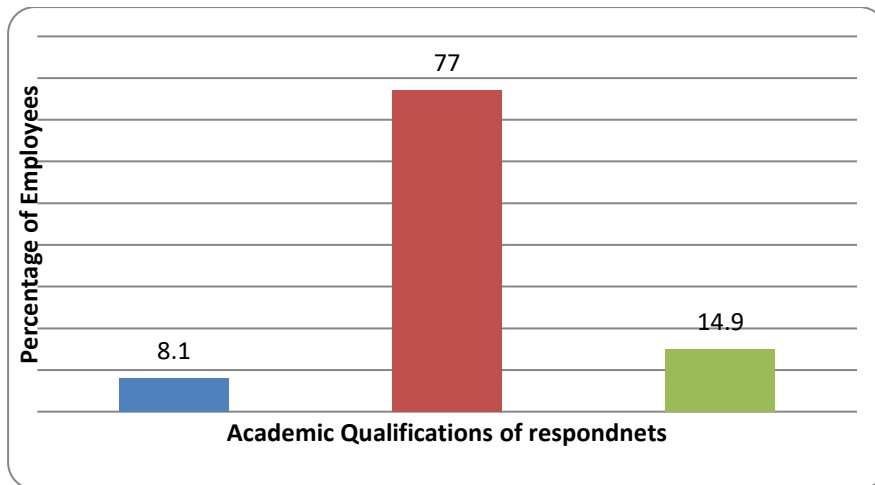


Figure 4: Academic Qualifications of Respondents

4.2.4 Position held by employees at the Bank

The results contained in table 4.4 indicate that majority of the employees (62.2%) were credit officers followed by 8.1% who were Branch managers. These were followed by credit managers who were 6.8%, Credit managers and Risk Officers followed with 5.4% each while credit analysts, recovery officers and Internal Auditors came last with 4.1% each. The findings indicate that the respondents to the questionnaires were those with adequate knowledge about the lending activities of the bank and hence any decisions made by such staff are construed to mean decisions reached by well-informed teams and as such very few errors are expected.

Table 4.4: Position held at Bank

	Frequency	Percent (%)
Credit Officer	46	62.2
Risk Officer	4	5.4
Credit Analyst	3	4.1
Recovery Officer	3	4.1
Credit Manager	4	5.4
Credit Supervisor	5	6.8
Internal Auditor	3	4.1
Branch Manager	6	8.1
Total	74	100.0

Source: Primary data (2019)

4.2.5 Department of the Respondents

The results of Table 4.5 reveal that majority (74.3 %) of the respondents belonged to the credit department followed by 13.5% who were from the risk and compliance department then 8.1% from Operations and 4.1% who were from Internal Audit Department. This probably implies that the participants to the study were those with requisite knowledge and information as well as competence to drive the lending function of the bank so as to propel better Loan performance.

Table 4.5: Department of the Respondent

	Frequency	Percent (%)
Credit Department	55	74.3
Risk and Compliance	10	13.5
Internal Audit	3	4.1
Operations	6	8.1
Total	74	100.0

Source: Primary data (2019)

4.2.6 Working experience

Regarding the working experience of respondents, the results reveal that majority of the employees (44.6%) have worked with Post Bank for 5(five) years and below followed by 43.2% who have worked 6 to 10 years while 12.2% have been in the service of the bank for more than 10 years as presented in Table 4.6 below. The results point to relatively lower staff turnover at the bank and also the fact that staff continues gaining consistence in the way they execute their activities since they are now well oriented to the environment, have a clear understanding of the bank's objectives and core values and hence they can effectively make well researched and informed decisions to guide the lending function and propel better levels of loan performance.

Table 4.6: Working experience at the bank

	Frequency	Percent (%)
1 - 5 years	33	45.0
6 -10 Years	32	43.0
11 - 15 years	9	12.0
Total	74	100.0

Source: Primary data (2019)

The researcher also presented the same contents of Table 4.6 on figure 4.5 below to aid visual basic interpretation and hence make sense of the data.

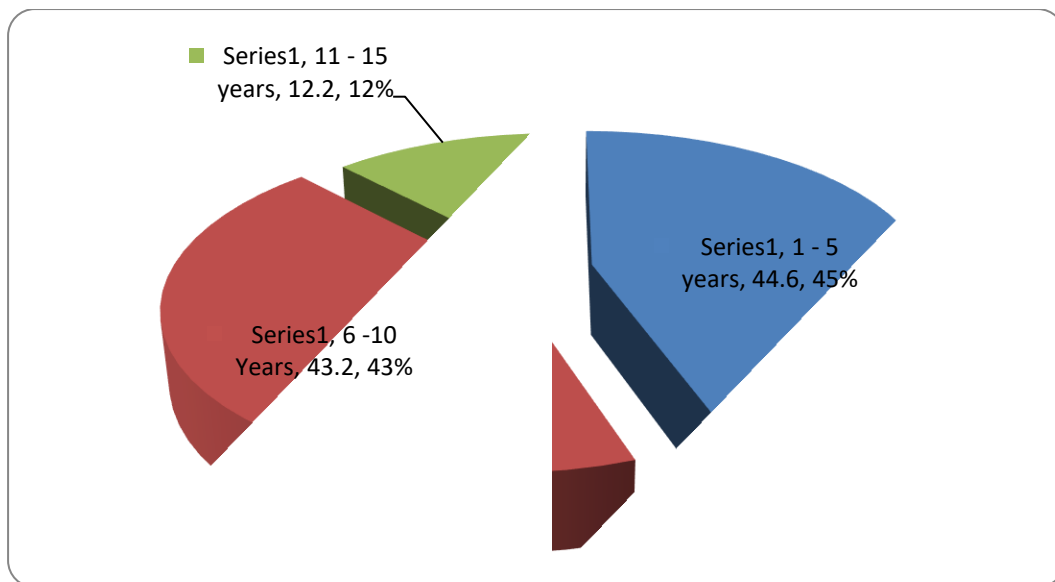


Figure 4.5: Working experience by respondents

4.3 Measurement of research objectives

To measure the research objectives and also aid testing of the study hypotheses, the formulated several statements to capture varying opinions of respondents on the extent of Interest Rate Policies, Collateral policies and Credit limit policies on Portfolio Performance at Post Bank as presented in subsequent sections below.

4.3.1 Descriptive Statistics on Interest Rates Policy

The researcher aimed at examining the effect of interest rates Policy on Loan performance at Post bank Uganda. To achieve this, the researcher formulated 10 statements on which respondents could rate their opinions and responses as captured from the field are as presented in table 4.7 below.

