CREDIT POLICIES AND LOAN RECOVERY IN MICROFINANCE INSTITUTIONS: A CASE STUDY OF FINCA UGANDA, BRANCH

BY

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DECLARATION

I, Kantono Miria, declare that this research report is my original work. It has not been submitted to any other University or higher institution for any award and where I it is indebted work of others, due acknowledgement has been made.

Signature..........   Date 30th/05/2018

APPROVAL

I hereby declare that this work entitled 'Credit Policies and Loan Recovery in Microfinance Institutions: A Case Study of FINCA Uganda, Branch: has been submitted with my approval for examination as the University supervisor.

Signature.....AAAwolusi.......... Date.....30th May, 2018.......

Dr. AWOLUSI.O. DELE

(SUPERVISOR)

DEDICATION

I heartily dedicate this report to my dear parents Mr. Nsawu James and Ms. Naigaga Sarah, my sisters Rebecca, Racheal, Eseza, Brother Paul, David Thank you for your financial support, courageous words and prayers which taught me to live a blessed life and finish my work. I owe you appreciation

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I would like to acknowledge the following people without whom this study could not have been successful.

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LIST OF ABBREVIATIONS/ ACRONYMS

CPA	-	Certified Public Accountants
CRB	-	Credit Reference Bureau
FINCA	-	Foundation for International Community Assistance
GDP	-	Gross Domestic Product
MFI	-	Micro Finance Institutions
UNDP	-	United Nations Development Programme
US	-	United States

ABSTRACT

The study was about Credit Policies and Loan Recovery in Microfinance Institutions: A Case Study of FINCA Uganda, Kamuli Branch. The study was based on three objectives; establish the existing credit policies in FINCA Uganda, Kamuli Branch; to examine how loans are recovered in FINCA Uganda, Kamuli Branch and to establish the relationship between credit policy and loans recovery of FINCA Uganda, Kamuli Branch.

The study adopted a descriptive research design and employed both qualitative and quantitative data and used both stratified and random sampling to select a sample size of 50 respondents. Self administered questionnaires were used to collect data which was analyzed using descriptive statistics.

The study revealed that a larger proportion of the respondents were aged between 25-30 years. Most of them were married females. Majority of the respondents had attained degrees and had worked with FINCA for 3 – 4 years hence were knowledgeable about the subject matter.

The study revealed that most of the FINCA clients have a positive perception about the existence of credit policies applied in order to manage exposures or risks of loan default. Findings also revealed that regulatory framework influences repayment of loans. The finding of the study indicated a strong positive relationship between credit policy and loan recovery.

The researcher concluded that credit policy has a significant impact on loan recovery of FINCA Uganda; therefore, it should be very selective in choosing credit policies which will yield desired results and fit in its resources and at the same time choose credible and trained officers to carry out monitoring and supervision of loaned amount.

The researcher put fourth some recommendations and among them included; making clients appreciate the credit policies and recovery procedures. FINCA has to educate the clients and also listen to their grievances. Education background was found out to have an impact on the client's understanding of policies and recovery procedures and that the weekly deposits affects the payback period, the institution should either extend the payback period from one year to at least two years or extend weekly deposit to monthly deposits so as to increase the percentage of payback from 50%-75% to 75%-100%. FINCA must look into scrutinize the customers who borrow loans thoroughly before loan is issued.

CHARPTER ONE

INTRODUCTION

1.0 Introduction

This chapter presents the background of the study, problem statement, purpose of the study, objective of the study, research question, and scope of the study and significance of the study.

1.1 The background of the study

1.1.1 Historical perceptive

Compared to other well advanced microfinance countries like Bolivia or Bangladesh, the microfinance industry in Uganda is fairly new. Informal financial arrangements like ROSCAs have existed in many forms in Uganda for several decades. The first true microfinance institution like FINCA and Uganda's Women Finance Trust (UWFT) appeared in the early 1990s. However, they did not start to expand in terms of significant client outreach and receive recognition until the mid-1990s. With increased interest from donors and NGOs discovering that they can make a lasting impact on poverty alleviation by offering sustainable financial services, the micro finance industry began to take shape. In January 1996, USAID sponsored a microfinance seminar that was considered to be an eye opener for many practitioners, who were exposed to best practice methodologies and the importance of sustainability for the first time in earnest. Micro finance became an issue for the ministry of finance and economic planning (MFPED) as well as the Bank of Uganda as both made themselves acquainted with national and international experience and practices in this field. In 1997, the Association of micro Enterprise Finance Institution of Uganda (AMFIU) was set up to serve as a practitioner platform to share experiences and technologies and act as lobby and advocacy body for Ugandan MFIS.

In mid-1999 many key players of the Uganda microfinance scene, especially among donors, left the country. After a brief period of less intense coordination a microfinance workshop facilitated by AFCAP brought the donor community together again in April 2000. Currently, there is one commercial bank providing microfinance services (CERUDEB), one recently established privately owned credit institution (CML), about 15 large MFIs and around 80 CBOs and NGOs providing saving and credit services on a small scale. The top five institutions (CERUDEB, FINCA, PRIDE, UMU, and UWFT) have already surf-passed or are close to full financial sustainability. New provides continue to enter the market ad join a relatively mature and professional industry. One of the most the most pressing challenges for a large number of MFIS in Uganda are high dropout rates, indicating that client also suggesting that clients are not satisfied with the product offered. In fact a close look at the majority of microfinance providers are very similar to each other and are not adjusted to the specific needs of different clients.

ble 1 microfinance providers in Uganda.

ᶠI	Year of establishment	Methodology	No. of clients	Sustainability
.RUDEB	Transformed into a commercial bank 1993	Individual lending	14000 borrowers 45000 savers	Full financial sustainability
ᐧCA	1992	Village banking	23500	Full financial sustainability
IDE	1995	Adjusted village banking	24500	Close to operational sustainability
ɅU	1997	Solidarity group and individual lending	10000	Close to operational sustainability
ɅF ltd	1999	Group lending and individual lending	13000	Close to operational sustainability
VFT	1985	Group lending and individual lending	35000	Operational of sustainability
CCAs	1995	Village banking with education	7500	Approx. 50% operational sustainability
ULU	1995	Groups and individual	8000	Just below 50% operational sustainability
VESO	1996	group	8000	Below 50% operational sustainability

1.1.2 Contextual perspectives

FINCA Uganda is an organization which re-invents itself on a daily basis, tapping the ideas and creativity of its clients, employees and board members alike, to find more effective and efficient ways to realize our common dream that is world without severe poverty.

