EFFECT OF MICROFINANCE CREDIT POLICIES ON LOAN REPAYMENT:

A CASE STUDY OF UGAFODE MICROFINANCE LIMITED.

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A DISSERTATION SUBMITTED TO THE FACULTOFBUSINESSADIMINISTRATION AND MANAGEMENT IN PARTIALFULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF BACHELORS DEGREE IN BUSINESS ADIMINISTRATION AND MANAGEMENT UGANDA MARTYRS UNIVERSITY

APRIL, 2014

DECLARATION.

I KIKONYOGO ARON, hereby declare that this Dissertation is my original work and has not been submitted for any award to any institution and where the work of others has been consulted, due acknowledgement has been made.

Signed …………………………………… Date ………………………

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2011-B021-20093

APPROVAL

This is to approve that this dissertation titled "Effect of microfinance credit policies on loan repayment. Case study of Ugafode Microfinance limited Rubaga branch. Has been conducted under my supervision and is now ready for submission as part of the requirement for the award of a bachelor's degree in business administration and management of Uganda Martyrs University.

Signed……………………………………. Date …………………………………..

NALELA KIZITO.

SUPERVISOR.

DEDICATION

This work is dedicated to my Parents Mr. and Ms Ssevume, my brothers Angelo, Emma, Linus Alex and sisters, Allen Flavia and Prosy for the tremendous work done. I also dedicate this work to my friends Belton, Charles, David, Daphine for the support and their precious time given to me. And the entire staff of Uganda martyrs university that participated towards the accomplishment of this study.

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My acknowledgement with deep gratitude goes to, my friends; for their financial, academic and moral support especially their word of encouragement that made this research a success, may the God Almighty reward them with joy and peace.

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LIST OF ACRONYMS

USA	UNITED STATES OF AMERICA.
MFI	MICRO FINANCE INSTITUTIONS.
SME’s	SMALL MEDIUM ENTERPRISES.
BOU	BANK OF UGANDA.
CBO’s	COMMUNITY BASED ORGANISATIONS
PMS’s	PERFORMANCE MEASUREMENT SYSTEMS
ERP	ENTERPRISE RESOURCE PLANNING.
ABC	ACTIVITY BASED COSTING.
KPI	KEY PERFORMANCE INDICATORS.
PI	PERFORMAMNCE INDICATORS.
$	DOLLAR.
SPSS	STATISTICAL PACKAGE FOR SOCIAL SCIENTISTS

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ABSTRACT

This study focuses on the main dimensions and key conceptual features of Microfinance institutions credit lending terms, networks and the performance of small medium enterprises. The theoretical survey of different views and conceptions characterizes the formation and development of Micro finance lending terms which greatly influences the performance of enterprises.

The study design was cross sectional. Both qualitative and quantitative data were collected; sample random sampling was used to select a sample size of 75 respondents. Analysis was carried out basing on the study objectives.

Findings indicated that the loan repayment period is conducive to the performance of SME's enterprises, total costs of the loan are high and enterprises mainly rely on social collateral to access loans. The findings in relation to the loan size indicated that the respondents were uncertain and there is a positive trend in the growth of working capital, profitability levels and business sustainability.

However, the respondents indicated low savings growth and there are low networking levels among clients accessing loans from Ugafode Uganda ltd.

There is a significant positive relationship between the credit lending terms, Networks and performance of SME's enterprises. There is need to introduce adult education among clients accessing credit to improve literacy and numeric to help them manage the loans better and also improve on the networking system by the women entrepreneurs where they can share business ideas, promote their products and Ugafode Uganda ltd should offer multiple loan products such as consumption loans to avoid loan diversion .

In conclusion, the evidence for the effect of micro finance credit terms on loan repayment. Some enterprises have prospered registering increase in business assets and profitability while others have failed to take off. The networks among the enterprises have not been fully developed to enable them expand on their markets and thus limit performance.

CHAPTER ONE

1.0 Introduction.

In this chapter the researcher presents the background of the study, statement of the problem, objectives of the study, scope, significance and justification of the study, and conceptual framework.

The research aims at establishing the effect of micro finance credit policies on loan repayment. A methodology in which a trader uses security as collateral in order to access finances inform of loans from the bank.

1.1 Background of the study.

Microfinance institutions belong to a wider group of financial institutions regarded as semi formal financial institutions. These are institutions which are registered as non-government organizations performing financial functions of lending and taking deposits (Microfinance Act 2003).

The concept of credit can be traced back in history and it was not appreciated until and after the Second World War when it was largely appreciated in Europe and later to Africa (Kiiru, 2004). Banks in USA gave credit to customers with high interest rates which sometimes discouraged borrowers hence the concept of credit didn't become popular until the economic boom in USA in 1885 when the banks had excess liquidity and wanted to lend the excess cash (Ditcher, 2003). In Africa the concept of credit was largely appreciated in the 50's when most banks started opening the credit sections and departments to give loans to white settlers.

In 1990s loans given to customers did not perform which called for an intervention. Most suggestions were for the evaluation of customer's ability to repay the loan, but this didn't work as loan defaults continued (Modurch, 1999). The concept of credit management became widely appreciated by Microfinance Institutions (MFI's) in the late 90s, but again this did not stop loan defaults to this date (Modurch, 1999).

A key requirement for effective credit management is the ability to intelligently and efficiently manage customer credit lines. In order to minimize exposure to bad debt, over-reserving and bankruptcies, companies must have greater insight into customer financial strength, credit score history and changing payment patterns. The ability to penetrate new markets and customers hinges on the ability to quickly and easily make well-informed credit decisions and set appropriate lines of credit. Credit management starts with the sale and does not stop until the full and final payment has been received.

It is as important as part of the deal as closing the sale. In fact, a sale is technically not a sale until the money has been collected. It may be difficult to establish an optimal credit policy as the best combination of the variables of credit policy is quite difficult to obtain. A firm will change one or two variables at a time and observe the effect. It should be noted that the firm's credit policy is greatly influenced by economic conditions (Pandey, 2008).

As economic conditions change, the credit policy of the firm may also change. Microfinance Institutions and other finance institutions must develop a credit policy to govern their credit management operations (Pandey, 2008) and since microfinance institutions generate their revenue from credit extended to low income individuals in the form of interest charged on the funds granted (Central Bank Annual Report, 2010) the loan repayments may be uncertain. The success of lending out credit depends on the methodology applied to evaluate and to award the credit (Ditcher, 2003) and therefore the credit decision should be based on a thorough evaluation of the risk conditions of the lending and the characteristics of the borrower.

Numerous approaches have been developed in client appraisal process by financial institutions. They range from relatively simple methods, such as the use of subjective or informal approaches, to fairly complex ones, such as the use of computerized simulation models (Horne, 2007). Many lending decisions by Microfinance institutions are frequently based on their subjective feelings about the risk in relation to expected repayment by the borrower. Microfinance institutions commonly use this approach because it is both simple and inexpensive.

While each company would have its own method of determining risk and quality of its clients, depending on the target group, the following client evaluation concepts are useful for most occasions. These concepts are referred to as the 5C's of credit appraisal (Edward, 1997). These elements are Character, Capacity, Collateral, Capital and Condition (Edward, 1997).

David Opio Okello (1997) stated that good governance policies and practices help to build confidence in the industry as it assures savers that their money is safe. This is high lightened in various provisions of the micro fiancé taking institutions act such as the board and the appointment and duties of the finance manager, internal auditor and external auditor. Thus institutions licensed under the micro finance deposit institutions act will be expected to be transparent and accountable and have in place good policies to ensure good governance.

The researcher was prompted to carry out an investigation on the effect of micro finance credit policies on loan repayment and effectiveness of credit policy management put in place and also investigates the cause of the steady rise in non repayment.

1.2 Statement of the problem.

The success of MFIs largely depend on the effectiveness of their credit management systems because these institutions generate most of their income from interest earned on loans extended to small and medium entrepreneurs. The Central Bank Annual Supervision Report, 2010 indicated high incidence of credit risk reflected in the rising levels of non- performing loans by the MFI's in the last 10 years, a situation that has adversely impacted on their profitability. This trend not only threatens the viability and sustainability of the MFI's but also hinders the achievement of the goals for which they were intended which are to provide credit to the rural unbanked population and bridge the financing gap in the mainstream financial sector. A Study on microfinance credit policies on loan repayment is a topic of considerable interest by many researchers. However, most studies undertaken in the past few years have focused mainly on credit models used by MFI's and their impact on profitability (Migiri, 2002). Absence of empirical studies on credit recovery systems and recognition of the critical role that MFI's play in the economy are the principal motivation behind this study which sought to find out the effect of micro finance credit policies on loan repayment among microfinance institutions.

1.3 Purpose of the study

To access the effect micro finance credit policies on loan repayment in micro finance institutions.

1.4 Specific objectives

i. To establish the effect of credit terms of microfinance institutions on loan repayment.

ii. To assess the performance of SME's accessing credit from MFIs.

iii. To assess the level of networking among SME's accessing loans from Micro finance institutions.

iv. To examine the relationship between the MFIs credit lending terms, networking and the performance SME's.

1.5 Research questions

i. To what extent has credit terms of microfinance institutions affected their loan repayment?

ii. To what extent is SME's accessing credit from MFI's performing?

iii. To what extent is the level of networking among SME's accessing loans from Micro finance institutions?

1.6 Scope of the study

1.6.1 Geographical scope.

The research was carried out at Ugafode Microfinance limited Rubaga branch. Where the emphasis was mainly on the credit and loans department for gathering data relating to credit and loans.

1.6.2 Time Scope

Credit policies and loan information between 2012 and 2013 was considered.