Table 4.7: Descriptive Statistics on Interest Rates Policy

	N	Minimum	Maximum	Mean	Std. Deviation
The bank has policy guidelines on various interest rates it charges customers	74	1	5	4.04	.835
The bank's lending decisions are based on the policy guidelines on interest	74	1	5	3.28	1.000
The interest rates are different for different bank credit products	74	1	5	3.35	1.091
Interest on loans forms the bank's core income line.	74	1	5	3.31	.920
The bank incurs interest expenses on customer deposits	74	1	5	3.64	.821
The bank's agricultural loans are repaid under special terms/plans due to nature of cash flow.	74	1	5	3.93	.689
The bank's loans to schools are repaid under special terms/plans due to nature of cash flow.	74	1	5	3.77	.837
Borrower's repayment rates are consistent with stable interest rates	74	1	5	3.12	.793
The bank adopts the Central Bank Rate as the basis for generating its interest rate	74	1	5	3.09	1.009
The bank counters the risk associated with unsecured loans by raising the lending rates.	74	1	5	3.03	.758

Source: Primary data (2019)

Key: 5 = strongly agree; 4 = Agree; 3 = Neutral; 2 = Disagree; 1 = Strongly Disagree

Asked whether, “the bank’s lending decisions are based on the policy guidelines on interest”, the respondents slightly agreed with a mean of 3.28. This could be linked to the banking considering a number of related guidelines to reaching a lending decision on a particular loan application and thus interest rates alone may not single handedly form the basis for granting a loan. There is however a high variation amongst the respondents’ opinions about the statement indicated by a standard deviation of 1.0 and this may negatively affect data reliability. The results are supported by D’Alberto, (2015) describing interest rates as the cost of hiring money. Further still, Wamabari (2017) contends that interest rate variables include the minimum rediscount rate, lending rates, deposit rates, treasury rates as well as interbank rates adding that in the normal practice of lending, commercial banks will either charge fixed interest rates, prime rates, variable rates as well as amortized rates and that each rate has its best product choice as well as some drawbacks to both the lender and the borrower. Similarly, results of interviews on the question,

what are some of the lending policies employed by Post Bank? The participants submitted that, “.....*Lending policies are part of the umbrella framework for credit risk management and those applied by the bank include interest rates policies, credit limits and exposures, securitization policies, credit appraisal and loan monitoring guidelines among others.....*”

Regarding whether, “the interest rates are different for different bank credit products”, the respondents generally agreed with a mean of 3.35. This may be attributed to various product features that come with the different loan products at Post Bank which features may include average loan tenure, loan type, the allowed loan amount, collateral choices and repayment interval among others which in turn call for different interest rates for optimizing loan performance. A standard deviation of 1.091 is however an indicator of high variation amongst the respondents’ views about the statement and may have a negative impact on data reliability. the findings opine with Wamabari (2017) contending that interest rate variables include the minimum rediscount rate, lending rates, deposit rates, treasury rates as well as interbank rates adding that in the normal practice of lending, commercial banks will either charge fixed interest rates, prime rates, variable rates as well as amortized rates and that each rate has its best product choice as well as some drawbacks to both the lender and the borrower.

As to whether, “Interest on loans forms the bank’s core income line”, the respondents generally agreed with a mean of 3.31. This may be attributed to the fact that lending is traditionally the prime activity of banking and as such, the loan portfolio forms the biggest income earning asset of a lending institution and consequently the highest income earning asset through interest charge. There is however a relatively high variation amongst the respondents’ opinions about the statement indicated by a standard deviation of 0.920 and may have an adverse effect on the

reliability of the data. The results opine with Nkuah (2015) submitting that the value of a loan portfolio depends not only on the interest rates earned on the loans, but also on the quality or likelihood that interest and principal will be repaid adding that one of the principal activities of commercial banks is to grant loans to borrowers and that loans are among the highest yielding assets a bank can add to its balance sheet as they provide the largest portion of operating revenue.

When asked whether, “the bank incurs interest expenses on customer deposits” the respondents agreed with a mean of 3.64. This may be linked to the fact that the bank strives to attract deposits for continuously on lending yet I must maintain a sound liquidity position and as such paying customers a certain percentage of interest on their deposits may be the only permissible means of attracting deposits. A standard deviation of 0.821 is however an indicator of relatively high variation amongst the respondents views about the statement and may affect data reliability negatively. The results agree with Mwangi and Wambari (2017) submitting that depositors provide maximum amount of the funds and they receive interest in return. Further still, interest margin is the difference between the interest paid and the interest received. If banks' interest margin increases the banks are in direct benefits but it will have negative impact on the lenders and borrowers. Throughout the last decade increasing trend in interest margin has been observed, (D’Alberto, 2015; Mwangi and Wambari, 2017). To this, Wambari cites lack of desirable amount of the possible opportunities for financial institutions as a key factor that further aggravates the impact of spread.

On whether, “the bank’s agricultural loans are repaid under special terms/plans due to nature of cash flow”, the respondents agreed with a mean of 3.93. This may attributed to the bank appreciating the fact that agriculture as a practice may hardly subscribe to the conventional

monthly installments and thus calls for special repayment terms such as quarterly, bi – annually or a single annual lumpsum. This way, the bank avoids unnecessary arrears one hand and averts distress of customers to such loans on the other hand thereby propelling a healthy portfolio. There is however a relatively high variation amongst the respondents’ opinions about the statement indicated by a standard deviation of 0.689 and this may have a relative adverse effect of data reliability. The results are in agreement with Benedikt et al., (2007) submitting that it is mandatory for a bank to prepare Credit Policy Guidelines (CPG) for making investment and lending decisions which reflect the banks’ tolerance for credit risk adding that prior to consent to a credit facility, the bank should make an assessment of risk profile of its customers such as of their business and which can be done through the credit procedure.

Regarding whether, “borrowers’ repayment rates are consistent with stable interest rates”, the respondents seemingly agreed with a mean of 3.12. This may be attributed to the fact in absence of fluctuations of interest rates; the borrowers make consistent repayments in terms of the defined installments, the repayment due dates and the overall loan tenure which is believed to results into better portfolio performance. A standard deviation of 0.793 reveals existence of a relatively high variation amongst the views of the respondents about the statement and hence may impact negatively on data reliability. The results concur with D’ Alberto (2015) asserting that changes in interest rate not only affect the cost of using money (cost of capital) as a result of the decision to invest but also influence the consumption level of an individual adding that when there is an increase in interest rates, it will affect the investment because the cost of capital will increase while a decrease in interest rate it will decrease the rates to depositors and suppress the savings. For this reason, serious repercussions are observed on the economy due to the interest rate changes (D’ Alberto, 2015).

Asked whether, “the bank adopts the Central Bank Rate as the basis for generating its interest rate”, the respondent seemingly agreed with a mean of 3.09. This may intimate to the fact that much as the central bank rate is ideally meant to form the basis for defining the respective lending institutions’ interest rates, often times this is hardly observed and instead the CBR is mere rubberstamp as the bank defines lending rates that way too far from the prevailing CBR probably due to the actions of other players in the same industry. There is however a high variation amongst the opinions of respondents about the statement indicated by a standard deviation of 1.009 and this may adversely affect data reliability. The findings are supported by Bank of Uganda (2017) as well as Khan and Sattar (2014) submitting that while setting the interest rates policy; commercial banks put into account the CBR of the central bank and also the level of activity in the economy, the extent of competition within the banking industry and the extent of demand for credit products among others.