In 1992 FINCA Uganda started its operations as a microfinance institution and became popular for its village banking methodology where customers would access loans through group membership, in 2004 FINCA Uganda was licensed as a micro finance deposit taking institution (MDI) thus becoming the first MDI Act 2003. In 20101 the concept of point of sale (POS) machine was introduced to support the core banking system especially in rural areas. In 2012 FINCA Uganda celebrated 20 years of providing life-changing financial service. In the same year it also launched ATM service using the FINCA access card to allow customers 24/7 access to their money through a multiplicity of inters witch member Bank's ATMs across the country. In 2014 FINCA Uganda offers savings, loans and money transfer services its clients across its 27 branches country wide. It also has more than 500 employees and is still growing. In 2015 FINCA Uganda acquired and opened its own lead offices in in magnificent building located on plot 11, Acacia Avenue, Kampala. In 2016 FINCA Uganda became the first financial institution in Uganda to adopt credit scoring a key credit analysis tool that enables the financial institution to make credit decision very fast. This was done in partnership with comp scan CRB and KFW, with this tool, FINCA Uganda is now able to make credit decisions within a matter of minutes. This tool has reduced turnaround time, improved operational efficiencies and enhanced customer experience. In 2017, FINCA Uganda marks 25 years of providing relevant financial services to her over 200,000 clients' hence empowering and impacting communities positively.

1.1.3 Conceptual perspectives

According to Kakuru (2000) credit policy is a set of policy actions designed to minimize costs associated with credit while maximizing the benefit from it.

Edminster (1990) defined credit policy as an institutions' method of analyzing credit request and its decision criteria for accepting or rejecting applications. The objective of this policy is to have optimal recovery from debtors as a firm may follow a lenient or stringent credit policy. FINCA

Uganda microfinance employees a combination of three decision variable measures as were also defined by Pandey (1995) credit standards, credit terms and collection efforts. Credit standards (accessibility measures) are criteria to decide the types of customers for purpose of extending credit such as capital adequacy and asset quality. Credit terms are stipulations under which credit is granted, they specify the duration of credit and terms of payments by customers such as loan period and loan size. Collection efforts determine the actual collection period that is procedures that the institution follows to recover payments of past dues. Like phone calls and individual visits.

Loan recovery (operational definition) refers to process and the rate at which the clients pay back the principal plus interest amount extended to them in form of loans, it is determined by repayment rate, portfolio quality ratios, profitability ratios, productivity and efficiency ratios and scale of depth of outreach.

According to Ssewagudde (2000) credit policy provides parameters, defines procedures and directives that have been carefully formulated, administered from top and well understood at all institution's levels. FINCA Uganda undergoes a set of three procedures of evaluating credit applicants to establish whether or not loans should be granted, these are credit information, credit investigation and analysis in a bid to maintain proper credit standards, avoid excess risk and evaluate business opportunity.

According to Michael Malan the managing director of compos can credit reference bureau (CRB) loan recovery is important in enabling lending institutions to clear their balance sheets in order to increase collection efforts to ease preparation of financial reports (The New Vision 15th September 2010)

Mugisa (1995) stated that loan recovery rates enable the measuring of performing and non-performing asset ratios (ability to measure the recycle of financial resource levels) hence enabling the institution to enjoy public confidence. Efficient and quick loan recovery minimizes default risk; transport cost for locating the defaulters as well as operating cost thus comfortable loan recovery is any lending institution's necessity.

FINCA Uganda microfinance institution uses credit policy as a marketing tool for expanding loan disbursement, maintain the market share, retain old customers and create new customers by weaning them away from highly competitive situation or recessionary economic conditions.

The researcher will prompt to carry out an investigation on the appropriateness and effectiveness of credit policies put in place and also investigates the cause of the steady rise in default risk.

1 .1.4 Theoretical perceptive

The classic micro finance theory of change. This theory suggests that a poor person goes to microfinance provider and takes a loan (or save the amount) to start or expand a micro enterprise which yields enough net revenue to repay the loan with major interests and still have sufficient profit to increase personal or house hold income enough to raise the person's standards of living (Dun ford, 2012

Credit risk theory. Although people have been facing credit risk ever since early ages, credit risk has not been widely studied until recent 30 years. Early literature (before 1974) o credit uses traditional actuarial methods of credit risk, whose major difficulty lies in their complete dependence of historical data up to now there are three a quantitative approaches of analyzing credit risk. Melton 1974 introduced the credit risk theory otherwise called the structural theory which is said the default event derives from a firm's asset evolution modeled by a diffusion process with constant parameters.

Tax theory of credit. The decision whether or not accepts a trade credit depends on the ability to access other sources of funds. A buyer should compare different financing alternatives to find out which choices is the best in traded between a seller and a buyer a post payment may be offered, but it is not free, there is an implicit interest rate which is included in the final price. Therefore, to find the best source of financing the buyer should check out the real borrower cost in other sources of funds. Brick ad Fug (1984) suggests that tax should be considered in order to compare the cost of trade credit with the cost of other financing alternatives. The main reason for this is that if buyers and sellers are in different tax brackets, they have different borrowing costs, since interest are tax deductibles.

Liquidity theory of credit. .this theory first developed by Emery (1984), proposes that credit rationed firms use more trade credit than those with normal access to financial institution. The central point of this idea is that when a firm is financially constrained the offer of trade credit can make up for the reduction of the credit offer from financial institutions in accordance with this view, those firms presenting good liquidity or better access to capital markets can finance those that are credit rationed.

Availability theory of credit. It held that monetary policy has its effects on spending not only directly through interest rates but also by restricting the general availability of credit and liquid funds.

1.2 Statement of Problem

FINCA like any Micro Finance Institution needs customers or clients in order to make profits and continue in existence through attracting and retaining customers. These Micro Finance Institutions can attract and retain customers through providing credit at low interest rates, providing loan bonuses, advertising their products and providing good credit incentives to people. A good credit management policy is an essential component and fundamental part of any Micro Finance Institutions. This policy and its implementation can ensure that the revenue record translates itself into cash according to the credit terms. A good credit policy can benefit Micro Finance Institutions through maintaining good cash flow, reducing the risk of loan default, improving performance asset ratio and bad debts, minimizing the costs of granting credit, promoting good customers relationship and prompt payment. Over time, the rate of loan recovery has not improved and thus has created a negative impact on the rate of loan application which has led to the institution not carry out its business functions normally and benefit from interest from risks and principals. The branch manager cited that FINCA Uganda failure to recover loans is as a result of inadequate application of the tools of credit policy management (FINCA Uganda annual report (2010). According to Mugisa (1995) bad quality assets (loans) not only erode the institution's ability to recycle its financial resources but also threaten their survival and deprive the economy of a continuous flow of capital.

This situation raises cause for concern, leading to the pressing need for the researcher to carry out a study on credit policy and loan recovery in micro finance institutions: a case study of FINCA Uganda, Kamli Branch.

1.3 Purpose of Study

The purpose of the study is to investigate the relationship between credit policy and loans recovery in FINCA Uganda micro finance Branch.

1.4 Objective of the Study

a) To establish the existing credit policies in FINCA Uganda, Branch.

b) To examine how loans are recovered in FINCA Uganda, Branch.

c) To establish the relationship between credit policy and loans recovery of FINCA Uganda, Branch.

1.5 Research Questions

1) What are the existing credit policies in FINCA Uganda, Branch?