1.6.3 Content scope

This covers the performance (loan repayment) as per credit polices carried out in Ugafode Microfinance limited to confirm whether credit policies improved loan repayment rate.

1.7 Significance of the Study

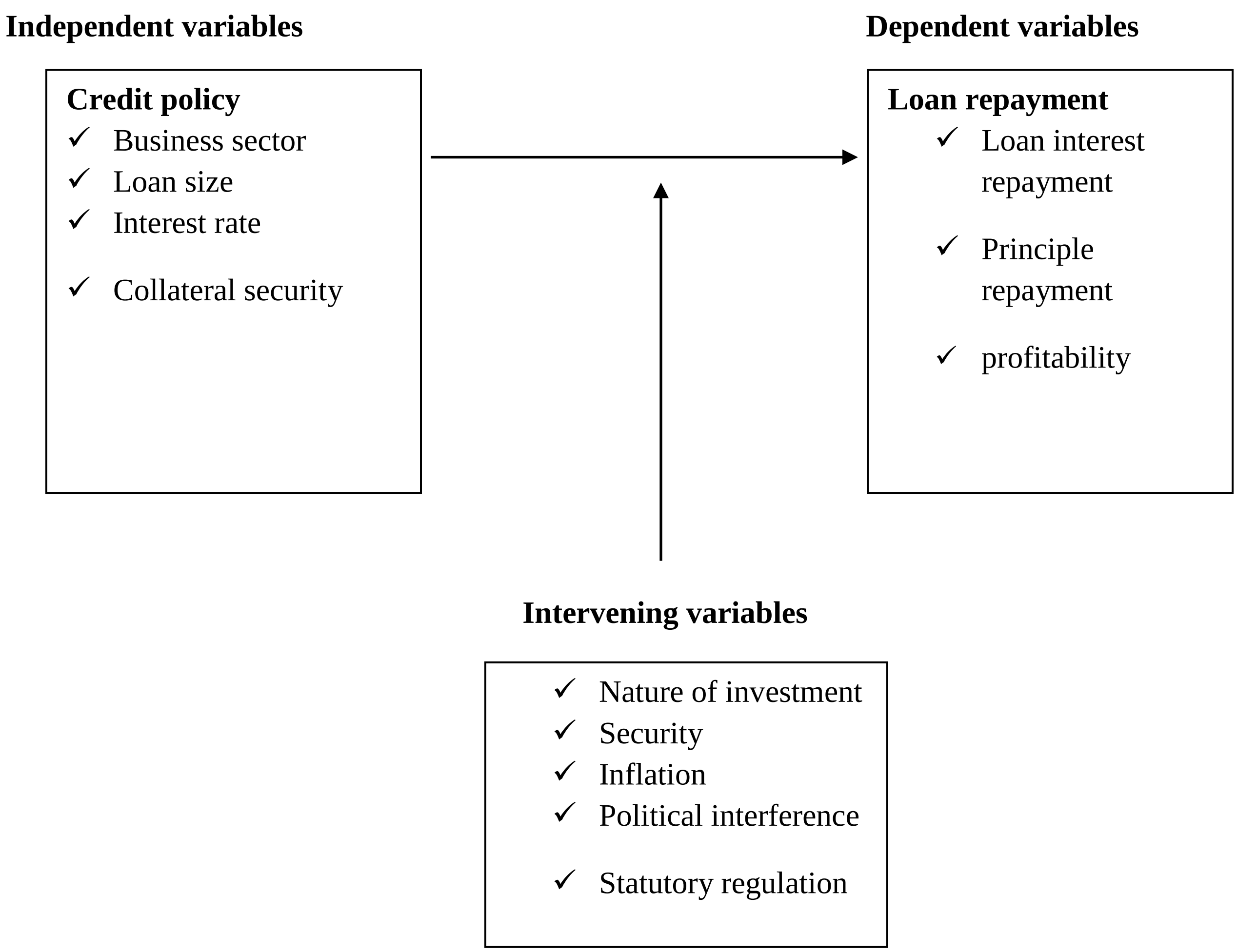
i. The research will highlight the areas of credit policy that may need to be modified.

ii. The study will help the researcher to better understand credit policy setting in relation to loan recovery.

iii. The research will pave way for other researchers interested in this field to learn from it and expand upon their research.

iv. Micro-finance institutions and commercial banks can improve their loan portfolio performance by undertaking to implement recommendations

1.8 Conceptual framework



Source: Adopted from Pandey (1995) and modified:

Figure 1:1 showing the conceptual frame work.

For purpose of scientifically studying the operations of the commercial banks and microfinance institutions loans, and identifying relationship between Credit policies and Loan repayment, a consistency Demand- Input-Output conceptual model will evolved. The logic is that the independent variables credit policies must be consistent with one another and operate as a unit to influence Loan repayment. It is the total relationship between credit policies and loan administration as a package that influence the dependent variable Loan repayment.

1.8.1 Independent variables

A number of factors have been identified as contributing to loan repayment. For purpose of this study they were categorized into loan policy and loan administration. Under credit policy the following elements will be studied. Business sectors, loan size, interest rates and loan collateral. Loan Administration elements studied were loan appraisal, disbursements mechanism, loan monitoring, repayment rates and follow up actions.

1.9 Conclusion

This section has provided an introduction, background, well explained conceptual framework and research problem of the area under study. This section has also explained why the study is important and its objectives. The next chapter provides a deeper analysis of the fact that microfinance credit policies and loan repayment has existed for a long time but very few but still there are hindrances that are affecting the banking sector.

CHARPTER TWO

LITERATURE REVIEW

2.0 Introduction

The chapter provides a critical review of issues that have been explored and studied both theoretically and empirically in the exiting literature on credit policy management. This literature shows a predominant role of the private sector. The literature is got from the books dealing in credit policy management and surveys of credit policy management practices in banking institutions and internet searches. This mainly covers the effect of credit management policies on performance and repayment levels of borrowers.

2.1 Overview of Uganda's Finance Sector

The bank of Uganda in 1999 issued a policy statement where all financial institutions are categorized in four tiers namely Commercial banks, Credit institutions, Micro-finance deposit taking institutions and institutions involved in micro-finance business that do not qualify for tier 1,2,or 3 (Micro Finance Forum, 2001). By identifying the different tiers, Bank of Uganda (BOU) recognized Micro-finance Institutions as one of the key players in Uganda Finance Sector. It is therefore important to investigate and learn more about Commercial banks and Micro-finance institutions success and failure in the area of credit delivery.

Commercial banks are broadly defined as financial institutions that are engaged in keeping, lending money and providing other monetary services to the commercial sector. The commercial sector includes delivery of services, trade, and small and light industry (Dennizer, 1997). Commercial banks focus on profits in providing services to the commercial sector. Micro-finance institutions are new and at the moment they are not yet regulated. Currently it estimated that there over 500MFI in Uganda including small Community Based Organizations (CBOs)

(Micro Finance Forum, 2001). There is still a high-unmet demand for flexible, market responsive and sustainable financial services in rural areas beyond the trading centers.

2.3 SME performance

According to Brem et al (2008), Performance Measurement Systems (PMS) in Small- and SMEs shows that the main contributions focus on the development of theoretical models, but not on guidelines for practical implementation. In this context, Brem established an important neglected aspect as the general fitness or readiness of an SME to implement a PMS. In this aspect, a case study in a German Small Medium Enterprises was conducted and the findings indicate that the existence of specific contingency factors - Corporate Strategy, software9 based Enterprise Resource Planning (ERP) and Activity Based Costing (ABC) – strongly supports the successful implementation of a PMS and its later use.

Of course to ensure a reliable performance measure among SMEs, there is need to use the Key Performance Indicators because a new paradigm of performance measure has been adopted by many SME’s. This is based on identifying what the business does in terms of levels of processes and attaching Key Performance Indicators to those processes. The recording and analysis of the Key Performance Indicators should significantly contribute to the achievement of business goals. The main reason for using KPIs include; telling businesses how well they provide services, how long they take to process customer requests, their product delivery performance and how much time they spend fixing mistakes. The KPIs are those critical measures which ultimately determine profitability and shareholder value. The traditional Statement of Financial Performance, Statement of Assets and Liabilities and Management Accounts are not enough to effectively manage businesses which are seeking to survive and add shareholder/owner value. Management needs additional timely information, much of which is not traditional Financial Data, if they are going to effectively manage their businesses.

A Performance Indicator (PI) measure is a measure of the behavior of a business process. In business, understanding the state of the financial health of a business is a very important issue relating to business survival. There is a strong similarity between physical fitness and the health of a business. The Cash Flow of a business can be likened to the blood circulating through a person. If there is blood loss in the flow, the consequences are swift and predictable.

According to Sudhir & Subrahmanya (2009) & Dalrymple (2004), growth over a period of time can be used for performance measurements of SMEs since this, rather than short term performance, will reflect the long-term strategy of the firm. The researchers (Sudhir & Subrahmanya) probed how far Indian SMEs carried out technological innovations as a result of technology and other related inputs acquired through subcontracting relationships and achieve growth using the case study approach covering two SMEs in Bangalore. It was established that customer requirements were the major causal factors while internal factors such as self-efforts and in-house technical capability along with external factors in the form of technical inputs, suggestions and initiative from Large Enterprises (LE) customers were the sources of innovations for these SMEs. Because of these innovations, SMEs achieved growth in terms of investment in plant and machinery, output and customer base, which are ideal indicators of SME performance.