When respondents were asked to respond to the statement, “the bank counters the risk associated with unsecured loans by raising the lending rates”, they were generally neutral with mean of 3.03. This probably implies that interest rates alone are not a standalone tool in mitigating the risk posed by unsecured credit at the bank. As a result, several other considerations are brought into picture by the bank so as to manage the credit risk for example, the bank requires guarantors, considers a reasonable loan tenure as well as the loan amount granted all aimed at achieving a satisfactory portfolio quality. A standard deviation of 0.758 is however an indicator of a fairly high variation amongst the opinions of the respondents about the statement and may have a relatively adverse effect on data reliability. The findings are concurring with Chernykh and Theodossiou (2011) submitting that the size of the bank (measured by assets) and the bank capitalization are the only determinants of not only loans expended to businesses but also long-

term loans since bigger and well capitalized banks can withstand the risks emanating from long-term lending. On a centrally, Ewert et al. (2000) asserts that interest rate premium increased with rise in the collateral pledged and hence contravenes the signaling and firm characteristics theories where we would expect higher interest rate premium for firms pledging little or no collateral.

4.3.2 Descriptive Statistics on Collateral Policy at Post Bank

The researcher aimed at examining the effect of Credit limits policy on Loan Performance in Post Bank Uganda. To achieve this, the researcher formulated 10 statements on which respondents could rate their opinions and responses as captured from the field are as presented in table 4.8 below.

Table 4.8: Descriptive Statistics On Collateral Policy at Post Bank

	N	Minimum	Maximum	Mean	Std. Deviation
The bank has policy guidelines on qualifying collateral by borrowers.	74	1	5	3.16	.828
The bank's lending decisions are guided by the policy guidelines on collateral.	74	1	5	3.57	.760
The collateral choices used are titles of control or ownership.	74	1	5	3.82	.669
Collateral required by the bank is appraised and valued by professionals.	74	1	5	3.92	.856
The bank offers both collateralized and unsecured loans.	74	1	5	3.38	.902
The collateralized loans are less risky for the bank.	74	1	5	3.28	.899
The bank is at liberty to sale the pledged assets in the event of default.	74	1	5	3.16	.937
The amount of funds lent to a borrower is limited by the collateral value.	74	1	5	3.24	.977
Unsecured credit is usually associated with a high risk to the bank.	74	1	5	3.43	.893
The bank is compelled into unsecured lending by the increasing levels of competition in the industry	74	1	5	3.65	.801

Source: Primary data (2019)

Key: 5 = strongly agree; 4 = Agree; 3 = Neutral; 2 = Disagree; 1 = Strongly Disagree

As to whether, “the bank has policy guidelines on qualifying collateral by borrowers”, the respondents slightly agreed with a mean of 3.16. This may be attributed to the fact that majority of the staff are aware of the existing guidelines on collateral choices that the bank adopts as a means of shielding against credit risk so as to achieve satisfactory portfolio performance. A standard deviation of 0.828 however indicates presence of relatively high variation amongst the opinions of respondents about the statement and hence may have an adverse effect on data reliability. The results are supported by Bank of Uganda (2017) submitting that all loans offered by banks must be secured to protect the customer deposits against the risk of loss by defaulting borrowers. Related to that, the Mortgage Act of 2012 as well as the Bank of Uganda guidelines

on collateralization of loans empowers the respective lenders to seize and sell off assets pledged as securities for recovery of loans in the event of default. Further still, the value of the security should be ascertained and title documents charged to the loan which should not exceed 2/3 of the value of the securities.

Asked whether, “the bank’s lending decisions are guided by the policy guidelines on collateral”, the respondents agreed with a mean of 3.57. This may be attributed to the bank always striving to adhere to the defined collateral policy that guides the bank’s lending function. This way; the bank is in position to engage into calculated risks and hence achieve sustainable levels of portfolio performance. There is however a relatively high variation amongst the respondent’s views about the statement indicated by a standard deviation of 0.760 and hence may affect data reliability. The findings concur with Owino (2013) submitting that assessing the collateral of the borrower usually is embedded in the credit appraisal process of the bank which pays vast attention to the 5Cs of credit namely Character, capacity, capital collateral and conditions adding that the purpose of credit appraisal is to assess the likelihood that a borrower will default on a given loan and that credit appraisal consists of evaluating a borrower’s needs and financial conditions. In the same relation, Comptroller’s Handbook (1998) concurs submitting that character or the person’s traits such as honesty, ethical considerations, integrity among others. This is usually based on the borrower’s past behavior in both banking and repayments of loans borrowed earlier.

Similarly, capacity of the borrower focuses on whether the borrower has the ability to generate sufficient funds to liquidate the loan and still stay financially healthy. This includes assessing the manager’s ability, policy documents of the firm, investment policies, strategic plans, credit

statements, etc. as well as judging the market potential of the institution and that the judgment should be both on liquidity as well as solvency of the institution.

About whether, “the collateral choices used are titles of control or ownership”, the respondents agreed with a mean of 3.82. This may be attributed to the fact that the bank either takes the collateral owned by the prospective borrowers or simply what they control. By control, the researcher refers to the collateral the borrower pledges supported by powers of attorney which empowers them to secure credit under such collateral choices. There is however an averagely high variation amongst the opinions of respondents as exhibited by a standard deviation of 0.669 and hence may have an averagely adverse effect on data reliability. The results are in agreement with George and Simonson (2000) submitting that banks can take hold of certificates of land title, Motor vehicle Logbooks, land sales agreements, fixed deposits, personal guarantees and letters of undertaking in the case of loans granted to salaried employees as well as household chattels among others as security for loans granted and that the collateral usually represents the ability of the borrower to pledge specific assets to secure a loan and consequently acts a shield against credit risk. In a similar manner the Central Bank (Bank of Uganda) provides that all loans offered by banks must be secured to protect the customer deposits against the risk of loss by defaulting borrowers. As a result, the Mortgage Act of 2012 as well as the Bank of Uganda guidelines on collateralization of loans empowers the respective lenders to seize and sell off assets pledged as securities for recovery of loans in the event of default adding that the value of the security should be ascertained and title documents charged to the loan which should not exceed 2/3 of the value of the securities (George and Samson, 2000; Owino, 2013)

On whether, “collateral required by the bank is appraised and valued by professionals”, the respondents were in agreement with a mean of 3.92. This imply that within the bank’s lending

policies, the procedures for collateral evaluation are provided and among the key concerns addressed is ensuring that security is evaluated by professionals who are technically well informed about the dynamics and risks that might manifest with various collateral types. It may however imply that the bank lacks the internal capacity to appraise and value collateral. A standard of 0.856 however indicates fairly high variation amongst the views of the respondents about the statement and hence may affect data reliability negatively. The results are in agreement with Wozniak et al., (2014) arguing that banks use various credit risk management methods such as taking collateral that is professional evaluated, diversification, loan selling, syndicated loans, credit insurance, and securitization and credit derivatives so as minimize the risk of loan default and to achieve profitable portfolios.