2) How are loans recovered in FINCA Uganda, Branch?

3) What is the relationship between credit policy and loan recovery?

1.6 Scope of the Study

The scope covers the geographical scope and content scope

1.6.1 Geographical scope

The research was carried out in FINCA Uganda, Branch, and district. District is located in south eastern Uganda; it lies at an average altitude of 1083m above sea level and extends from 00-56 North/330-05 East up to 010-20 North/330-15 East. The district is bordered by River Nile and Kayunga district in the West Jinja district, in the south Luuka district and in the south East Buyende district. It has a total land area of 1622000km and 62.64 km (3.9%) of water.

1.6.2 Content scope

The study focused on establishing the relationship between credit policy and loan recovery of FINCA Uganda, Branch.

.7 Significance of the Study

'he research will provide a deeper insight to the researcher of the physical issues entailed in redit policies and loan recovery in microfinance

'he research will highlight the areas of credit policy that may need to be modified.

'he study will help the researcher to better understand credit policy setting in relation to loan ecovery.

'he research will pave way for other researcher interest in this field to learn from it and expand pon their research.

'hc study being academic will extend to the frontiers of knowledge in the field of finance and ccounting and a basis of future research.

'he will help the researcher in partial fulfillment of the award of bachelor degree in Business dministration.

.8 The conceptual framework

Independent variable | **Dependent variable**

Credit policy
- Credit standards
- Credit terms
- Collection efforts

Loan recovery
- Performance asset ratio
- Non-performing asset ratio

'igure 1: Conceptual framework

'he conceptual frame work above shows the relationship that exists between the variables (credit tandards, credit terms and collection efforts) and highlights the indicators for credit policy and oan recovery measurement (performance asset ratio and Non-performance asset ratio).

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter covers a review of major existing literature on credit policy and loan recovery. It is done mainly from the survey already conducted in the field of credit policy and loan recovery in micro finance institutions in Uganda.

2.1 Conceptual Review

2.1.1 Concepts of Micro Finance Institutions

Wood (1998) defined micro finance institutions as institutions that provide financial services to low income earners. These financial services may include savings, loans, insurance transfer and payment services to enhance growth of small scale enterprises.

According to Graham et al (1990) microfinance. refers to the provision of financial services to the low- income earners who do not earn or obtain their services from the formal financial institutions because of their business saving levels and credit needs are very small.

To Bank of Uganda definition, microfinance institutions are non -governmental institutions savings and credit co-operatives that provide savings and microloans not exceeding US $ 5000 for project to poor individual's average not exceeding US $1000 per project to poor individual enterprises or groups for the purpose of engaging in income generating activities.

According to Dumba (1997), microfinance is an economic development approach intended to benefit the low income groups by providing financial services that are not obtained from other formal financial institutions, financial services generally include savings and credit facilitates. However, some microfinance institutions provide payment services and insurance in addition to financial services.

The features that differentiate microfinance from formal financing are; Informal appraisal to borrowers and investment use of collateral substitute's access to loans based on payment performance, stream line with disbursement, monitoring and secure savings product (Bank of Uganda, 1995).

2.1. 2 Credit Policy

A credit policy is an institutional method for analyzing credit requests and its decision criteria for accepting or rejecting applications (Girma, 1996).

Credit policy is important in the management of accounts receivables. A firm has time flexibility of shaping credit policy within the confines of its practices. It is therefore a means of reducing high default risk implying that the firm should be discretionary in granting loans (Pandey, 1995).

Policies save time by ensuring that the same issue is not discussed over and over again each time a decision is to be made. This ensures that decisions are consistent and fair and that people in the same circumstance get treated in the same manner (Khandkar and Khan, 1998)

According to McNaughton (1996), credit policy provides a frame work for the entire management practices.

Written credit policies are the cornerstone of sound credit management, they set objectives, standards and parameters to guide micro finance officers who grant loans and manage loan portfolio. The main reach for policy is to ensure operation's consistency and adherence to uniform sound practices. Policies should be the same for all and is the general rule designed to guide each decision, simplifying and listening to each decision making process. A good credit involves effective initiation analysis, credit monitoring and evaluation.

2.1.3 Loan recovery

Robinson (1994) defines a loan as an extension of credit to another person (client) which maybe long term (more than a year) a short term (less than a year).

Breth (1999) stated that before a deal in signed a loan application is to be completed. This provides risk protections by enabling the lending institutions to follow up when the borrowers fail to honor the agreement.

2.1.4. Indicators of credit policy

Pandey, (2000) observers that credit policy refers to a combination of three decision variables. These decision variables determine who qualifies for the loan. They include, credit standards, credit terms and collection efforts on which the financial manager has influence.

Credit Standards

This is a criteria used to decide the type of client to whom loans should be extended. Kakuru (1998) noted that it's important that credit standards be basing on the individual credit application by considering character assessment, capacity condition collateral and security capital.

Character it refers to the willingness of a customer to settle his obligations (Kakuru, 2000) it mainly involves assessment of the moral factors.

Social collateral group members can guarantee the loan members known the character of each client; if they doubt the character then the client is likely to default.

Saving habit involves analyzing how consistent the client is in realizing own funds, saving promotes loan sustainability of the enterprise once the loan is paid.

Other sources of income. Other source should be identified so as to enable him serve the loan in time. This helps micro finance institutions not to only limit loans to short term projects such qualities have an impact on the repayment commitment of the borrowers it should be noted that there should be a firm evidence of this information that point to the borrowers character (Katende, 1998).

Capacity, this is subjective judgment of a customer's ability to pay. It may be assessed using a customer's ability to pay. It may be assessed using the customer's past records, which may be supplemented by physical or observation.

Condition, this is the impact of the present economic trends on the business conditions which affects the firm's ability to recover its money. It includes the assessment of prevailing economic and other factors which may affect the client ability to pay (Kakuru, 2000).

Collateral security, This is what customers offer as saving so that failure to honor his obligation the creditor can sell it to recover the loan. It is also a form of security which the client offers as form of guarantee to acquire loans and surrender in case of failure to pay; if borrowers do not fulfill their obligations the creditor may seize their asset (Girma, 1996).

According to Chan and Thakor (1987), security should be safe and easily marketable securities apart from land building keep on losing value as to globalization where new technology keeps on developing therefore lender should put more emphasis on it.

Credit Terms

Ringtho (1998) observes that credit terms are normally looked at as the credit period terms of discount and the amount of credit and choice of instrument used to evidence credit. Credit terms may include;

Length of time to approve loans, this is the time taken from applicants to the loan disbursement or receipt. It is evaluated by the position of the client as indicated by the ratio analysis, trends in cash flow and looking at capital position.

Maturity of a loan, this is the time period it takes loan to mature with the interest there on.

Cost of loan. This is interest charged on loans, different micro finance institutions charge differently basing on what their competitors are charging.

The chartered institute of bankers and lending text (1993) advises lending institutions to consider amount given to borrowers.