2.4 MFI-SME relationship

Omeke (2010) stressed that Microfinance Institutions provide a wide range of financial and non financial services to small and medium entrepreneurs, loans, savings mobilization, micro-insurance, money transfer and financial education among others and that in Uganda, the microfinance industry has been recognized for its major contribution towards the fight against poverty and improvement of household welfare. Several semi-urban and rural people have been able to participate in the livelihood activities through access to microfinance services. This however requires a great deal of cooperation between the clients and the lenders so as to ensure that there is a good working relationship.

However, today the vibrant microfinance industry is encountering stiff competition at the marketplace. The entry of new commercial banks and downscaling of the old banks' operations into the SME sector has instigated tough and unprecedented competition against MFIs. After the lifting of the suspension on commercial banks in the budget year (2007/08), a stream of foreign banks stormed the Ugandan financial sector. The traditional commercial banks had neglected the SME markets as high-risk sectors. Likewise, there has been improvement on the quality standards of service delivery. Hence, the ultimate, beneficiary from all these reforms and innovations is the customer who has received a good and strong intimacy with the SME/MFI relationship especially with the demand tailored services.

In order for MFIs to remain afloat, they need to realign and reposition themselves at the marketplace. MFIs must adopt and come up with varied innovative market survival strategies to avoid being edged out by the big boys.

Therefore, MFIs should capitalize on the already existing competitive advantage and long relationship they have had with the SMEs to have a cutting- edge over the other financial institutions. All they need to do is streamline and improve on the speed and quality of service delivery by providing demand-driven and market responsive services and/or products. In their arguments, Ozkan and Ozkan (2004) maintain that building relationships with financial institutions improves firms' ability to access external financing. This suggests that firms with a higher proportion of bank debt will be able to access external financing more easily. Establishing MFI relationships with SMEs reduces information asymmetry and agency problems, since valuable information about SME quality can be disclosed. Thus, establishing stable links with financial institutions can improve both the availability and the conditions of financing. Various works have empirically demonstrated that keeping banking relationships can be beneficial to firms, insofar as contact between the MFI and SME can improve the availability of funds and lower their costs.

In a study by Fidrmuc et al (2009) about banks and SME's in emerging market, it was established that there is a lot of uncertainty about the risks involved in lending. The study used a unique unbalanced panel of 700 short-term loans made to SMEs in Slovakia between January 2000 and June 2005. It was found out that of the loans granted, on average 6.0 per cent of the firms defaulted. This affected the relationship between the banks and SMEs hence deflecting the possibilities of accessing finances in future because the terms would change and become more stringent against the borrowers for fear of more defaults.

Kumar and Jeyanth (2007) agree with Fidrmuc that a good relationship between SMEs and MFIs helps them to easily access finances and information. They add on that capacity building of staff for preparedness is perhaps the most important task. MFIs are unique in their way of operation as the staff has rapport with even the most remote clients. Their argument was that in the event of an emergency, MFI personals are often the first to reach affected communities. Hence they should be trained on disaster risk reduction before disaster strikes – as to their responsibilities and the extent of their decision making authority.

Client preparedness is another area where any MFI can play a constructive role in strengthening their relationship with SMEs because they serve the marginalized groups, their clients often live in highly vulnerable physical locations. Encouraging clients through education on disaster risk reduction and designing loan products to develop disaster-proofing shelters.

The MFIs can develop relationships with specialized institutions on disaster management. Except in areas frequently hit by cyclical disasters, MFIs are rarely aware of disaster warning systems. Rather than suggest that each MFI create these partnerships, however, donor organizations or microfinance network organizations may be more cost efficient channels to track and disseminate disaster warning information. This channel of communication may also serve to link MFIs with relief organization that can also prepare by developing lines of credit – either with commercial banks or donors – for emergency drawn down. All of these partnerships offer important opportunities for MFIs to become better prepared to serve their clients – as well as survive the crisis themselves – without losing their financial services perspective.

2.5 Loan Performance

There are several ways of measuring performance and one of them is the "SCALE" performance measure (OECD, 1996). This measure calculates self- sufficiency ratio, capital adequacy, asset quality, liquidity and earnings quality. The asset quality ratios that look at delinquency rate, loan loss rate and loan ageing report are relevant for estimating loan repayment. The other performance ratios focus on other business components and would not be useful for this study.

2.6 Loan Operations

2.6.1 Loan Policies

Loan Policy provides a general rule to guide decisions concerning credit management. Loan policies provide a framework for credit management process. They set standards and parameters to guide managers and credit officers in evaluating, granting and loan monitoring and follow up actions. They provide Directors, regulators, auditors with a basis for evaluating performance (Me Naughton, 1992). Credit policy involves three decision variables namely credit terms (interest charge, loan size, loan period, collateral requirement and eligibility criteria) credit standards and collection effort (Pandey 1995). It is therefore important to scrutinize the three loan policy decision variables of the two institutions in order to account for the differing loan portfolio performance.

Banking institutions assist low income earners to set up their own businesses to earn a living. These include nongovernmental organizations credit and saving co operations, self help groups, private companies and others.

Banking institutions help mainly in finance services and their related services like training how to administer financial development of self confidence and management capabilities among others, therefore its simply banking and development.

2.7 The credit policy management concept

It is a collection of assets that a business and individuals own. The objectives of credit policy management are to maximize profitability and liquidity. The concept of credit policy management is the process of allocating and managing assets. If your throw your money in a hand full of investments and never think about them again, you may have a credit but your are not practicing credit management.

Credit policy management takes time from senior managers. This is because it takes additional time to manage a credit as a group from members of the steering committee. In Uganda since 1988, commercial banks have registered a decreasing trend on the performance on loans due to poor credit policies that has led to the closure of some banks (musalizi, 1998).

2.7.1 Importance of credit policy management.

The objectives of credit policy management are to maximize profitability and liquidity. Credit policy management is a process to ensure that your company spends its scarce resources on the work that is of most value to the organization. If credit policy management is practiced, then this process helps to ensure that only the most valuable work is approved and managed. The value of utilizing a credit policy management approach includes the following.

i. Improved resource allocation.
ii. Improved allocation of the work.
iii. Improved balance of work.
iv. Changed focus from cost to investment.
v. Increased collaboration between senior managers and other departments.
vi. Enhanced communication.
vii. Increased focus on when to sell.

The above are of an advantage to banks if credit policy is properly selected and managed. Brownbridgr and Harvey, (1998) observed that banks often continue their bad lending policies; resources are frequently used prudently leading to large numbers of nonperforming loans and under capitalized banks. The large inefficiencies in the banking system of Uganda have resulted in great loss. As a result, Uganda has had signs of individual bank crises and the central bank has had to intervene depending on the gravity of the problem of the bank in question.

According to Nkanja of Uganda commercial bank, financial resources in banks and financial institutions represent national savings, which must be utilized efficiently so as to generate a desirable response to the economy. Each bad loan given out is not only a loss to the individual but the economy as a whole. Bank loan credit must perform to allow a continued flow of funds to economically viable activities that increase the stock of investment upon which any country's growth and development essentially depends.

In most African economies, there are inadequate savings, capital and credit because the population is still at or only slightly above subsistence levels. Both the absolute and relative capacity of indigenous capital formation is quite limited and collateral securities do not exist. African saving is among the most liquid in the world since they are in terms of small cash hoards that remain idle and cannot be mobilized through the banking and investment mechanism for the use by other entrepreneurs. (Geiger and Armstrong, 1964).

Shekhar and Shekha (2001) talks about janakiraman which was constituted to inquire into the irregularities committed by banks and financial institutions were submitted in April 1993. This report sets out the overall findings. The findings reiterate the nexus between brokers financial institutions, banks and subsidiaries covered in the reports consciously sought to circumvent the reserves banks guidelines on credit policy management services so as to enable financial companies' access large funds for use in the stock market for huge profits. The reports have identified four key factors in the penetration of irregularities:

Improper and indiscriminate use of bankers receipts

Banks' failure to periodically reconcile investments and complete breakdown of internal control system in a number of banks. The committee has observed that as a consequence of these irregularities, the investment credits have been fragile and weak.

Lehman (1998), also remarked that by the mid of 1998, banks in Asia (excluding china and India) had nearly US dollars 13580 billion in assets of which 15% were problem loans which added up to US dollars 1080 billion due to poor credit policies contributing to this alarming state of affairs. The performance on loans of Chinese banks have suffered bad and non performing loans to defaulting debtors in order to protect the bank's balance sheet and maintain the viability of the borrowers.

2.7.2 Problems of credit policy management

The following areas describe reasons why it will be difficult to implement credit policy management. Senior managers in banks need to be aware of these as well so that they make sure that they do not consciously or unconsciously fall into these traps.

Credit policy management takes time from senior managers. It requires additional time from the members of the steering committee and senior managers.

You never have all the information you need. Senior managers are used to making decisions based on less than complete information.

They are tough to make. Groups of people need to get together and make decisions on what to get funded and what not to get funded. Managers are paid to make these type of decisions but it's not easy.

It's difficult and now some people thrive on change and may even get bored doing the same thing year after year.

It's had to reach group consensus. Some level of consensus has to be reached and it is not easy to reach a consensus with senior managers. Then credit policy management process with will break down if managers do look out for the banks best interest rather than their own.

Managers may be uncomfortable subjecting their projects to additional scrutiny. Some projects are important to senior managers but they might not make sense to other senior executives.

2.8 Credit management dilemma

Every institution that offers credit has to be with a credit management policy, which will enable them to get returns and repayments from their clients.

Grimma (1996) it's useful to have credit approach which suits their objectives (to run a cost effective scheme) due to the high cost of dealing in small scale credit provision.

A lender may use the threat of cutting of credit to desired behavior of an individual that in general the borrower hormonally want to avoid default on loans because it troubles their reputation and limit their access for future credit desires. Stigliz (1983) it's basically informal to inter link credit policy contracts that may provide means to alleviate the problems of screening and enforcing loan conditions to show the relationship of the lender and the borrower is expected to pay a greater role in enforcement of contracts and repayments according to Undry (1990).