Regarding whether, “the bank offers both collateralized and unsecured loans”, the respondents averagely agreed with a mean of 3.38. This may probably imply that once the bank assesses and ascertains the potential risks to its portfolio, it finds it easy to lend under both secured under unsecured loans. Further still, the intensity of competition coupled with the drive to build a profitable and sustainable portfolio could one of the reasons the bank engages into unsecured lending so as to stimulate credit uptake and improve loan portfolio performance. With a standard deviation of 0.902, the results indicate existence of a high variation amongst the respondents’ views about the statement and hence could affect the data reliability. The results agree with Chernykh and Theodossiou (2011) arguing that the size of the bank (measured by assets) and the bank capitalization are the only determinants of not only loans expended to businesses but also long-term loans and that bigger and well capitalized banks can withstand the risks emanating from long-term lending adding that there are supply-side constraints to credit expansion,

although they did not consider the role of collateral on bank lending levels. The interview results concur with this position. For example the statement, ‘how are lending policies developed at Post Bank?’, the interview participants submitted that, “.....*lending policies are usually board and senior management decisions that are routed in the overall central bank guidelines on lending. It therefore becomes apparent that usually such policies are developed during board and management meetings/engagements given the dynamic nature of the environment within which the bank operates and the extent of volatility of the banking industry.....*”

On whether, “the collateralized loans are less risky for the bank”, the respondents seemingly agreed with a mean of 3.28. This may attributed to the reasoning that with collateralized loans, the lender always has a fallback position in the event of loan default as collateral pledged can be seized and sold off and offset the outstanding loan amounts. On the other hand, there appears to be no tangible alternative to the lender should a non-secured loan go delinquent hence increasing the default risk and worsening loan performance. A standard deviation of 0.899 is an indicator of high variation amongst the respondents’ opinions about the statement and may affect data reliability negatively. The findings are supported by Bank of Uganda (2015) revealing that the default increased with unsecured loans over the years as compared to fully secured facilities and that overall, the banking sector registered a 3.5% growth in loan volume between 2012 and 2015 while portfolio quality declined over the same period adding that between 2014 and 2015 alone, non – performing loans grew from UGX 389billion to UGX 574 billion, (BoU, 2015).

Asked whether, “the bank is at liberty to sale the pledged assets in the event of default”, the respondents slightly agreed with a mean of 3.16. This may attributed to the salient intricacies that

the bank encounters in trying to dispose of assets pledged by defaulting clients some of which being high collateral values compared the amount defaulted, high collateral liquidation costs in comparison to the loan amount in default as well the reputation the bank wishes to maintain with the general public as the bank finds it challenging to identify herself with grabbing people's assets. A standard deviation of 0.937 however indicates high variation amongst the opinions of respondents about the statement and consequently may have an adverse effect on data reliability. The results are supported by both the Mortgage Act (2012) Laws of Uganda as well as the Bank of Uganda (2017) guidelines on collateralization of loans that empowers the respective lenders to seize and sell off assets pledged as securities for recovery of loans in the event of default. Further still, to reduce the risk exposed to the banks, the central bank guideline advocate that the value of the security should be ascertained and title documents charged to the loan which should not exceed 2/3 of the value of the securities.

Regarding whether, "the amount of funds lent to a borrower is limited by the collateral value", respondents were seemingly in agreement with a mean of 3.24. This may be attributed to the fact that always the bank wishes to shield her against the risk of loan loss and this way it becomes less feasible to grant loan amounts that outweighs the pledged collateral. Further still, even in the event of unsecured loans, there are guarantors or corporate undertakings that give assurance to the lender that they undertake to indemnify the principle and interest in the case of eventualities that may happen to the employees. A standard deviation of 0.977 however indicates existence of high variation amongst the opinions of respondents about the statement and may affect the reliability of the data. The findings opine with William et al., (2016) submitting that collateral is any tangible and valuable asset that a borrower can surrender to the lender as a backup in exchange of a loan adding that financial institutions usually require their borrowers to deposit

with them valuable properties such as certificates of land titles, Motor vehicles as well share certificates prior to the advancement of credit to them. Related to that, Bank of Uganda submits that the value of the security should be ascertained and title documents charged to the loan which should not exceed $\frac{2}{3}$ of the value of the securities. Similarly, Banerjee et al., (2015) further opens submitting that asset-collateralized loans might potentially be more likely to flow towards investment, since lenders making collateralized loans presumably have stronger incentives to ensure that borrowers actually obtain the assets than lenders making un-collateralized loans and that some institutions go ahead to finance assets as collateral for their borrowers such as Motorcycles, Motor vehicles and even mortgages since lack of collateral for loans affects greatly credit uptake especially in developing countries.

Regarding whether, “the bank is compelled into unsecured lending by the increasing levels of competition in the industry”, the respondents agreed with a mean of 3.65. This may be attributed to the fact that the bank does not operate in a vacuum and hence has to adjust the practice in the industry including granting unsecured loans just like its counterparts do. This way, the bank can achieve satisfactory portfolio performance by increasing disbursements and neutralizing the portfolio at risk (P.A.R). A standard deviation of 0.801 is an indicator of relatively high variation amongst the respondents’ views about the statement and hence may have an adverse effect on data reliability. The results are in agreement with Chernykh and Theodossiou (2011) who on investigating the determinants of long-term lending by banks to firms in an emerging market and examined factors such as bank size, capitalization, liability structure, risk taking, ownership type, managerial expertise and location of individual banks found that the size of the bank (measured by assets) and the bank capitalization are the only determinants of not only loans expended to businesses but also long-term loans.

4.3.3 Credit Limits Policy and Loan Performance

In the third objective, the researcher aimed at examining the effect of Credit limits policy on Loan Performance in Post Bank Uganda. To achieve this, the researcher formulated 07 statements on which respondents could rate their opinions and responses as captured from the field are as presented in table 4.9 below.

Table 4.9: Descriptive Statistics on Credit Limits Policy

	N	Minimum	Maximum	Mean	Std. Deviation
The bank has a policy on Credit limit exposure	74	1	5	4.04	.835
The bank's lending decisions are guided by the policy on credit limits	74	1	5	3.28	1.000
The credit limits are consistent with collateral choices	74	1	5	3.09	1.009
The distance of the borrower from the bank branch affects loan amount granted	74	1	5	3.03	.758
Borrowers who are permanent residents are allowed large loan amounts.	74	1	5	3.16	.828
The most disturbing loan cases the bank has had have been as a result of over funding.	74	1	5	3.57	.760
The bank digs beyond the Credit Reference Bureau reports during the loan screening process so as to gather reliable facts about the borrower.	74	1	5	3.82	.669
Valid N (listwise)	74				

Source: Primary data (2019)

Key: 5 = strongly agree; 4 = Agree; 3 = Neutral; 2 = Disagree; 1 = Strongly Disagree

On whether, “the bank has a policy on Credit limit exposure”, the respondents agreed with a mean of 4.04. This may be attributed to Post Bank having in place relevant policy guidelines that define the basis for which loan amounts granted are based so as to propel profitable portfolio volumes at the bank. There is however a fairly high variation amongst opinions of the respondents about the statement indicated by a standard deviation of 0.835 and this might have a relatively high effect on data reliability. The results are supported by Saurina (2005) submitting

that lending policies relate to a lending institution's statement of philosophy, standards, and the guidelines that its employees must observe in granting or rejecting a loan request. Relatedly, Wozniak et al (2014) submits that credit limits policy offers guidelines that are used to determine which customers are extended credit and billed, sets the payment terms for parties to whom credit is extended, defines the limits to be set on outstanding credit accounts and also outlines the steps or procedures used to deal with delinquent accounts.