Robinson M.S (1994) pointed out that the maximum loan amount per cycle are determined basing on the purpose of the loan and the ability of the client to repay (including guarantee).

Collection Efforts

McNaughton (1996) defines a collection effort as the procedure an institution follows to collect past due account. Collection policy refers to the procedures micro finance institutions use to collect due accounts. The collection process can be rather expensive in terms of both product expenditure and lost good will (Brighan, 1997).

Effort may include attaching mandatory savings forcing guarantors to pay, attaching collateral assets, courts litigation (Myers, 1998). Micro finance institutions may send a letter to such individuals (borrowers) when say ten days elapse or phone calls and if payment is not received with in thirty days, it may turn over the account to a collection agency (Myers, 1998).

Collection procedure is required because some clients do not pay the loan in time some are slower while others never pay. Thus collection efforts aim at accelerating collections from slower payers to avoid bad debts. Prompt payments are aimed at increasing turn over while keeping low and bad debts within limits (Pandey, 1995). However, caution should be taken against stringent steps especially on permanent clients because harsh measures may cause them to shift to competitors (Van Horn 1995).

2.1.5 Indicators of Loan Recovery

The following are the measures used to determine loan recovery.

Repayment rate measures the amount of payment received with respect to the amount due. Portfolio quality ratios; involves the arrears rate portfolio risk and the ratio delinquent borrowers. The arrears ratio rate shows how much of the loans have become due and has not been received. Portfolio rate refers to the outstanding balance of all loans that have an amount due. Delinquent borrowers determine the number of borrowers who are delinquent relative to the volume of delinquent loans.

Profitability ratio measures on micro finance institutions net income in relation to the structure of its balance sheet. This helps investors and managers determine whether they are earning an adequate return on funds invested in the microfinance institutions. Productivity and efficiency ratios provide the information about the rate at which micro finance institutions generate revenue to cover their expenses. Productivity ratio focuses on the productivity officers because they are primary generators of revenue. The ratio includes;

Number of active borrowers per credit officer (performing assets).

Total amount disbursed in the period per credit officer.

Portfolio outstanding per credit officer (Non-performing assets)

Efficiency ratios measure the cost of providing loans to generate revenue; these are referred to as operating costs and should include neither financing costs nor loan loss provisions.

Scale and depth of outreach, Microfinance institutions collect data on their clients base both the scale of their activities (number of clients served with types of instruments) and the depth of outreach (type of client reached and their level of poverty).

Outreach indicators include; number of active borrowers, total balance of outstanding loans average outstanding, real annual average growth rate of loans outstanding during the past years loan size, average minimum and maximum, average disbursed loan size, average outstanding raters, average loan term, nominal interest rates, effective annual interest rates, value of loans per staff member and number of loans per staff member.

2.2 Theoretical Review

This explains the theories of credit policies and loan recovery in microfinance institutions.

2.2.1 The classic micro finance theory of change.

This theory suggests that a poor person goes to microfinance provider and takes a loan (or save the amount) to start or expand a micro enterprise which yields enough net revenue to repay the loan with major interests and still have sufficient profit to increase personal or house hold income enough to raise the person's standards of living (Dun ford, 2012). There are three key steps the poor person must take to make this theory true.

1. Take a loan from (or save with) a microfinance institution
2. Invest the money in available business
3. Manage the business to yield major return on investment

In short the classic microfinance theory of change doesn't apply to a whole lot of poor people because so many choose not to participate even when they can.

2.2.3 Credit risk theory.

Although people have been facing credit risk ever since early ages, credit risk has not been widely studied until recent 30 years. Early literature (before 1974) o credit uses traditional actuarial methods of credit risk, whose major difficulty lies in their complete dependence of historical data up to now there are three a quantitative approaches of analyzing credit risk. Melton 1974 introduced the credit risk theory otherwise called the structural theory which is said the default event derives from a firm's asset evolution modeled by a diffusion process with constant parameters.

2.2.4 Tax theory of credit.

The decision whether or not accepts a trade credit depends on the ability to access other sources of funds. A buyer should compare different financing alternatives to find out which choices is the best in traded between a seller and a buyer a post payment may be offered, but it is not free, there is an implicit interest rate which is included in the final price. Therefore, to find the best source of financing the buyer should check out the real borrower cost in other sources of funds. Brick ad Fug (1984) suggests that tax should be considered in order to compare the cost of trade credit with the cost of other financing alternatives. The main reason for this is that if buyers and sellers are in different tax brackets, they have different borrowing costs, since interest are tax deductibles. The author's hypothesis is that firm in a high tax bracket to offer more trade credit than those in low tax brackets. Consequently only buyers in a lower tax bracket than the seller will accept credit since those in a higher tax bracket could borrow more cheaply more cheaply directly from a financial institution. Another conclusion is that firm's allocated to a given industry and placed in a tax bracket below the industry average cannot profit from offering trade credit. Therefore, Brick and Fung (1984) suggests that firms cannot both use and offer trade credit.

2.2.5 Liquidity theory of credit. .

This theory first developed by Emery (1984), proposes that credit rationed firms use more trade credit than those with normal access to financial institution. The central point of this idea is that when a firm is financially constrained the offer of trade credit can make up for the reduction of the credit offer from financial institutions in accordance with this view, those firms presenting good liquidity or better access to capital markets can finance those that are credit rationed. Several approaches have tried to obtain empirical evidence in order to support this assumption for example Nielsen (2002) using small firms react small firms a proxy for credit rationed firms find that when there is a monetary contraction by increasing the amount of the credit accepted.

2.3 Empirical review

This section explains the problems faced by micro finance institutions in delivering financial services to rural poor people, the relationship between credit policy and loan recovery.

2.3.1 Problems faced by microfinance institutions in delivering financial services to rural poor people

Whereas micro finance institutions and other credit programs are designed to benefit the rural poor and disadvantaged in Uganda, their operations have faced a number of constraints, these involve;

Poor client's assessment procedures, clients are given loans without assessing the character, capacity and collateral of the borrower.

Low loan supervision, clients need to be supervised on how to utilize the loan advanced to them.

Low incentive to save, Uganda has a very low domestic saving to gross domestic product (GDP) of 6-8% (Bureau of labor statistics 2010).

High interest rate. The higher the interest rate, the more income to micro finance institutions but also means that the higher the cost to borrowing to the clients, (Stem, 1991). If the customers fail to pay on time, the rates cannot yield income. Demand of credit is a function of interest, in accordance to the law of demand (Brook, 1993) customers will stop borrowing if the interest rate is high.

In order to succeed in the promotion of economic interest of member lending institutions, most recognize the responsibility to members; it is important for the aim at sustainability.

Sustainability is the ability of micro finance institutions to generate income from operation that covers administration costs and losses covering costs from earned income (Ministry of finance, planning and economic development 2004) Micro finance institutions need increasing income size and repetitive borrowing of increasing loan size and fail to pay, the micro finance institutions lose revenue and if it continues may lead to its collapse (micro finance forum, 2003). To ensure long term sustainability there must be growth in customers and size of portfolio lent out. Micro finance institutions need to grow in order to generate income needed to pay for operations of their services (Atuhaire, 2001).