2.9 Networking

Networks are a web of relationships with mutual complementary action able to harness synergistic potential of members to achieve a common goal. Internal networks among associations and organizations most especially among SME's facilitate horizontal knowledge flow and management between sub units and are central to innovation process. Ritter et al (2002) argues that the ability of a firm to develop and manage relations with key suppliers, customers and other organizations and to deal effectively with interactions among these relations is a core competence of a firm- one that has a direct bearing on a firm's competitive strength and performance.

Emmanuel (2006) observed that networks once established, are used as a strategic alliance for specific purposes including managing the business, access to resources, developing ideas, and cultivating social support. Networks have been considered to play a significant role in helping entrepreneur's access market information and new markets. Burt et al (1983) observed that engagement in networks allows entrepreneurs to access new markets, develop efficient business processes, share and reduce risks, complement skills and achieve an efficient exchange of information and technology. Boashan, Robert and Dong ,(2009), postulate that the network awe provide a special structure for connecting to the outside to get useful information , resources and social support that allows the firm to identify and make use of various opportunities. This was also supported by Fafchamps (1999), where he notes that relationship networks shape the firm of ensuing market exchange and that market entry due to externalities generated by the networks is easier for members than for none members.

Adil Chaudry (2007), asserts that networking allows entrepreneurs to promote their products and services to others, and also allows them to educate people about the unique aspects of their businesses and enroll them into finding entrepreneurs new prospects and leads.

People tend to be involved in economic activities for which they have regular required traditional skills which means that they are largely confined to less productive and less profitable market niches. Enterprises to compete favorably on the global market depends on their level of access to critical resources like finances, technology and managerial skills which in most cases are not readily available in the enterprise sphere. Consequently, the lack of technical expertise, adequate capital and other vital resources to undertake technical enhancement, suffer from inadequate organizational planning and differ from each enterprise in the extent of the product or service range available to customers, (Ankunda, 2009). Buttery et al (1994), noted that trends towards higher competitiveness through productivity growth and market expansion paradoxically requires firms to form cooperative alliance and networks through cooperation. He goes to argue that Networks usually focus on the combination of cost reduction and customer service orientation which is the important prerequisite for improving competitiveness of companies. Networking can also serve as a transitional stage to help organizations become leaner, more innovative and responsive to meet today's organizational challenge to change.

Findings by Aldrich et al (2000), indicated that women networks were organized around the spheres of work, family and social life. Women entrepreneurs were found to be more likely to use other women as information sources within the same locality.

Brooke (2001), contends that some kind of network content lowers the firm's cost for material and capital. The ties based on strong, affective community bonds may hurt the firms financially, restricting their options and their access to information about the market.

Studies by Woolcock (2002), indicate that the variation in the content of network ties affects the willingness of members to disclose and debate the information they have. In effect, network ties based on similarity/attraction exert a kind of "centripetal force" that encourages a socially comfortable consensus at the expense of decision quality.

Barr (1998) demonstrates that Ghanaian manufacturers with better business contacts perform better than well connected firms. She interprets the evidence as consistent with the idea that large firms use networks to access information about new technologies and market opportunities while small firms rely on closely knit networks of mutual insurance.

Fafchamps et al (1999), provide contemporary evidence regarding the survival of small firms and they indicated that with poor networks, the small firms headed by individuals with loose ties to existing businesses, information sharing is less developed. Chaudry 2007 observed that business networking allows entrepreneurs to tap into a Synergistic business mastermind group where business ideas are shared and opportunities discussed and reviewed by other members. In addition to that, Dess and Starr, (1992) viewed networks as away of enhancing communication and exchange of resources. The use of Networks for small medium enterprises has been reported as a factor influential in the development process of entrepreneurial activity (Mbabazi (2006).

Networking plays a role in enabling the entrepreneur to take on a multifaceted role set. Thus networking can be seen as helping the entrepreneur to be present and active in different roles simultaneously which helps the entrepreneur in managing the tension inherent in running a commercial business, (Andrea and Gustav, 2009)

While learning may be stimulated by a variety of factors scholars have suggested that inter firm relationships, such as networks result in organizational learning, facilitating adaptation of new processes and procedures (Hamel, 1991, Lyles 1988). Scholars further noted that net work participation can allow members to learn more about themselves and each other thereby enhancing competitiveness in dealing with firms outside the network. This is further supported by Larson, (1991) who contends that networks have the benefit of the transfer of knowledge and technology which may enhance the firm's ability to obtain intangible resources quickly. Knowledge based resources are particularly important for providing sustainable competitive advantage, because they are inherently difficult to imitate thus, facilitating sustainable differentiation (Provan, 1993). Zimmer (1986), McGrath et al 1996 also argue that knowledge based resources play an essential role in a firm’s ability to be entrepreneurial and to improve performance. Using networks allows firms to locate variable resources and improve acquisition capability. Powell (1990) argue that if the relationship among members is so closer, group members will have a common vision, which facilitate the exchange and combination of resources but also use the resources acquired from other groups properly to enhance acquisition capability and outcomes. Business networking is currently adopted by a significant proportion of business enterprises (Gulati, 1995).

Kogut and Walker (1993) propose that the acceptance of the cooperative network is so wide spread that the ‘make or buy’ decision that was previously considered by companies is now ‘make or cooperate’. Buttery and Buttery (1995) argues that due to the established complexity of new product development and market segments, businesses now find it difficult to establish the necessary expertise in all areas of its operation required to compete thus, cooperating with other companies provides a mechanism with which new product development can be achieved.

They further show that Networks enable firms to concentrate on core competencies, and to achieve economies of scale and scope through their loosely integrated form. Communities may also develop norms of behavior – a business culture – that are deemed suitable to conduct business (Hayami and Kikuchu (1981)). Another possibility is that business communities or clubs strive to build a reputation as a group with respect to other business communities with whom it is trading. This idea has been formalized by Kandori (1992) and Ellison (1994). In this case trade takes place across communities and the benefits from repeated interaction are captured not through individual relationships but through community relationships. The reputation of the group becomes an asset that serves as collateral to guarantee good behavior.

Each community may then choose to punish its own members for opportunistic breach of contract. Selz, (1992) asserts that networks help small companies think and act big thus allowing the SMEs to gain knowledge, resources and customers that might be available to much larger firms. Selz also argues that involvement of firms in networking activities will help them to learn more about other firms, gaining knowledge about markets, customers, production. In addition, as part of the cooperative interaction process, firms and their members are able to learn more about themselves and their own competitiveness, including strength and weaknesses.

2.10 Types of loans

Micro –finance institutions basically provides short- term loans and the members choose themselves, the principle is that each member should know the capabilities of other member in a group and acts as a guarantee on the loan given out.

Brown (1993) shown in this study of micro-credit and small –scale entrepreneurs in Elsacado reported that Grupos Solodanias Agropecuenios (GSA) provides working capital for agricultural production on small farms. He further reported that another program Grupos Graneros Unfamiliaries (GGU) promotes effective marketing by providing credit to implement a suitable grain preservation and storage infrastructure. For example through (GGU) program, rural households are providing with a metallic silo (costing around us$75) as a loan.

2.10.1 Loan size.

Microfinance loans vary in size and will greatly depend on the number of loan cycles made by the client. Findings by George (2008) indicated that the size or amount of loans issued by MFIs is too small to make an impact on businesses. He further noted that clients were taking multiple loans due to the fact that the first loans taken did not provide adequate impact and hence the need to take a second one. Graham (2001) also observed that the small loans given when it cannot be used to meet the business demands will always be diverted to other uses other than the business.

Some mechanisms have been designed to reduce the risk that individual behavior may impose on the group as a whole. Sequential lending, when loans are provided sequent to different sub groups of borrowers participating in a given group lending scheme, is one example that reduces coordination failure risks (Besley, 2002). Further, he observed that self selection leads to the formation of groups of relatively safe borrowers, hence limiting the transfer of risk from the group to the individual borrower.

One concern is that group lending schemes have been argued to be overly conservative in risk taking, selecting only the safest projects, (Stiglitz and Weiss, 2007).

Woller (2002) indicated that within the lending function of micro finance institutions, the loan products offered almost entirely consists of enterprise loans. Nonetheless, significant unfulfilled market demand also exists for consumption and emergency loans. The loan sizes always advanced do not enable the borrower to cater for both his social and business needs.

In a study by George (2008), among people accessing loans in Nairobi, Kenya, he found out that the size of the loan issued was too small to make an impact on their businesses forcing many of them to take multiple loans as a way of supplementing the inadequate loans acquired from the micro financial institutions.

2.11 Interest rate

Interest rate is the price of accessing and utilizing credit resources. Interest rates can be looked at from the borrower (customer) and the lender (financial institutions) point of view. To the customer, interest rate is the cost of borrowing money expressed as a percentage of the amount borrowed (Martin, 1998). A customer evaluates all costs including interest rates and expected returns before deciding to take a loan or not. To the lender, interest rate is determined by factoring in costs such as cost of production, the inflation rate, cost of production delivery, personnel and administrative costs, loan loss provision and capital growth (Kasibante, 2001). The rate charged should be able to cover costs and make a contribution for the financial institution. Different institutions charge different interest rates depending on their peculiar conditions for example FINCA's interest rate is 4% per month, Uganda Women finance Trust 2.5% and MED-net charges 3% (Brochures, 2001).