Regarding whether, "the bank's lending decisions are guided by the policy on credit limits", they seemingly agreed with a mean of 3.28. This could probably be attributed to the bank officials charged with the lending function of the bank paying little attention to the established credit limits guidelines while formulating the lending decisions. Thus this implies that much as the credit limit guidelines exist, the lending decisions are least observed in reaching the final decisions to granting loans. Instead, on top of credit limits, concentration appears to be given to a host of aspects such as interest rates, ability to pay, collateral as well as the general environment within which the bank operates. A standard deviation of 1.000 however indicates existence of a significantly high variation amongst the views of the respondents about the statement and this might adversely affect the reliability of the data. The findings are in agreement with Tetteh (2012) submitting that sound credit extension is one of the most essential principles which strengthen financial institutions in their financial standing and that sound credit extension establishes credit limits as well as develop credit granting process for approving new credits. Similarly, Nwanna and Oguezie (2017) observes that credit plays a very vital part in the economic growth and development of a country adding that the roles credit plays can be categorized into two; it enables the transfer of funds to where it will be most effectively and

efficiently used and secondly, credit economizes the use of currency or coin money as granting of credit has a multiplier effect on the volume of currency or coin in circulation.

Asked whether, “the credit limits are consistent with collateral choices”, the respondents slightly agreed with a mean of 3.09. This may be attributed to the bank paying more attention to ascertaining the capacity by simply appraising the various streams of cash flows and probably matching them with the proposed monthly installment clearly taking into account the interest rates and thus credit limits are likely to largely hinge on capacity to pay than collateral values. A standard deviation of 1.009 is however an indicator of a very high variation amongst the opinions of respondents about the statement and consequently may have adverse effects on data reliability. The study findings are supported by Pasha and Mintesinot (2017) asserting that credit management encompasses the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. Similarly, Sahle and Michael(2009) concur with Pasha and Mintesinot noting that in banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, and recovery of non-performing loans.

Regarding whether, “the distance of the borrower from the bank branch affects loan amount granted”, the respondents were generally neutral with a mean of 3.03. This may be attributed to the bank staff lacking a clear understanding of the causes of loan default. It may also intimate to the fact that the in general terms, the defaulted loans have no linkage with the distance of the respective borrowers from the bank branches. Thus credit volumes granted may be largely based on the appraised capacity to pay by the borrowers and not necessarily the distance between the borrowers and the branch. There is however a relatively high variation amongst the views of the

respondents about the statement indicated by a standard deviation of 0.758 and this might have an average adverse effect on data reliability. The results are supported by Ledgerwood (1999) stressing that responsive and non-bureaucratic approaches throughout the loan process impacts on customer loyalty and respect of their obligations with the financier. Ledgerwood gives an example of the Grameen Bank in Bangladesh to explain her argument urging that the bank is well known throughout the village population for her swift loan processes and as a result the bank has registered numerous achievements and a large quality portfolio.

Asked whether, “borrowers who are permanent residents are allowed large loan amounts”, the respondents slightly agreed with a mean of 3.16. This may be attributed to that fact that having a permanent address is somehow a better shield against default risk though it cannot single handedly form the basis for a loan decision. A standard deviation of 0.828 however reveals presence of a relatively higher variation amongst the opinions of the respondents about the statement and hence might have a relative negative effect on reliability of the data. The results concur with Chernykh and Theodossiou (2011) who on investigating the determinants of long-term lending by banks to firms in an emerging market and examined factors such as bank size, capitalization, liability structure, risk taking, ownership type, managerial expertise and location of individual banks found that the size of the bank (measured by assets) and the bank capitalization are the only determinants of not only loans expended to businesses but also long-term loans. They further submit that bigger and well capitalized banks can withstand the risks emanating from long-term lending.

As to whether, “the most disturbing loan cases the bank has had have been as a result of over funding”, the respondents agreed with a mean of 3.57. This may probably imply that every

time a borrower is overfunded, chances of increasing his/her excitement scale up which in turn may affect investment decisions of the borrower and fuel loan diversion thereby adversely affecting loan portfolio performance. A standard deviation of 0.760 however indicates relative variation amongst the views of the respondents and consequently affect data reliability negatively. The results are supported by Bank of Uganda (2017) submitting that a lending institution may not extend more than 1% of its core capital to single borrower. Further still, Wozniak et al (2014); B.O.U (2015) as well as Benedict et al., (2007) advise that, it is mandatory for a bank to prepare Credit Policy Guidelines (CPG) for making investment and lending decisions and which reflect the banks' tolerance for credit risk adding that prior to consenting to a credit facility, the bank should make an assessment of risk profile such as its customers, their business which can be done through the credit procedure.

Regarding whether, "the bank digs beyond the Credit Reference Bureau reports during the loan screening process so as to gather reliable facts about the borrower", the respondents agreed with a mean of 3.82. This may probably be attributed to the fact that the feedback of CRB reports is used as supplement to other relevant information gathered about the prospective borrowers through a holistic credit appraisal process. This is because CRB only generates secondary data about a client that may even not be real time and hence may hardly be the basis for a loan decision. A standard deviation of 0.669 however indicates presence of moderately high variation amongst the respondents' opinions about the statement and may have an impact on data reliability. The results are in agreement with Wozniak et al (2014) argue that banks use various credit risk management methods such as credit limits, taking collateral, diversification, loan selling, syndicated loans, credit insurance, securitization and credit derivatives.

4.3.4: Descriptive Statistics on Loan Performance

To assess the extent of loan performance at Post Bank Uganda, the researcher formulated 10 statements on which respondents could rate their opinions and responses as captured from the field are as presented in table 4.10 below

Table 4.10: Descriptive Statistics on Loan Performance at Post Bank Uganda

Statements	N	Minimum	Maximum	Mean	Std. Deviation
The bank has an overall framework on loan performance	74	3	5	4.41	.826
The always writes off loans	74	3	5	4.45	.665
The volume of written off loans is always increasing	74	1	5	4.19	.822
The bank provides for bad loans	74	2	5	3.69	.618
The bad loans provisions are always on an incremental trend	74	2	5	3.59	.618
The portfolio at risk is within tolerable limits	74	2	5	4.38	.887
Portfolio performance is largely measured by the Portfolio at Risk, bad loans written off and net interest income.	74	1	5	4.49	.763
Portfolio art risk increases annually	74	1	5	4.05	1.058
The bank's profits are affected by the provisions for bad loans	74	1	5	4.36	.837
The loan book has remained stagnant over a reasonable period	74	1	5	3.86	1.307

Source: Field Data (2019)

Key: 5 = strongly agree; 4 = Agree; 3 = Neutral; 2 = Disagree; 1 = Strongly Disagree

Regarding Loan Performance, the results revealed that the bank has an overall framework on loan performance and that it always wrote off loans with the volume of written off loans always increasing. Further still, the bank provides for bad loans with the bad loans provisions always being on an incremental trend although the portfolio at risk is within tolerable limits. Relatedly, portfolio performance is largely measured by the Portfolio at Risk, bad loans written off and net interest income and that the portfolio art risk increases annually. The results further indicate that the bank's profits are affected by the provisions for bad loans with the loan book remaining stagnant over a reasonable period. This thus shades a picture that the extent of loan performance at Post bank is unsatisfactory and hence might jeopardize attainment of the performance objectives of the bank.