Micro finance institutions quote only nominal interest rate to customers but there are other additional costs the clients incur like penalties on default, travel time for meetings, mandatory saving and loan size.

According to UNDP (2005) clients that receive small loans do not utilize the loan on economic activities and those that receive bigger loan spend them on non-productive activities.

Regulatory frame work; Lack of proper regulatory frame work has made micro finance institutions face a high non-loan repayment. Poor regulatory system determines a minimum standard of operation through self-regulatory body of micro finance saving mobilization of fixed interest rates operation overlapping can be looked in to by regulatory body (Shafiques, 2000). Micro finance institutions must set a law in order to deal with defaulters to recover loans.

Poor physical infrastructure, particularly roads and communication facilities that make contact between lenders and borrowers very difficult (Musinguzi, 1999).

Multiple borrowing most clients borrow from several micro finance institutions beyond capacity to pay. Consequently plunging those institutions into loans (the new vision Monday, July 11 2005).

2.3.2 Relationships between credit policy and loan recovery

2.3.3 Credit standards and loan recovery

Good credit management provide the institution with a reasonable and adequate return on loans and capital employed primarily through improvement in operations efficiency this generates adequate internal resources to finance the institution's growth (Pandey, 2000).

The institution may have tight credit standards that it may extend loan to the most reliance and financially strong customers such standards will result in no bad debt losses and less cost of credit administration (Pandey, 2000).

(Pandey, 1995) stressed that credit standards are criteria for selecting customers for credit; the fund may have higher credit standards that is extending loans to selected customers with good reputation or record. On the other hand customers have to be evaluated to see if they meet the standards set by the management before loans are extended to them. However, (Van Home, 1995) states that when an institution extends loan to only strongest customers, it will never have bad losses and will incur fewer administration expenses.

2.3.4 Credit terms and loan recovery

When borrowers are given small amount of money it will not be sufficient for business operations yet given too much money it is spent on non-productive activities causing high non - loan repayment. The credit manager should check on the amount the customer is demanding for, whether it is too much or little. The chartered of bankers and lending text (2002) advises lending institutions on the amount to give a borrower.

2.3.5 Collection efforts and loan recovery

Collection efforts determine the actual collection period of the loan (Pandey, 2000) it is the supervision of the credit loans. The policy refers to procedure an institution or firm follows to obtain payment of past due. It may involve sending a letter to such clients when they are for instance, ten days past due date or phone calls, if payment is not received within thirty days court action may be taken. Collection procedures are needed because some clients do not pay their dues in time if firms carry out this policy, it will quicken recovery portfolio and hence reduce bad debts.

However, it may not guarantee full recovery because some clients are slower in repayment while others never pay (Pandey, 1992). Credit policy decisions are based solely on borrower's will and ability to recover loans, the amount of loan is therefore based on the client's needs and assessed loan recovery ability of the enterprises.

2.4 Gaps in literature

The research concentrated on credit policies and loan recovery in only FINCA Uganda microfinance yet there are other microfinance in Uganda therefore further research should be carried out in other micro finances for example PRIDE microfinance limited.

The research also left out the effects of the lending policies on the levels of non-performing loans of micro finance institutions.

Also the research left a gap on the effects of credit management on the financial performance of Micro Finance Institutions therefore further studies should carried on the effects of credit management on financial performance.

Research on credit policies and loan recovery left out the lending terms and loan portfolio performance of Micro Finance Institutions therefore other research should be carried out on lending terms and loan portfolio.

The study also concentrated on microfinance institutions yet there many financial institutions in Uganda therefore studies should be carried out on other financial institutions for example the influence of interest rates on loan recovery in commercial banks.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This presents the methods that were employed in data collection and analysis. It describes the research design, study population, sample size, sample design, sample procedure. Data collection tools, data processing and analysis.

3.1 Research Design

The study adopted descriptive research design where both qualitative and quantitative data were employed to gain an in-depth understanding of credit policy and loan recovery in MFIs a case of FINCA Uganda microfinance. Qualitative data helps to draw conclusions and recommendations; it further enables the understanding of effectiveness and efficiency of the credit policy and loan recovery while quantitative design helps to evaluate facts from the field.

3.2 Study Population

The researcher collected data from a total of 60 respondents which included; staff and clients of FINCA Uganda in . Clients and staff members were used as a control group to study the behavior and the rate of credit policy, loan recovery and criteria of loan disbursement.

3.3 Sampling methods

Stratified sampling was used to create different strata in the study population and simple random sampling was also used to select a sample of respondents from each stratum.

3.4 Sample composition and size

A sample of 50 respondents were selected to represent the views of the entire population. These were selected in different propositions as presented below.

Table 1: Showing selected respondents of the sample

Stratum	Target Population	Number of respondents
Management	2	2
Credit officers	12	10
Banking officers	6	5
Customers	40	33
Total	60	50

3.5 Validity and Reliability of Research Instruments

3.5.1 Validity

The validity of administered questionnaire items were tested using a content validity test. This test involved consulting the supervisor and asking any other colleagues who were knowledgeable about topic of study and the data was measured by rating each item in the questionnaire as either relevant or irrelevant.

3.5.2 Reliability

To determine the reliability of the instruments, the researcher conducted pretest. The result of the investigation enabled appropriate adjustment to the instrument and to collect accurate and reliable data.

3.6 Sources of Data

3.6.1 Primary data

This was obtained through questionnaires and interview guides.

3.6.2 Secondary Data

Data was obtained from annual reports, journals, newspaper, publications, library research and other research work on the subject.

3.7 Data collection methods

The researcher used questionnaires and interviews as methods for collecting data from the field.

3.8 Research instruments

3.8.1 Questionnaire

The questionnaires were the main instrument in the study. The questionnaire consisted of close ended questions. They administered to staffs and clients. This method was appropriate because it saved time and money and respondents were given chance to answer questions at their convenient time, it also eliminated interview bias.

3.8.2 Interview guide

The researcher also used an interview guide to collect data that could not be possible to collect using the questionnaires. The interview guide was used to get information from informants. Here the researcher used both formal and informal methods to collaborate information from the questionnaire. An Interview guide was prepared and used during the face-to-face interviews. This method was flexible, accurate and quicker in yielding results.

3.9 Data Processing and Analysis

3.9.1 Data Processing

The data was edited to ensure completeness and accuracy. This was done through sorting and summarizing so as to make meaningful information.

3.9.2 Data Analysis

Data was analyzed using correlation analysis, percentages, tables and frequencies using SPSS computer program so as to assess the relationship between credit policy and loan recovery of FINCA Uganda, Branch.

3.10 Limitations

The researcher encountered problems in soliciting data given the fact that this is a financial institution where secrecy is encouraged given the stiff competition. Here the researcher assured the institution confidentiality of study.