Interest rates charged by micro finance are relatively higher than commercial banks (Micro finance forum 2001). Justification given for high rates is that smaller enterprises have high turnover which has a direct relationship with income and repayment capacity of the client and that the rates are lower than what is being charged by loan sharks.

2.12 Repayment schedule

Snodgrass and Sebstad, (2002) argue that inflexible and non- negotiable repayment schedules of Micro finance institutions have implied little assistance in coping with stress events and financial shocks suffered by members and have also caused liquidation of assets by families in order to meet deadlines.

MFIs provide similar products and services to their customers as formal sector financial institutions. The scale and method of delivery differ, but the fundamental services of savings, loan repayments and insurance are the same. Notwithstanding, to date most efforts to formalize micro finance lending (loans for enterprise formation and development) together with short repayment schedules normally one week or two which remain far today the dominant repayment schedules offered by micro finance institutions, (Nourse (2001), Woller (2007)). Nourse (2001) reviews the context and rise of micro finance products and argues that there is need for savings and insurance services for the poor as a way of minimizing on the loan risks which can facilitate micro finance institutions to advance big loan sizes to its clients. He goes on to argue that MFIs need to provide tailored lending services for the poor and not just credit products. Similarly, Woller (2007), Cohen (2002) and Dunn (2006) argue that MFIs need to be client focused including offering a mix of financial products tailored to the varied needs and wants of poor consumers. This is mainly evidenced in the rigid repayment schedules where clients have to meet so often to meet their weekly repayments to the lending institution.

George (2008), argues that a large majority of the micro finance institutions were offering very short loan repayment periods without grace periods, thus straining and pressuring them to make quick repayments. The clients from the micro finance institutions did not feel the immediate impact of the loan but instead they felt immense pressure to put all their earnings towards loan repayment. He further indicated that the immense pressure associated with quick loan repayment and short grace period could have led some micro entrepreneurs to sell their land in order to meet the demand for quick repayments.

2.12.1 Repayment period

Action plan on revised loan manual (May 1995) reveals that the repayment period and the length of the grace period shall be agreed on during the appraisal base on the type of the project. Unless the credit requirements, the projected cash flows of the borrowers knows the repayment promptly.

Gomez (1998) clients always satisfy with the repayment period on their loans there some exception this is because the terms will depend more on the size of loan than cash flows of the borrowers.

2.12.2 Repayment mechanisms

These are grouped in different categories include:

2.12.3Financial incentives

In this aspect, there is a basically different category that is the system where new loans are advanced to members before full or nearly full repayment has been established. However today, centenary bank has changed for instance if the member has remained with a quarter of the loan it’s possible to give him another loan of the savings available is favorable to it. Adats, South India, where they match every loan repaid I time with a great of the same amount to the credit fund. This repayment has to be ensured by other mechanisms as soon as the matching grant system reaches its ceiling and has to be gradually stopped.

2.13 Collateral

Commercial banks predominantly request for collateral before extending loans to its customers. The collateral is always of higher value than the loan taken to ensure that the loan is paid back. On the other hand micro finance institutions use the group guarantee system as collateral substitute in extending loans to individual members of the group (Yunus, 1996). If one member fails to pay the other group members must pay on his behalf. This system makes it possible for group members to monitor one another thus leading to improved loan repayment. However, some studies have found out that group members don't want paying for others and they also don't like others paying for them (Antonio, 2000).

2.14 Relationship between loan operations (policies & administration) performance.

The objective of extending credit is to meet both clients' needs and institutional sustainability, while implementing loan policies and procedures that work (Micro finance forum 2001). Six best practices referred to as loan policies & procedures that work were identified. These include adaptation of urban lending policies and procedures to client environment, repayment capacity, loan size and period, group lending, individual lending and progressive lending. In all the six best practices identified, AMFIU stressed the importance of synchronizing policies and procedures to serve clients efficiently. This indicates the possibility of a relationship between loan operations and loan portfolio performance.

2.15 Loan Administration.

2.15.1 Loan Appraisal.

Assessing effective credit demand based on repayment potential requires certain skills in an institution. The success or failure of a loan depends to a large degree on an accurate appraisal of the customers' repayment capacity (Hartmut S., 1997). In a paper prepared to examine the proposition that movement towards larger and more complex banking may come at the expense of provision of credit to the small business (Allen N. Berger and Gregory F.Udell), it was noted that extending loans to the small borrower depends on bank-borrower relationship and appraisal requires loan officers with intimate knowledge of the local more than just relying on documents but also on knowledge of local environment and bank-borrower relationship built over time. A forum on barriers facing banks in lending to many small and disadvantaged businesses (Florida International University, 1993) was undertaken and six barriers were identified. The barriers include location of business; banks are not a source for startup capital, lack of equity, educational/experience needs for start-ups, adequate technical assistance for startups and poor management. The six barriers identified by stakeholders especially bankers do shade light on what banks look out for while appraising loan requests. One needs to undertake this study to find out the appraisal process in Uganda's context.

2.15.2 Loan Disbursement.

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

2.15.3 Loan monitoring.

As correctly pointed out in a paper on universal banking and the future of small business lending, (Allen N. Berger and Gregory F.Udell), small loans require a strong bank-borrower relationship and are more information intensive. There is thus need for close monitoring in small loans than it is the case for big loans.

2.15.4 Repayment mechanism.

Each organization has a different repayment mechanism. Based on the specifics of the enterprise, a borrower can chose to repay weekly, bi-weekly or monthly installments (Uganda Micro finance Union, 2001).

2.15.5 Follow up actions.

The success of any institutions depends on its ability to adapt to changing circumstances. Institutions should have a culture of handling funds that must be repaid. They should be prepared to seize the client's collateral if necessary (Garber, 1997). The organization should have a system of tracking late payments and real losses, deploy staff to maximize return of resources.

2.15.6 Collection procedures.

These are the numbers of collection procedures that are employed. Gitman (1976) identified different collection methods.

Letters: these are sent immediately the account is in arrears and they can be sent into two or three times.

Telephones: these are used due to possible failures in the letter system.

Personal visits: this is when credit officers visit these clients to see what exactly is there. Girma (1996) remarks that to protect loan losses, micro finance should ensure themselves against the possibility of non repayment by clients although this increases the cost of borrowing which then becomes a problem to small borrowers and this may lead to more savings in financial assets, reduced risk and potential losses and increases investment.

2.16 Relationship between micro finance credit policies and loan repayment.

The repayment of loans depends on many factors but especially the favorable credit policies and other factors. They include collateral security; interest rates paid which many customers complained about and the repayment period. Collateral affects the loan repayment in such a way that staff knows that failure to pay back the loan, the collateral will be taken. They tend to relax and ignore the payback period. Interest rates also affect the loans since they are high and fixed on the loan and may be a burden to the borrower when paying back.

Micro finance institutions play many roles in enhancing the repayment of the loan by building a saving culture in their customers since it constitutes part of their collateral security and increases capital for loan repayment. Micro finance is also providing training and skills in development of the self-confidence, financial literacy and management. Capabilities for the enterprise such that loan repayment is done staidly and fast.

2.17 Conclusion.

Despite the fact income promotion is based on loans form micro finance institutions, its appropriateness as a strategy for loan repayments in case of poor people is questionable. (Montgomery 1996)

Therefore, there is a debate on whether the credit policies may lead to detoriation in the quality of loan repayment that should receive immediate attention to the banks. Most of the micro finance institutions, customers pay the loan with difficulty and others default and at times loss even the already existing property due to failure to pay. Some clients have had at time to divert funds to activities which were originally not declared to the bank. It’s argued that the character and integrity of the customers is very important for good performance and effective loan repayments. It’s hoped that good micro finance credit policies will go a long way to streamline the operations of financial institutions by monitoring the credit policies and loans given to customers.

CHAPTER THREE

METHODOLOGY

3.0 Introduction.

This chapter was concerned with the research techniques that were used in execution of the study. It begins with a brief description of the research design, area of the study, study population, sampling techniques, data collection methods and instruments, quality control methods, data management and processing, data analysis, ethical considerations and limitations of the study.

3.1 Research design.

The researcher used both qualitative and quantitative research approaches through case study research design which involved intensive descriptive and holistic analysis of a single entity in order to gain insight into the larger case (yukol, et al.2005).The design was be used because it excels at bringing an understanding of a complex issue, extends experience by adding strength to what is already known through previous research and it emphasizes detailed contextual analysis of a limited number of events and their relationships(Saunders et all..2003)

3.2 Study population.

The study population was composed of 90 traders who are members of the Uganda traders association and 10 employees from the Ugafode Microfinance limited a micro finance institution. The selected population, involved members who accessed loan finances from Ugafode. The banks and collateral bodies population was composed of banks that have extended the line of credit to traders and collateral management firms that exist in Uganda. These entire stakeholders play a crucial role in loan financing and therefore have rich information that was of help to the researcher.

3.3 Sample size and design.

The study took a sample of 100 traders. This was determined according to a sampling formula by Kish (1965).

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

3.3.1 Sample size

Table 3:1 Sample Size

Clients	**90**	**70**
Staff	**10**	**5**
Total	**100**	**75**

Source: *primary data.*

3.4 Sampling procedure

Probability sampling was used since its most commonly associated with case study research where you make inferences from a sample about a population to meet your objectives (Saunders et al.2003). The strategy was preferred because the study involved selecting sample traders from the entire population of 75 of the respondents.

3.5 Data collection methods and instruments

Data collection instrument used was a questionnaire which was used to gather responses quantitatively. The questionnaires were structured to contain questions that addressed the three variables; Micro credit lending terms, loan repayment terms and Performance.

3.6. Data sources

The study used both primary and secondary data. Primary data was collected from the owners of businesses while secondary data was got through the review of relevant literature from publications such as the municipal council financial reports, journal articles, textbooks and other related publications.