To further understand the extent of loan performance at Post Bank, the researcher conducted interviews on the prime causes of NPLs at the bank. In response, the participants observed that, “.....NPLs are due to Laxity in credit standards for borrowers and counter parties, poor risk management and lack of attention to rapid changes in economic, social and political circumstances that can lead to deterioration in the credit portfolio performance in commercial banks.....”

4.4 Correlation Analysis

To establish whether a relationship existed between the examined measures of lending policies and loan performance, the researcher performed Pearson’s Two Tail statistics on each measure of lending policies and achieved the following results.

4.4.1 Correlations between Interest Rates Policy and Loan Performance

The results of Pearson’s two tail statistic reveal that Interest rates Policy has a weak negative significant relationship with Loan Performance indicated by a correlation value of $r = -0.283^{**}$; $p < 0.01$ as presented in table 4.11 below

Table 4.11: Correlations between interest rate policies and Loan Performance

Variables		Interest Rates Policy	Loan Performance
Interest Rates Policy	Pearson Correlation	1	-.283**
	Sig. (2-tailed)		.008
	N	74	74
Loan Performance	Pearson Correlation	-.283**	1
	Sig. (2-tailed)	.008	
	N	74	74

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

Generally, the existence of a negative relationship between Interest rates Policy and Loan Performance concur with the empirical reviews advanced by previous scholars such as Wamabari, (2017); Russell (2012); Khan and Sattar (2014) as the Bank of Uganda (2013) who have exhibited that lending rates were negatively correlated with Loan Performance of lending/financial institutions. The results further imply that favorable interest rate policies stimulate uptake of credit and hence growth in the loan portfolio while at the same time enable good recovery rates since the overall monthly installments remain within a manageable range. On the other hand, Unfavorable interest rate policies will deter prospective borrowers from accessing loans which will result into a stagnating loan portfolio growth and its associated consequences. It is evident that every time the interest rates change/shift towards a particular direction, loan performance inversely takes another direction and thus increases in interest rates negatively affects the monthly installments, extent of loan uptake and the borrowing power by a prospective customer. On the other and, falling interest rates are likely to induce increase in loan uptake and lower the overall installment amount thereby positively influencing loan performance.

4.4.2 Correlations between Collateral Policy and Loan Performance

The results of Pearson's two tail statistic reveal that Collateral Policy has a moderate negative significant relationship with Loan Performance indicated by a correlation value of $r = - 0.398^{**}$; $p < 0.01$ as presented in table 4.12 below.

Table 4.12: Correlations between Collateral Policies and Loan Performance

Variables		Collateral Policy	Loan Performance
Collateral Policy	Pearson Correlation	1	-.398**
	Sig. (2-tailed)		.000
	N	74	74
Loan Performance	Pearson Correlation	-.398**	1
	Sig. (2-tailed)	.000	
	N	74	74

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

Generally, the existence of a negative relationship between Collateral Policy and Loan Performance concur with the empirical reviews advanced by previous scholars such as Owino (2013); William et al., (2016); Banerjee et al., (2015) and B.O.U (2015) who observed that collateral requirements by financial institutions negatively related with Loan Performance of lending/financial institutions. The results further imply that favorable collateral policies stimulate uptake of credit and hence growth in the loan portfolio. However, this may not necessarily translate into good repayment rates since repayment of a loan is more consistent with reliable cash flows than the assets owned by the borrower.

It is evident that the more the bank gets stingy on collateral, the poorer the loan portfolio gets. This may imply that spending time in appraising and valuing collateral without necessarily appraising capacity to pay and probably authenticating the information may hardly lead to improved loan performance.

4.4.3 Correlations between Credit Limits Policy and Loan Performance

On seeking statistical evidence; the results of Pearson's two tail statistic reveal that Credit limits Policy has a weak negative significant relationship with Loan Performance indicated by a correlation value of $r = -0.272^{**}$; $p < 0.05$ as presented in table 4.13 below.

Table 4.13: Correlations between Credit Limits Policy & Loan Performance

Variable		Credit Limits Policy	Loan Performance
Credit Limits Policy	Pearson Correlation	1	-.272*
	Sig. (2-tailed)		.017
	N	74	74
Loan Performance	Pearson Correlation	-.272*	1
	Sig. (2-tailed)	.017	
	N	74	74

*. Correlation is significant at the 0.05 level (2-tailed).

Generally, the existence of a negative relationship between Credit limits Policy and Loan Performance concur with the empirical reviews advanced by previous scholars such as Ledgerwood (1999);Brown & Reilly (2009); B.O.U (2015); Wozniak et al (2014);Tetteh (2012); Nwanna & Oguezue (2017) as well as Pasha & Mintesinot (2017) submitting that who observed that credit limits established by financial institutions negatively related with Loan Performance of such institutions.

The results further imply that favorable credit limits policies stimulate uptake of credit and hence growth in the loan portfolio and vice versa. However, this may not necessarily translate into good repayment rates since repayment of a loan is more consistent with reliable cash flows than the assets owned by the borrower. This further implies that every time the bank tightens the credit limits basically due to a high degree of risk aversion, portfolio performance is negatively affected in return.

4.5 Multiple Regression Analysis for the study variables

Having established the existence of relationships between the major the study variables, the researcher further sought to measure the extent of extent of the relationship between these variables. To achieve this, multiple linear regression analysis was employed in determining the effect and prediction capability of lending policies on Loan performance.

Table 4.14: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.422 ^a	.178	.143	.88511952

a. Predictors: (Constant), Credit Limits Policy, Collateral Policy, Interest Rates Policy

The results of the regression model summary in Table 4.14 indicate that the dimensions of lending policies account of only 17.8%(R square = 0.178) of the variation in loan performance and thus there is sufficient evidence that overall, measures of lending policies are weak in predicting loan performance and as such, the observed feedback appears to be widely spread from the fitted regression line.

Further still, interview results on the question, ‘how has lending policies influenced loan performance at Post Bank? Revealed that, “.....*the bank has managed to set performance threshold of NPA of and PAR of at maximum acceptable risk together with the classification of loans as performing, substandard, loss (provisioning) and adaptation of IFRS.....*”

In a similar manner, the findings contained in Table 4.15, clearly reveal that credit limits policy has the highest positive contribution to loan performance given a beta value of (0.758;t = 1.713; p = 0.091) and thus credit limits are a significant predictor of loan performance at Post Bank Uganda. This is followed by Collateral policy which contributes ($\beta = 0.645$; t = 3.674; p = 0.000) to loan performance and hence a significant predictor of loan performance at the bank while interest rates trail with ($\beta = 0.028$; t = 0.539; p = 0.592)has a moderate contribution to loan performance at Post Bank.

Table: 4.15: Coefficients

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.003E-013	.103		.000	1.000
Interest Rates Policy	.028	.449	.028	.539	.592
Collateral Policy	.645	.243	.645	3.674	.000
Credit Limits Policy	.758	.443	.758	1.713	.091

a. Dependent Variable: Loan Performance

It therefore implies that unit improvement credit limits result into a 0.758 improvement in loan performance while a unit adjustment in collateral policy and interest rates policy results result into 0.645 and 0.028 in loan performance respectively.