High cost of data collection in the form of transport, telephone calls, typing and stationery coupled with financial constraints. This was minimized by soliciting for enough funds and identifying cheap stationary centers or even bargaining for lower price.

The time that was given for the research was not enough to collect sufficient data. However, the researcher put aside other work and concentrated on research and limited the survey on only the sample population that was selected.

Delays in response, some respondents took a lot of time filling the questionnaire. The researcher solved this by motivating respondents through buying items from them as the study was focused on business people; this gave them the moral to give the required information.

The researcher faced a problem of non-response from; officers who were willing to release information. However, the researcher was assured the respondents of confidentiality of the information to be released.

3.11 Ethical Considerations

Before going to the field, the researcher begun by getting authorization letter from the department of Accounting and finance of Kampala International University which she took to the respondents and this enabled the researcher to attain adequate information from the respondents. During the process of data collection, confirmation was given to the respondents assuring them that the reason for the research was mainly academic. The researcher ensured confidentiality during data collection and avoided plagiarism by recognizing authors of different information

CHAPTER FOUR

PRESENTATION, ANALYSIS, INTERPRETATION AND DISCUSSION OF FINDINGS

4 Introductions

This chapter presents the findings about the Credit Policies and Loan Recovery in Microfinance Institutions: A Case Study of FINCA Uganda, Branch. It further provides the analysis and interpretations from 50 respondents drawn from the management, Credit officers, Banking officers and Customers on the instruments and sources of data collection.

4.1 Demographic Characteristics

4.1.1 Sex of respondents

The respondents were asked to indicate their sex in order to make the study gender sensitive. Their response is indicated in the table below.

Table 2: Showing Sex of respondents Frequency

	Frequency (x)	**Percentage (%)**
Female	35	70.0
Male	15	30.0
Total	**50**	**100.0**

Source: *Primary Data, 2016*

The table above indicates that majority of respondents (70%) were females while minorities (30%) were males. This implies that the study involved more females than males. Which might be due to women emancipation and involvement in ventures that originally involved men? The composition of both female staff members and female clients was higher than that of males. When questioned about this unfair distribution, the branch manager explained that females tend to be honest in their dealings with clients and so efficient service delivery and those female customers were more than their male counterparts because women have been highly marginalized in the society and so they have embraced microfinance as a way of elevating themselves from poverty. When one male was asked to comment on the same issue, he said that "there is a poor perception among men that microfinance is basically a government program to benefit women only, hence, they have tended to ignore it".

4.1.2 Marital status of respondents

In order to assess the level of decision making and responsibility of the respondents, respondents were asked to indicate their marital status and their responses are indicated in table below;

Table 3: Marital status of respondents

Marital statues	**Frequency**	**Percentage (%)**
Married	23	46.0
Single	15	30.0
Divorced	0	0.0
Widowed	12	24.0
Separated	0	0.0
Total	**50**	**100.0**

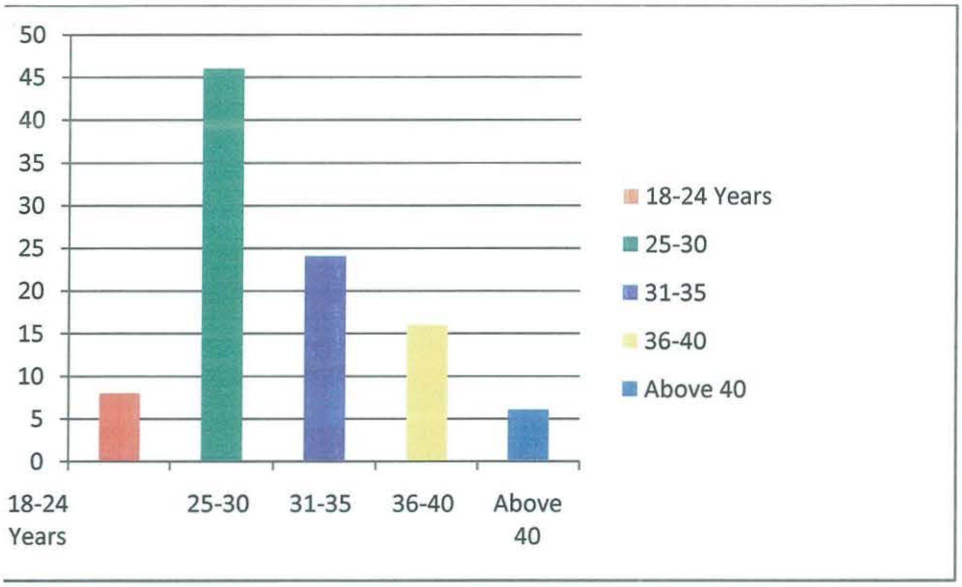
Source: *Primary data, 2016*

According to the table above, 46% of the respondents which is the biggest percentage were single while 30% and 24% of the respondents married and divorced respectively. Findings revealed the majority singles indicated poor loan repayment simply because they can easily switch from one area to another in case legal actions were applied, the second biggest percentage who were married had few chances to move from one locality to another since they were established and were constrained by their family responsibilities much as they can default just like singles.

4.1.3 Age bracket of respondents

In order to assess the responsibility of the respondents, the respondents were requested to give their age and the responses were as below.

'igure 2: Showing age of respondents



ı accordance with the figure above, 46% of the respondents were in the 25-30 years of age ʼhich were the majority. 24% were between 31-35, 16% were between 36-40 years while 8% ʼere between 18-24 years and 6% of them were above 40 years which is the minority. This ıdicates that most of the clients are already married, established and mature to organize and orrow money for income generating projects.

.1.4 Education information

ı order to be sure of the quality of the information given, the respondents were requested to give ıeir level of education and the response is portrayed below.

'able 4: Showing Level of Education of respondents

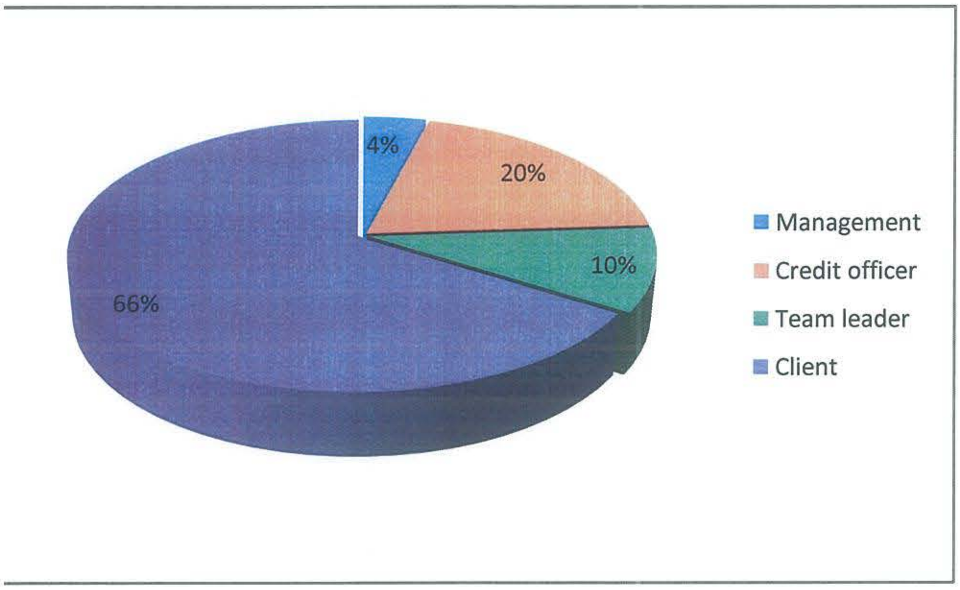
	Frequency (x)	Percentage (%)
rofessional certificate	17	34.0
HD	0	0.0
lasters	1	2.0
'egree	24	48.0
'iploma	8	16.0
otal	**50**	**100.0**