3.7 Data collection

Data was collected by the use of questionnaires which were be distributed to the respondents and then collected after. For those respondents that did not understand the English language, interpretations were be made in order to help them (respondents) give accurate information.

3.8 Data analysis

The data collected was entered using Epi-Info version 6.04b statistical package and then exported to a statistical package for social scientists (SPSS version17) for analysis. This generated frequency tables for demographic and descriptive data. The relationship between the study variables was established using correlation. Regression analysis was used to determine the prediction potential of the model

3.9 Study Variables and their measurement

Credit terms were measured according to Collateral Loan period, Loan Repayment schedule, Interest rates and maximum Loan size. Liquidity levels were measured based on current ratios, and the quick /acid test ratios while MFI-SME relationship was measured based on intimacy, Interaction and Trust as used by William (2004). On the other hand, SME performance was measured according to return on capital employed, gross profit margin, sales margin, Portfolio growth, Timely Loan repayment as used by Kazzoba (2006). The researcher used a 5-point likert scale to measure the responses across all the variables.

3.10 Reliability and validity.

The study instrument was first tested for reliability using the content validity index and cronbach's alpha co-efficient respectively. This helped to yield consistent measurements, and drew satisfactory conclusions. For validity test the researcher was able to measure the extent to which the results of the study were generalized (Campbell and Stanley, 1966).

Table 3:2 Reliability tests

Variables	**Cronbach's Alpha**	**No. Of Items**
Credit Terms	.827	10
Network	.780	10
Loan Performance	.910	12
MFI-SME Relationship	.876	12

Source: *Primary data*.

The table above shows the results obtained from a reliability analysis test carried out using Cronbach's alpha test. Results revealed very good reliability measures for the constructs which all above 0.7 as recommended by Nunnlly (1978)

3.11 Limitations to the study.

The respondents could not easily interpret and translate the research instruments since it is designed in English. A lot of time was spent while trying to translate the questions. However, the researcher translated the questionnaire in the local languages to make sure that the desired responses are obtained.

The value of the research depends critically on the accuracy of the data collected. Data quality can be compromised via a number of potential routes, for example leading questions, unrepresentative samples and biased interviews. However the researcher had to ensure that data is accurate, samples were representative and the interviews were objective so that mistakes were avoided.

Most borrowers in Uganda do not maintain proper financial records (Ocici, 2006). This raised a challenge of measuring their performance and particularly the financial aspect and some respondents provided estimates that were relied on. Because most of the SME operators have low education levels GEM (2003), the researcher faced a challenge of explaining technical terms to the respondents.

3.12 Ethical considerations.

In an attempt to produce a quality and a reliable study, the researcher first sought for permission from the Rubaga local Council authorities to allow him undertake his study and also intends collect the data himself to avoid any collection of information through unethical means such as research assistants who fill questionnaires themselves instead of interviewing the respondents.

Also the researcher got an introductory letter from the university introducing him to the various places that he intended to collect his data.

CHAPTER FOUR

PRESENTATION AND INTERPRETATION OF FINDINGS

4.0 Introduction

This chapter analyzes and presents the findings of the study. The findings are presented in tables showing frequencies, percentages, correlations and figures. It was guided by the following objectives:

i. To establish the effect of credit terms of microfinance institutions on loan repayment.
ii. To assess the performance of SME's accessing credit from MFIs.
iii. To assess the level of networking among SME's accessing loans from Micro finance institutions.
iv. To examine the relationship between the MFIs credit lending terms, loan repayment terms and the performance SME's.

4.1 Background information.

In this section, the researcher presents the demographic characteristics pertaining to the response rate of respondents, gender, age, marital status and level of education. These were followed by the characteristics of the firms such as the type of business, longevity of your business, for how long have you been borrowing

4.1.1 Response rate:

A total of 100 questionnaires were sent out to the respondents and the response rate was as shown in the table below.

Table 4:1 Response rate

	Population size	Sample size	Response rate
Clients	120	90	70
Staff	25	10	5
Total	**145**	**100**	**75**

Source: *Primary data.*

From table above, it is indicated that though the sample size was 100 the actual response rate was 75. Therefore the analysis was based on the perceptions from the 75 respondents

4.1.2 Gender of respondents.

Table 4:2 showing gender of respondents.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	**Male**	42	52.5	56.0	56.0
	Female	33	41.2	44.0	100.0
	Total	75	93.8	100.0	

Source*: primary data.*

The result in the table 4:2 shows that most of the respondents were male with a percentage of 56.0%. The study also indicated that the female respondents were least with a percentage of 44.0% of the total of 100%.

4.1.3 Age group of respondents.

The age of the respondents was established to determine the respondent's maturity and the results were as below.

Table 4:3 showing age of respondents.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	18 - 25	5	6.2	6.7	6.7
	25 - 35	30	37.5	40.0	46.7
	35 - 45	22	27.5	29.3	76.0
	45 - 55	15	18.8	20.0	96.0
	55 +	3	3.8	4.0	100.0
	Total	75	93.8	100.0	

***Source**: primary data.*

The results in table4:3 above; reveals that the majority of the respondents were between 25-35 years (40%) that is 30 respondents out of 75 respondents. These were followed by the age bracket of 35-45 years (29.3%) representing 22 respondents out of 75, followed by the age bracket of 45-55 years (20%) that is 15 out of 75 respondents and the rest 3 respondents were above the age 55 years presenting a response rate of (4%). These reflected that most respondents were mature and are able to give information they know about their business with confidence.

4.1.4 Education level of respondents.

The education level of the respondents was used to establish their level of competence as regards the subject matter and the results are indicated in the table below.

Table 4:4 showing educational level of respondents.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Certificate	34	42.5	45.3	45.3
	Diploma	20	25.0	26.7	72
	Degree	8	9.8	10.6	82.6
	Masters	13	16.2	17.3	100.0
	Total	75	93.8	100.0	

Source*: primary data*.

The results in table 4:4, above revealed that the majority of the respondents had a certificate (45.3%) that is 34 respondents out of 75 while only 10.7% that is 8 respondents out of 75 of the respondents had a degree as the highest level of education. Those with other qualifications were less than 6% that is 4 respondents out of 75 of the entire respondents. Therefore, since the majority had a certificate as the highest qualification, it signified that they were not knowledgeable enough on issues relating to loans.

4.1.5 Type of business engaged in by respondents.

The type of business determines the degree of risk to both the lending institution and the borrower of the loan. Thus it affects the repayment and the loan size to be extended to the clients from micro finance institutions. The results are in the table below.

Table 4:5 showing business type engaged in by respondents.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Agriculture	30	37.5	40.0	40.0
	Manufacturing	7	8.8	9.3	49.3
	Trading	18	22.5	24.0	73.3
	Education	6	7.5	8.0	81.3
	Health	10	12.5	13.3	94.7
	Others	4	5.0	5.3	100.0
	Total	75	93.8	100.0	

***Source**: primary data.*

The results in table 4:5 above, revealed that the majority of the respondents were engaged in agriculture associated businesses giving a percentage of 40%, 30 respondents out of the entire 75 while 24% of the respondents were mainly dealing in trading that is 18 respondents out of the 75 then manufacturing and health had 9.3% and 13.3% respectively of the population while others occupied only 5.3% that is only 4 respondents out of 75 respondents.

4.1.6 Longevity of the business.

Sustainability is very crucial to any business since the stakeholders can enjoy scale in the long run in form of reduced costs of production.

Table 4:6 showing longevity of business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0 - 1 years	36	47.8	48	48.0
	1 - 3years	20	25.6	26.6	74.6
	3 - 5 years	10	12.5	13.3	87.3
	6 and above years	9	11.7	12.0	100.0
	Total	75	97.8	100.0	

Source: *primary data.*

Table 4:6 indicates that 48% of the respondents, their businesses had lasted for 0 -1 year this implies that there are many startups in the country generally, while 26.6% had businesses ranging from 1 – 3 years. In addition, 13.3% had businesses of 3 - 5 years existence, 12.0% their businesses were 6 years and above this implied that usually may be due to poor management of business resources, few businesses live and exist for a long time as evidenced in the table. I think this is due to poor management and also miss management of business funds.

4.1.7 The period the respondents have been borrowing.

Mainly most businesses have been able to sustain themselves depending on borrowed funds from MFIs. Below is the distribution of the respondents.

Table 4:7 showing borrowing period of respondents.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0 -1 year	5	6.2	6.7	6.7
	1 - 3 years	29	36.2	38.7	45.3
	3 - 5 years	16	20.0	21.3	66.7
	6 and above years	25	31.2	33.3	100.0
	Total	75	93.8	100.0	

Source: *primary data.*

The researcher also investigated the period of borrowing for SMEs, and results in the table 4:7 above indicated that majority of the SMEs have borrowed for at least 1-3 years (38.7%) while, only 6.7% used borrowed capital for less than a year. This implies that the rate at which businesses are adopting to use borrowed capital is still low since only 6.6% were involved in less than one year.

4.2 Credit Lending Terms of MFIs extending Credit.

The results in the table below shows the credit lending terms of Ugafode Microfinance limited extended to customers.