4.6 Conclusion

Overall, the results indicate that the state of loan performance at Post Bank Uganda is not satisfactory and needs urgent redress. The researcher further concludes that the bank registers better Loan performance if staff effort is devoted effectively managing credit limits and defining flexible collateral choices and that Post Bank may only need to establish how it manages the interest rates for competitive loan performance.

CHAPTER FIVE

SUMMARY CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

The chapter presents a summary of the study findings as per the study objectives. It also offers meaningful conclusions drawn from the study finding in line with the study objectives as well offering recommendation coupled with suggestion of areas the researcher deems ripe for conducting further inquiries.

5.1 Summary of the study findings

The study aimed at establishing the effect of Lending Policies on Loan performance at Post Bank Uganda under three study objectives namely; i) to examine effect of interest rates Policy on Loan performance in Post Bank Uganda; ii) To examine the effect of Credit limits policy on Loan Performance in Post Bank Uganda and iii) To assess the effect of Collateral policies on Loan Performance in Post Bank Uganda. The study utilized a total of 74 respondents drawn from the respective departments and units of Post Bank that are associated with credit risk and collected data using both SAQs as well as an interview guide. Qualitative and quantitative data approaches were used in collecting and analyzing data in particular descriptive statistics (which used means and standard deviations), correlation and regression analysis as well as thematic analysis were used in analyzing data revealing the summaries below based on the study objectives

5.1.1 Interest rates policy and Loan Performance

With regard to interest rates policy, the results reveal that the bank has policy guidelines on various interest rates it charges customers and that the bank's lending decisions are based on the

policy guidelines on interest. Further still, the interest rates are different for different bank credit products adding that interest on loans forms the bank's core income line with the bank incurring interest expenses on customer deposits. The results further reveal that both the bank's agricultural loans and loans to schools are repaid under special terms/plans due to the nature of cash flow and that borrowers' repayment rates are consistent with stable interest rates. The results also indicate that the bank adopts the Central Bank Rate as the basis for generating its interest rate with the bank encountering the risk associated with unsecured loans by raising the lending rates. However, the findings indicate presence of a very high variation with respondents' opinions on several statement such as the bank's adaptation to the Central Bank Rate as the basis for generating its interest rate, the bank basing its lending decisions on the policy guidelines on interest as well as interest on loan forms the bank's core income line which imply adverse effect on data reliability.

Relatedly, statistical evidence indicates existence of a negative significant relationship between interest rates policy and Loan performance with a correlation coefficient of $r = -0.283$; $p < 0.01$. Further still, regression simple linear reveals that interest rates policy accounts for only 9.5% of the variation in loan performance with a beta value of while multiple regression reveals that interest rates policy contributes only 2.8% to loan performance at Post Bank.

5.1.2 Collateral Policies and Loan Performance

Under this objective, the findings reveal that the bank has policy guidelines on qualifying collateral by borrowers and that the bank's lending decisions are guided by the policy guidelines on collateral with collateral choices used are titles of control or ownership. The results further indicate that collateral required by the bank is appraised and valued by professionals with the

bank offering both collateralized and unsecured loans adding that collateralized loans are less risky for the bank. Similarly, the bank is at liberty to sale the pledged assets in the event of default with amounts of funds lent to a borrower being limited by the collateral value. The results also indicate that unsecured credit is usually associated with a high risk to the bank and that the bank is compelled into unsecured lending by the increasing levels of competition in the industry. On seeking scientific evidence about the existence of a relationship between collateral policy and Loan performance, Pearson's two tail statistic reveal a significant relationship between the two variables with a correlation coefficient of $r = -0.398$; $p < 0.01$. Relatedly, linear regression analysis further reveals that collateral policy accounts for 18.5 % ($R^2 = 0.185$) of the variation in loan performance. On running multiple regressions, the results revealed that Collateral Policy has positive significant contribution to loan performance indicated by a beta value of 0.645.

5.1.3 Credit Limits Policy and Loan Performance

Regarding credit limits policy, the results indicate that the bank has a policy on Credit limit exposure with its lending decisions being guided by the policy on credit limits. The results further indicate that it is not whether the credit limits are consistent with collateral choices or whether the distance of the borrower from the bank branch affects loan amount granted. Further still, the findings reveal that borrowers who are permanent residents are allowed large loan amounts and that the most disturbing loan cases the bank has had have been as a result of over funding. Further still, the findings reveal that the bank digs beyond the Credit Reference Bureau reports during the loan screening process so as to gather reliable facts about the borrower.

Relatedly, statistical evidence indicates existence of a negative significant relationship between credit limits policy and Loan Performance with a correlation coefficient of $r = -0.272$; $p < 0.05$. On a centrally however, linear regression analysis reveals that credit limits accounts for 7.6% of the variation in Loan Performance at the bank while multiple regression indicates that credit limits policy has the highest effect on loan performance given a beta value of 0.758.

5.2 Study Conclusions

Going by the aforementioned study findings, the following conclusions based on the study objectives can be drawn namely:

5.2.1 Interest Rates Policy and Loan Performance

Given that Pearson's two tail statistic reveal existence of a negative significant relationship between Interest rates Policy and Loan Performance indicated by a correlation value of $r = -0.283$; $p < 0.01$; it is worth concluding that efforts devoted to enhancing interest rates policies for improved loan performance are counterproductive to a large extent. Further still, regression analysis indicates that interest rates policy has a small positive contribution to loan performance with a beta value of 0.28 and hence the researcher concludes that it benefits the bank too little when it clings on interest rates as a basis for a loan decision.

5.2.2 Collateral Policy and Loan Performance

Correlation statistics indicate a significant negative relationship between collateral policy and Loan performance given a correlation value of $r = -0.398$; $p < 0.01$. The researcher thus concludes that concentrating on collateral to inform loan performance is futile and hence these efforts ought

to be devoted to other aspects of credit relationship management to improve loan performance. Further still, a beta value of 0.645 indicates that collateral policies of the bank to a large extent contribute positively to loan performance. It is therefore prudent to conclude that every time lending decisions are based on collateral values and choices, the loan portfolio may negatively grow but the quality may always remain promising.

5.2.3 Credit limits Policy and Loan Performance

Going by the correlation results, it is evident that credit limits policy is negatively and significantly associated with loan performance given a correlation value of $r = -0.272$; $p < 0.05$. Thus the researcher concludes that credit limits negatively affect loan performance. However, regression analysis indicates that a unit improvement in credit limits results into a 0.758 improvement in loan performance and thus the researcher concludes that managing credit limits is paramount in managing excitement emanating from overfunding and hence improving loan performance.

5.3 Implications of Findings

Going the study findings obtained, the following implications are can be conceived;

Overall, since lending policies account for only 17.8% of the variation in loan performance, the bank needs to pay more attention to other factors that influence repayment rates of a loan by a borrower. Thus attention can paid to authentic assessment of the repayment capacity, information quality, credit rating of the customer and potential for future cash flows by a customer. This is because; customers can always afford to pay their installments if they have a health cash flow position despite changes in interest rates, credit limits and collateral requirements.