ource: *Primary Data, 2016*

'his indicates that FINCA's clients are fairly educated able to have capacity to understand uestionnaires and answer accordingly. 48% of the respondents were found to be at the degree :vel, 34% had Professional certificates like CPA, ACCA and so on, 16% of them had diplomas nd the minority 2% had masters. The majority of the respondents had attained degree level of ducation as their highest qualification and therefore their data can be relied upon as they are :garded as knowledgeable respondents.

.1.5 Position of respondents

'igure 3: Occupation of respondents



indings from the figure show that 66% of the respondents were clients, 20% of them were 'edit officers, 10% of them were team leaders and 4% of them were managers.

1.6 Duration of Service with the FINCA

s a precondition to assess the reliability of the data collected, the respondents were requested to .dicate the period they have worked with the bank. Their responses are as given below.

Table 5: Number of years working with the bank

	Frequency (x)	Percentage (%)
1-2 years	5	10.0
3-4 years	32	64.0
5 years and above	23	26 .0
Total	**50**	**100.0**

Source: *Primary Data, 2016*

From the analysis in the table above, 64% have worked with the FINCA for between 3-4 years, 26% have worked for more than 5 years and only 10% have worked between 1-2 years. Thus this analysis indicates that probably they fail to embrace organizational policies as a result of low payments and lack of motivation since majority of the respondents have only worked in the organization for a period of between 3-4 years.

4.2 Findings about Credit Policies in FINCA Uganda

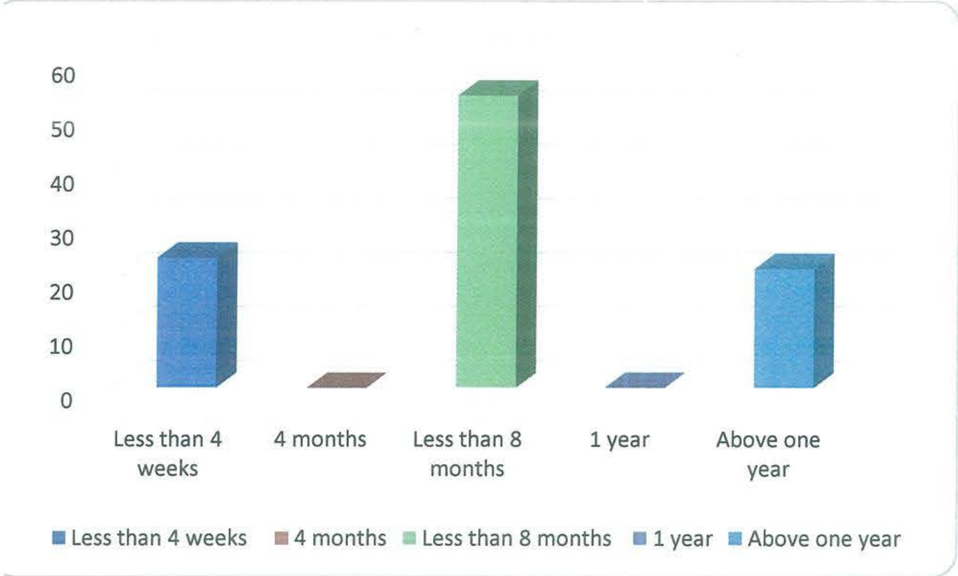
4.2.1 Credit policies employed by FINCA Uganda

The study sought to establish the different credit policies employed in FINCA. For this mater therefore respondents were asked to indicate some credit policies used in FINCA and these included; Credit standards, Character assessment, Collateral security assessment, Collection efforts.

4.2.2 Length of the Loan period

Considering the length of the loan period, respondents had this to say in accordance with the table below.

'igure 4: Response of the length of the loan period.

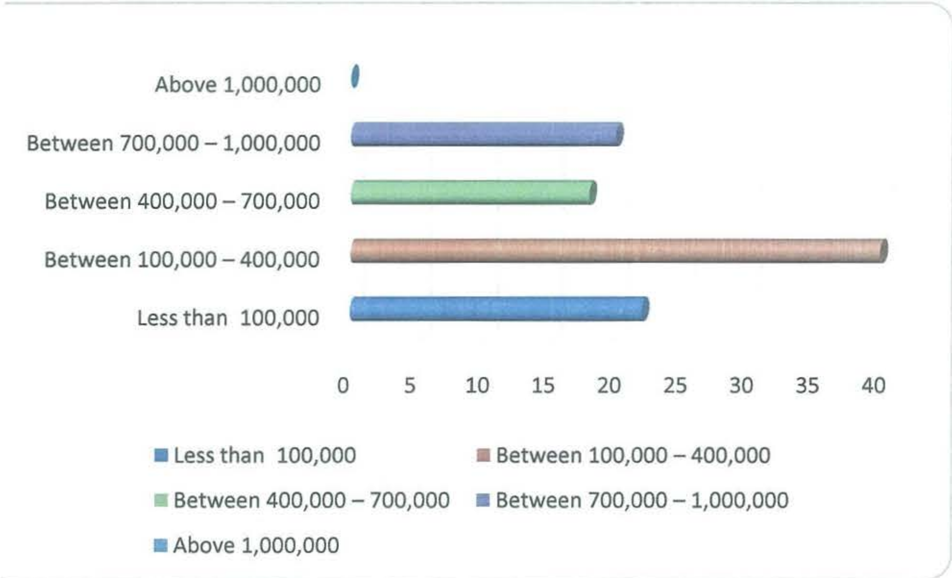


'he figure above shows that majority of respondents (54%) acquired the loan for one year, while 4% for less than 4 weeks and 22% acquire for a period of above one year. This implies that ıost of the loans extended have a life span of more than eight months therefore enough periods ɔr the clients. The researcher concluded that the length of loan was sufficient in accordance to ne's loan size.