Table 4:8 The Credit lending terms of MFIs extending credit to SME's

Credit lending terms.	**Min**	**Max**	**N**	**Mean**	**Std. Deviation**
The period extended to repay the loan.	1.00	5.00	75	1.63	1.01
The loan amount given is always enough to meet my business needs	1.00	5.00	75	3.39	1.36
The interest rate charged by Ugafode microfinance ltd is appropriate.	1.00	5.00	75	1.61	0.76
I am satisfied with the loan repayment schedule	1.00	5.00	75	4.13	1.00
I always use part of the loan acquired to meet my first loan repayment installment.	1.00	5.00	75	3.16	1.58
I always pay my loan repayments with ease when they are due	1.00	5.00	75	4.44	0.89

***Source**: primary data.*

From the table above, the perception of the respondents in relation to the period extended to repay the loans is adequate (M= 1.63), the interest rate charged by Ugafode Microfinance ltd to be appropriate (M= 1.61). However, the perception by the women respondents indicated that they were not satisfied with the loan repayment schedule (M=4.13), disagreed that they pay their loan installments with ease (M= 4.44) .In addition, respondents were uncertain that the loan extended by Ugafode Microfinance is always enough to meet their business needs (M= 3.39) and that they use part of the loan acquired to meet their first loan repayment installments (M=3.16).

4.3 Networking

Networking among clients accessing loans from Ugafode Microfinance ltd was examined and the findings were as indicated in the table (4:9) below.

Table 4:9 the level of networking among clients accessing credit from MFIs.

Networking.	**Min**	**Max**	**N**	**Mean**	**Std. Deviation**
My business always consults with other businesses.	1.00	5.00	75	1.77	1.00
I can freely discuss my business concerns with my fellow clients.	1.00	5.00	75	1.80	1.43
Able to get financial support through my group members at Ugafode.	1.00	5.00	75	3.90	1.34
Ugafode Microfinance has helped to improve on the income generating ability	1.00	5.00	75	3.67	1.501
Have been i position to open up new business branches in other areas.	1.00	5.00	75	4.29	1.09
My capacity to compete in the business environment has greatly improved.	1.00	5.00	75	3.93	1.732

***Source**: primary data.*

The perception of the respondents in relation to networking indicated that clients accessing loans from Ugafode Microfinance ltd can freely discuss business concerns with fellow clients (M= 1.80), their businesses always consult other businesses (M= 1.77) . However, on the other side, clients have low accessibility to markets (M= 3.46), clients were not in position to open up new branches in other regions (M= 4.29) and their capacity to compete in the business environment was limited (M=3.93). In addition it was revealed that Ugafode Microfinance limited has not put in effort to provide the networking opportunities to the women respondents, (mean= 4.05).

4.5 Loan Performance.

The assessment in the performance of small medium sized enterprises accessing credit from Ugafode Microfinance was carried out and the results were as indicated in the table 4:10 that follow.

Table 4: 10 loan Performance of SME's.

Loan performance.	Min	Max	N	Mean	Std. Deviation
My business has been able to increase on the number of employees.	1.00	5.00	75	3.87	1.49
My business has expanded in terms of working capital.	1.00	5.00	75	1.47	0.75
My sales have increased than before.	1.00	5.00	75	1.65	1.00
My savings have increased.	1.00	5.00	75	4.24	0.93
Have been able to acquire more business assets.	1.00	5.00	75	1.79	0.99
Have been in position to meet my business goals and targets.	1.00	5.00	75	1.84	0.78

Source: *primary data.*

The perception of the respondents in relation to the working capital indicated that Ugafode Microfinance ltd has enabled them to expand the working capital of their enterprises (M= 1.47), they have acquired more business assets (M= 1.79), they have been in position to meet their business goals and targets (M= 1.84), have been in position to increase on their sales volume (M=1.65). However, the respondents indicated that their enterprises did not realize an increase in savings (M= 4.24), and they have not been able to increase on the number of people employed. (M = 3.87).

4.6 Correlation

Correlation is the statistical measurement of relationship between two variables.

The results in the table below show the relationships among the variables which were generated using the Pearson correlation coefficient (r).

Table 4:11 Correlations.

		Credit terms	Loan performance
Credit terms	Pearson Correlation	1	.260*
	Sig. (2-tailed)		.024
	N	75	75
Loan performance	Pearson Correlation	.260*	1
	Sig. (2-tailed)	.024	
	N	75	75
*. Correlation is significant at the 0.05 level (2-tailed).			

Source: *primary data spss.*

4.6.1 The Relationship between Credit Lending Terms and Performance.

The results showed that there is a positive relationship between Credit Lending and performance ($r=.260^*$, $p<.05$). The results imply that if Credit lending is well structured and monitored, then the institution will realize improved levels of performance.

4.6.2 The Relationship between Credit Lending terms and Networking.

The analysis indicated a positive relationship between the Lending terms and networks ($r=.298^*$, $p<.05$). This shows that if credit terms are improved, then Ugafode Microfinance ltd will improve on the level of networking.

4.6.3 The Relationship between Networking and performance.

Furthermore, a positive relationship was observed between Networking and performance ($r = .263^*$, $p < .05$). This shows that if there is an improvement in networking, the institution will realize a growth in performance for the SME's.

CHAPTER FIVE

DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter includes the discussion of the major findings in relation to the study objectives. It also compares the findings to those of the previous researchers.

5.1 Discussion

5.1.1 Credit Lending Terms.

Credit terms which include cost of loan/interest rates, amount of loan disbursed, repayment schedule, collateral, and credit period have been viewed by researchers as vital in influencing the use the use of the loan.

Interest rates affect the nature of the transactions such as the size of the loan accessed by the clients. In an attempt to identify borrowers with high probability of repayment, financial institutions tend to set interest rates that an individual is willing to pay as a screening devise.

Respondents from Ugafode Microfinance limited were asked about their opinion on the interest rates and other charges incurred while servicing loans and they indicated that the costs were moderate. The majority indicated that the interest rate and other charges such as insurance charges, membership renewal fees, pass books and LC recommendation letter fee are not high thus affordable. However this was based on comparison with other sources of financing such as the individual money lenders but the real interest rate was high that is over 30% per annum. This concurs with Nissanke and Aryeety (2004); Bhuyan (2006), who indicated that MFIs maintain a wider interest rate charged to their customers. This is further confirmed by Lehmann et al (2004) who revealed that MFIs charge higher interest rates where their sustainability comes from the poor paying high interest rates.

The loan sizes in most cases affect the nature of business and type of investment for the borrowers. The small loan size is often advanced by the micro finance institutions as a way of minimizing risks. However, when the clients are not given adequate funds to cater for their business needs, they tend to resort to multiple borrowing. This in turn affects their repayment and increases the risks of the loan. The respondents were divided as to whether Ugafode Microfinance limited is giving them enough credit to cater for their business needs with some indicating that it was enough while others indicated that it was not. This is in line with the findings by George (2008) who indicated that sometimes the loans issued by MFIs are too small to make an impact on client's businesses.

In the formal banking structure the loan repayment schedule is embodied in the contract before a client is advanced with a loan. This shows the frequency when the clients are expected to make their regular repayment to the lending institution. Respondents were asked whether the repayment schedule set by Ugafode Microfinance limited was conducive to their businesses and the findings indicated that the loan repayment schedule is stressful to the clients since they always have to pay back the first loan installment just one week after disbursement. This has forced some of them to use part of the loan to meet the first loan installment which greatly undercapitalizes the businesses for the entrepreneurs. This concurs with the findings by Snodgrass and Sebstad,(2002) who indicated that the inflexible and non negotiable repayment schedules of MFIs implies little assistance in copying with stress events and financial shocks suffered by members.

Repayment periods have been adjusted by most of the lending institutions to suit client's needs.

Micro finance institutions are offering a diversity of loan products with different repayment periods ranging from weekly, bi monthly and monthly.

The perception of the respondents as to whether the loan period given by Ugafode Microfinance ltd is appropriate to their business needs indicated that members were satisfied with the loan period of five months.

This concurs with Woolcock (2002), who argued that a long loan period may make the client to be extravagant and end up failing to pay back the loan. Jackobson (2003), also indicated that the loan period should always depend on the amount of loan advanced to the intending borrower. Clients taking small loans should not be given very long repayment period. From the research findings since the majority of the clients were dealing in small businesses and taking small loans, they need a short loan period for regular recapitalization.

Lack of collateral by entrepreneurs limit some to access loans. A few members can stand as guarantors to the members intending to borrow funds from Ugafode Microfinance ltd. Members use social collateral where they do not have to be with physical properties in order to access loans from MFI's.

In this case a percentage is deducted from their loan on the disbursement day and retained by the MFI to act as security. In addition, a client has to be with guarantors from the clients who are already accessing loan services. This concurs with Woolcock, (2002) and Atieno (2009), who indicated that MFIs do not insist on physical collateral, the group guarantee loan act as collateral for group borrowers. Findings by Wenner (2006), were true when he indicated that if physical collateral were a requirement for borrowing, most MFI clientele would be unable to participate.

5. 1.2 Networks

Networks have been considered as important in enhancing performance of small enterprises through creation of opportunities for provision of market information, ideas and knowledge sharing among business people.

Market information is key to the growth of any business and one of the ways in which enterprises can be able to access market information is through forming or joining business associations. Associations form functions that could have a facilitating role on the development of enterprises as it can be an avenue to secure financing from many agencies and other business support including training, providing information and contacts and providing advice on how to overcome difficulties and barriers.

Findings indicated that the majority of clients from Ugafode do not belong to business associations. The findings were in line with Fafchamps (1999) who revealed that there are poor networks amongst small firms in form of associations which limits sharing business information. Entrepreneurs apart from accessing credit need regular information updates which can be spearheaded by Micro finance institutions. This is in relation to the trend in market prices and new technologies which they can exploit to boost performance in their enterprises.