5.4 Recommendations

Based on the study findings, the researcher fronts the following recommendations based on study objectives are proposed namely:

The results indicate that despite credit limits policy being negatively associated with loan performance, there is evidence from authors such as Wozniak et al (2014); Tetteh (2012); Nwanna & Oguezie (2017) as well as Pasha & Mintesinot (2017) that credit limits positively contribute to loan performance. Therefore, the researcher recommends that efforts should be put to objectively managing credit limits through an informed credit appraisal process. This will yield objective management of loan exposures and address both under and over funding as well as the associated consequences and hence improve Loan performance.

With interest rate policies, the bank needs to closely and continuously adhere to the Central Bank Rate as the basis for generating its interest rate and should also ensure that the formulated policy on interest rates is always adhered to given the extent of volatility in interest rates. Further still, the researcher recommends that uniform interest rates should be charged across all products as this may address the challenge of adverse selection.

With regard to collateral policies, the study recommends that effort should be devoted to ascertaining and objectively evaluating other aspects that improve the borrowers' capacity to pay such as various sources of income of borrowers and instead only take collateral as a fallback position in the event of default than appraising collateral an indicator of ability to pay.

Other recommendations the researcher deems vital are routine loan monitoring, effective borrower screening, continuous updating of the policy manual to address issues that are ever changing in the business environment.

Interview results further recommended that, “.....*quality and training of the human resources involved in the credit management is critical to improving loan portfolio quality and hence should be appropriately addressed; formation of clients through financial literacy trainings on money management, savings management, budgeting and financial planning as well; retraining staff on proper micro credit appraisal, assessment and documentation as well as continuous monitoring and tracking of both performing and non-performing loans culture needs to be redefined taking into account disbursement targets.....*”

5.5 Areas for further studies

The study recommends that further researches be carried out in following areas namely;

- Lending Policies and Loan Performance in Tier 4 institutions in Uganda
- Credit underwriting and Loan Performance among Financial Institutions in Uganda

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APPENDICES

Questionnaire schedule for credit staff and staff in sections associated with credit risk at Post Bank Uganda Limited.

Dear Respondent,

This questionnaire is intended to collect data that will be used in “Examining the effect of Lending Policies on Loan Performance among Ugandan commercial banks using a case of Post Bank Uganda Limited. You have been selected to participate in this study as one of the respondents. Please spare a few minutes off your busy schedule and complete this questionnaire as honestly as possible. Your responses to the questions contained in here will assist the researcher in making the study a success and conversely will be treated with utmost confidentiality. Your contribution to this study will be highly appreciated.

Thank you,

Ndibalekera Helga

MBA Student at Uganda Martyrs University

Instructions

Please indicate your answer by ticking **OR** circling the option you consider the most appropriate choice.

SECTION A: BACKGROUND INFORMATION

1 Gender: Male-----Female-----

2. Age in years

A). Less than 25	B) 25 – 34	C) 35 - 44	D) 45 – 54	E) ≥ 55

3. Academic qualification held

A). Diploma B) Bachelor's Degree C) Master's Degree D). Others, specify-----

4. Position held at the bank

A). Credit officer B) Risk Manager C) Credit Analyst D) Branch Manager

E Credit Manager F) Internal Auditor G) Recovery Officer H) Credit Supervisor

5. Department

a) Credit Department b) Risk and compliance c) Internal audit d) Operations e) Others

6. Working experience at the bank

a) 1 – 5 years b) 6 – 10 years c) 11 – 15 years d) above 15 years

In the following sections, please indicate your response by ticking the most appropriate choice (1 = Strongly Disagree; 2= Disagree; 3 = Neutral; 4 = Agree; 5 = Strongly Agree)

SECTIONB: CREDIT APPRAISAL						
S/N		1	2	3	4	5
	PART ONE: POLICY ON INTEREST RATES					
IR1	The bank has policy guidelines on various Interest rates it charges customers					
IR2	The bank's lending decisions are based on the policy guidelines on interest					
IR3	The interest rates are different for different bank credit products					
IR4	Interest on loans forms the bank's core income line.					
IR5	The bank incurs interest expenses on customer deposits					
IR6	The bank's agricultural loans are repaid under special terms/plans due to nature of cash flow.					
IR7	The bank's loans to schools are repaid under special terms/plans due to nature of cash flow.					
IR8	Borrower's repayment rates are consistent with stable interest rates					
IR9	The bank adopts the Central Bank Rate as the basis for generating its interest rate					

IR10	The bank counters the risk associated with unsecured loans by raising the lending rates.					
S/N	POLICY ON COLLATERAL	1	2	3	4	5
C1	The bank has policy guidelines on qualifying collateral by borrowers.					
C2	The bank's lending decisions are guided by the policy guidelines on collateral.					
C3	The collateral choices of are titles of control or ownership.					
C4	Collateral required by the bank is appraised and valued by professionals.					
C5	The bank offers both collateralized and unsecured loans.					
C6	The collateralized loans are less risky for the bank.					
C7	The bank is at liberty to sale the pledged assets in the event of default.					
C8	The amount of funds lent to a borrower is limited by the collateral value.					
C9	Unsecured credit is usually associated with a high risk to the bank.					
C10	The bank is compelled into unsecured lending by the increasing levels of competition in the industry					
S/N	POLICY O CREDIT LIMITS	1	2	3	4	5
L1	The bank has a policy on Credit limit exposure					
L2	The bank's lending decisions are guided by the policy on credit limits					
L3	The credit limits are consistent with collateral choices					
L4	The distance of the borrower from the bank branch affects loan amount granted					
L5	Borrowers who are permanent residents are allowed large loan amounts.					
L6	The most disturbing loan cases the bank has had have been as a result of over funding.					
L7	The bank digs beyond the Credit Reference Bureau reports during the loan screening process so as to gather reliable facts about the borrower.					
SN	SECTION C: LOAN PERFORMANCE	1	2	3	4	5
1	The bank has an overall framework on loan performance					
2	The always writes off loan					
3	The bank rarely writes off loans					
4	The volume of written off loans is always increasing					
5	The bank provides for bad loans					
6	The bad debts loans provisions are always on an incremental trend					
7	The portfolio at risk is within tolerable limits					
8	Portfolio performance is largely measured by the Portfolio at Risk, bad loans written off and net interest income.					
9	Portfolio art risk increases annually					
10	The bank's profits are affected by the provisions for bad loans					
11	The loan book has remained stagnant over a reasonable period					

END

THANK YOU

Interview Schedule for Top Management and heads of Department at Post Bank Uganda

Dear Participant,

This interview Guide is intended to collect opinions of participants that will be used in “Examining the effect of Lending Policies on Loan Performance among Ugandan commercial banks using a case of Post Bank Uganda Limited. You have been selected to participate in this study as one of the participants. Please spare a few minutes off your busy schedule and take part in this interview as honestly as possible. Your responses to the questions contained in here will assist the researcher in making the study a success and conversely will be treated with utmost confidentiality. Your contribution to this study will be highly appreciated.

Thank you,

Ndibalekera Helga

MBA Student at Uganda Martyrs University

1. What do you understand by the term Lending Policies?
2. What are some of the policies applied at Postbank Uganda?
3. What do you consider to be the causes of non – performing loans at Post Bank Uganda?
4. How have lending policies influenced non-performing loans at Post bank Uganda?
5. What do you think should be done to improve loan performance at Post Bank Uganda?
6. Do you have any other remarks?

Thank You for your Corporation