The findings as to whether Ugafode provides market information to its clients indicated that it has not done enough to update its clients with information about the market trends and new technologies to promote their businesses. Further, the respondents felt Ugafode has not shown efforts in providing networking opportunities for their enterprises. Findings revealed that market vibrancy is lacking and this has affected the micro businesses. This was evidenced by the fact that the majority of the respondents had not opened up new branches in other areas. This concurs with Ankunda (2009) who indicated that clients tend to be involved in economic activities for which they have traditional regular skills meaning that they are largely confined to less profitable market niches.

Atieno argues that many clients find themselves in the market place because of the immediate needs to provide a livelihood for the family and at times they lack the necessary training and businesses know how to grow their business and compete effectively through penetrating various markets.

Findings indicated that the capacity of women to compete in the market environment is low. On the other hand, findings revealed that there were networking efforts among women accessing loans from

Ugafode, though it was on a small extent as evidenced by clients efforts to consult among themselves, the ability to discuss business concerns, accessibility to markets and improvement in the quality of the products as a result of joining Ugafode Microfinance ltd.

5.1.3 Performance

The increase in the working capital by borrowers is one of the performance were in position to expand their working capital after being extended with credit and most businesses were in position to increase on the volume of sales. However, findings indicated that there was slow growth in saving levels, and the enterprises mainly employed 1 -2 people mainly composed of family labor. The inventory was found to be high soon after getting a loan but gradually goes on reducing after the subsequent loan repayments. This is in contrast with the findings by Moore et al (2003) who indicated that the increased access to micro finance contribute to business expansion resulting into larger inventories, higher employment and productivity. However, the research concurs with some of their findings where clients registered increased sales and business expansion in form of working capital.

SME's are in position to make profits basing on change in interest rate and other lending terms of the contract. These change the return on the projects which affects the level of profitability. Respondents were asked whether they were in position to generate profits after accessing loans and the findings indicated the majority of the respondents were in position to get some profits ranging from 6 – 10%. This concurs with the findings by Almeyda (2000) who revealed that individuals are engaged in businesses with low profitability.

The findings were also in line with Hirsch and Brush (2004) who contends that the majority of the enterprises were moderately successful with revenue increases of approximately 7% per year. One of the critical concerns by most businesses is their ability to survive in the existing unstable micro and macroeconomic environment rather than the source of credit and its terms. The respondents from Ugafode were asked whether they were in position to efficiently sustain their businesses and the findings were as indicated the respondents were equally divided to efficiently sustain their businesses after accessing credit. This still pose a challenge to micro finance institutions extending credit to them since many argued that they need regular financing of their businesses in order to survive**.**

5.1.4 The Relationship between Credit Lending Terms and loan Performance of eterprises.

Findings indicated that micro finance lending terms have positively impacted on the performance of enterprises in terms of profitability, productivity and business sustainability. However, some respondents from Ugafode were not in position to increase on their savings level which has made them to entirely depend on loans for business financing. This is in line with the findings by Kiriti (2006) who found out that micro finance institutions were really assisting the less poor clients improve their welfare where as the poorer become worse off. This is evidenced from the respondents of Ugafode where half of the respondents indicated that they had not realized growth in savings despite the continued access to loans plus the low levels of profitability since all the funds they get are used to service the loans in form of the weekly repayments.

5.1.5 The Relationship between Networking and Performance of loans of SME's.

Networks among the customers and financial institution have been argued to improve performance of the enterprises in form of improved sales, profitability and asset base.

The research findings indicated that there is a significant positive relationship between networking and performance of the enterprises. This concurs with Coleman (1998) who contends that networks have a positive impact on performance together with Vandle (1994) who indicated that networks enable firms to concentrate on core competence and achieve economies of scale. However, despite the potential benefits accruing from the networks, existing evidence shows that the networks are not well developed among enterprises. This further concurs with the findings by Atieno (2009), who indicated that most small and medium enterprises do not belong to business support groups and have limited interaction with firms that are bigger than their own.

5.2 Conclusion

This report indicates that both the credit terms for Micro finance institutions and the networking levels affect significantly the repayment of loans and performance of enterprises. The performance of the enterprises is further affected by their small size, the education level of the clients and the networks that prevail among the enterprises.

The appropriate credit terms will lead to the adoption development of strategies that are appropriate and desirable for growth in sales, profits and savings levels by the clients.

5.3 Recommendations

In reference to the discussions and conclusions, the following recommendations should be implemented. Ugafode should partner with other bodies or agencies and promote adult education programs to its clients for literacy and numeric. With time the entrepreneurs can be trained in business management skills and this shall increase confidence in business management plus the ability to compete in the market environment.

Ugafode should encourage clients to form or join the already existing associations which can help then to get market information and business ideas in general.

Members should be encouraged to open up savings accounts with commercial banks as a way of promoting the saving culture and this can also help them to improve on their debt management and investment capacity.

Micro finance institutions should go an extra mile to promote the networks that can widen their markets for enterprises other than only concentrating on the repayment since the well functioning enterprises form a strong clientele base that gives rise to a healthy portfolio for the lending institution.

Members should be granted a grace period as many expressed dissatisfaction with the way Ugafode gives them a loan and expects them to make repayment in just after one week which has forced many of them to use part of the loan funds to service their loans hence recapitalizing their businesses. Members who take very small loans should be allowed to access more loans without waiting for the entire five months to elapse.

Within the lending function of Ugafode, it is useful to divide loans into enterprise loans and consumption/emergency loans. The loan programs typical of Ugafode almost entirely consist of enterprise loans without advancing consumption loans which has forced the clients to use part of the Funds acquired to cater for their home needs. This negatively affects the growth of their enterprises by reducing the working capital.

5.4 Areas of further Research.

This study reviewed the effect of Micro finance credit policies on loan repayment however; future researchers are urged to look at areas such as;

i. Causes of Loan defaulting in micro finance institutions.
ii. The role of micro finance institutions in rural economic development.
iii. Improvement of female participation in decision making and other causes of delay in loan repayment.

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APENDICIES

APPENDIX 1

QUESTIONNAIRE

Topic: the effect of microfinance credit policies on loan repayment.

Dear respondent

My name is Kikonyogo Aron a student of Uganda Martyrs University pursuing a bachelor's degree in business administration and management. The questions that follow are intended to facilitate a study of MFI credit policies on loan repayment. Please take a few minutes of your precious time and answer them. Your responses will be used for academic purposes only and will be treated with utmost confidentiality.

SECTION A: DESCRPTIVE DATA (Please tick where appropriate**)**

1. Gender

1. Male ☐ 2. Female ☐

2. Age

1.18-25 ☐ 2. 25-35 ☐ 3. 35-45 ☐ 4. 45-55 ☐ 5.55+ ☐

3. Level of highest education

1. Certificate ☐ 2.Diploma ☐ 3.Degree ☐ 4.Masters ☐ 5. Other (Specify)……

4. **Marital status**

1. Single ☐ 2. Married ☐ 3. Divorced ☐ 4.Widowed ☐

5. Type of business

1. Agriculture ☐ 2.Manufacturing ☐ 3.Trading ☐ 4. Education ☐

5. Health ☐ 6 Others …………………………………………. (Specify)……

6. **How long has your business operated (Years)?**

1.0-1 ☐ 2. 1-3 ☐ 3. 3-5 ☐ 4. 6+ ☐

7. **How long have you been borrowing (years)?**

1.0-1 ☐ 2. 1-3 ☐ 3. 3-5 ☐ 6+ ☐

Under the following sections, please tick according to your level of agreement

SD STRONGLY DISAGREE = 1

D DISAGREE = 2

NS NOT SURE = 3

A AGREE = 4

SA STRONGLY AGREE = 5

SECTION B: CREDIT TERMS

NO.		1	2	3	4	5
1	I am contented with the maximum money that the MFI lends to me.					
2	The MFI that lends to me is very strict with collateral					
3	Even when I delay to pay the collateral, my lender (MFI) warns before attaching my property					
4	Even when I delay to pay the collateral, my lender (MFI) warns before attaching my property					
5	The flexibility of loan collection procedures by my MFI allow me to make good use of my money.					
6	I am comfortable with the period in which I have to repay the loan.					
7	I am on a good repayment schedule and it is flexible for me.					
8	The grace period on my loan is adequate to prepare for					

	payment.				
9	The interest rate on my loan is affordable.				
10	There is adequate information provided before a loan is offered by the MFI that lends to me.				

SECTION C: NETWORKING

NO.		**1**	**2**	**3**	**4**	**5**
1	My business always consults with other businesses.					
2	I have been able to get financial support through my group members at Ugafode.					
3	I have been in position to get membership to associations with enterprises in the same kind of activity					
4	My accessibility to markets has been improved.					
5	My capacity to compete in the business environment has greatly Improved.					
6	I have gained knowledge to help me manage my business better					
7	I have been in position to open up new business branches in other areas					
8	There is deliberate effort by Ugafode to provide networking opportunities					
9	Ugafode regularly helps me to get market information					
10	I share business ideas with my colleagues.					

SECTION D: LOAN PERFORMANCE.

NO.		**1**	**2**	**3**	**4**	**5**

1	My enterprise has been able to increase on the number of employees					
2	With the use of the loan my business has been has expanded in terms of working capital					
3	I have been able to acquire more business assets					
4	My savings have increased					
5	I have been in position to meet my business goals and targets					
6	My sales have increased than before					
7	I always have larger inventories.					
8	The loan has enabled me to accumulate funds to run sustain my business efficiently					
9	My business is not always indebted					
10	With the use of the loan my business has been has expanded in terms of working capital					

My enterprise has been in position to generate profits ranging from

1) 50,000 – 100,000 ☐

2) 100,000 – 250,000 ☐

3) 250,000 – 500,000 ☐

4) 500,000 – 750,000 ☐

5) 750,000 – 1,000,000 ☐

6) 1000,000 and above ☐

Thank you for your co-operation.