.2.3 What loan amount do clients ask for

INCA considered giving small loans to ensure quick repayment; nevertheless, loan default was eadily rising implying the existence of a problem in FINCA's policies. In response to the loan nount clients ask for, the table below shows the results.

igure 5: Response to loan amounts asked for



rom the figure above, 40% of the respondents ask for loans that range Between 100,000-)0,000 Shillings, 22% ask for the amounts Less than 100,000/=, 20% ask for Between)0,000–1,000,000 while 18% ask for the amounts Between 400,000 – 700,000. The results nply that

INCA cuts across all categories of people in loan offer a condition that encourages people from .l walks of life to access loans for development.

.2.4 How respondents describe the interest rate charged by FINCA Uganda

able 6: Description of interest rates charged

.esponse	Frequency	Percent
'ery high	0	0.0
.igh	17	34.0
air	23	46.0
ow	10	20.0
'ery low	0	0.0
'otal	**50**	**100.0**

ource: *Primary data, 2016*

It is shown from the table above that 46% of the respondents were convinced that the interest rate charged is fair, 34% said the interest was high because FINCA serves a number of customers who are scattered and so high operating cost. This interest rate was meant to cover operating cost and consequent burden is felt by borrowers while 20.0% claimed that the interest was low. This implies that the loans extended by FINCA were client friendly.

4.2.5 How often do Customers reminded by FINCA Uganda in case of a default

When asked how often customers are reminded in case of a default, the respondents had the following to say as summarized in the table below.

Table 7: Frequency of customer reminder

Responses	Frequency	Percent
Weekly	13	26.0
After 2 weeks	0	0.0
Monthly	31	62.0
End of loan period	0	0.0
End of year	6	12.0
Not at all	0	0.0
Total	**50**	**100.0**

Source: *Primary data, 2016*

From the able above, 62% of the respondents which was the majority said customers are reminded monthly, 26% said they are reminded weekly while 12% said they are reminded at the end of the year, this is in an attempt to reduce the rate of loan default and at the same time avoid unnecessary excuses from borrowers that they were not aware of payment date.

⁝.2.6 FINCA Uganda uses the following methods to communicate and remind its clients

'able 8: FINCA Uganda uses the following methods to communicate and remind its clients

Aethod	Very common		Common		Not common		No opinion	
etter	0	0	0	0	49	98%	1	2%
elephone	0	0	0	0	42	84%	8	16%
'ersonal visit	50	100%	0	0.0	0	0.0	0	0.0

ource: *Primary data, 2016*

'he results indicated that 49(98%) out of the respondents said letters were not commonly used in ecovery procedures by FINCA, 1(2%) gave no opinion, 42(84%) said that telephones were also ot commonly used, 8(16%) had no opinion while 50(100%) said that personal visits were very ommonly used by loan officers. However, recovery rate is not all that successful due to other actors like deaths; sickness and business failing hence need to revise its collection procedures uch as credit screening, debt monitoring and consistency in delivery of letters and phone calls to emind its customers to pay.

.2.7 Whether customers face penalties if they don't pay the loan in time

espondents were asked to indicate whether customers face penalties if they don't pay the loan 1 time. Their responses are indicated in the table below;

'able 9: Whether customers face penalties if they don't pay the loan in time

esponse	Frequency	Percent
trongly agree	29	58.0
gree	11	22.0
lot sure	6	12.0
isagree	4	8.0
'otal	**50**	**100.0**

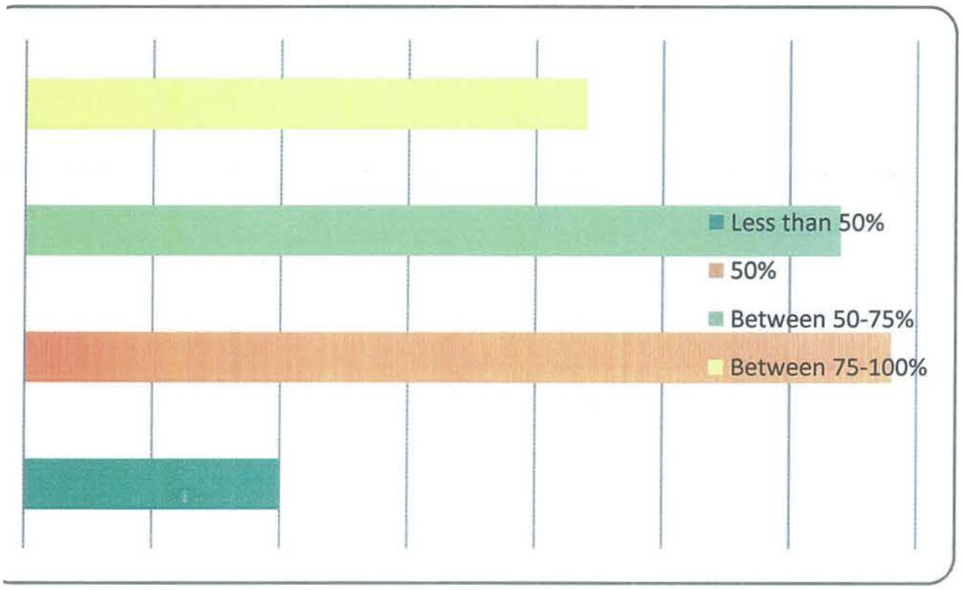
ource: *Primary data, 2016*

indings from the table above show that 58% of the respondents strongly agreed with the atement that customers face penalties if they don't pay the loan in time, 22% of them agreed, 2% were not sure about the statement and 8% of them disagreed with the statement.

2.8 Whether the loan disbursed to customers, is paid back

was also equally important to ask the respondents the percentage of the loan disbursed to istomers if it is paid back. The table below shows the responses.

igure 6: Whether the loan disbursed to customers, is paid back



om the figure above, 34% of the respondents said that 50% of the loan is paid back. 32% iid that the percentage is between 50 - 75%, 22% said it is between 75 -100% while)% of the respondents said it is less than 50%. The findings above depict that loans are covered in varying ways relying on the ability of borrowers.

Table 10: Credit Policies in FINCA Uganda

;laim	SA (%)	A (%)	SA+A (%)	NS (%)	D (%)	D (%)	SD (%)	D+SD (%)
'INCA Uganda considers lient's characters before xtending a loan.	34	34	68.0	16	8	16	0.0	16.0
'INCA Uganda considers ustomer's collateral before xtending the loan to them.	62	38	100.0	0.0	0.0	0.0	0.0	0.0
'o qualify to credit, prevailing conomic conditions are onsidered	0.0	42	42.0	26.0	10	20	12	32.0
'o access capital it considers the ustomer's financial status in rder to loan to them.	12	12	24.0	46	14	28	0.0	30.0
INCA Uganda assesses ustomer's capacity to pay back 1 order to qualify for the loan.	22	50	72.0	8	10	20	0.0	20.0
INCA Uganda considers the ·ustworthiness of customers efore extending a loan to them.	34	48	82.0	4	7	14	0.0	14.0
ustomers are comfortable with 1e loan period that FINCA Jganda extends to them	0.0	42	42.0	10	7	14	34	48.0
'he loan size that FINCA Jganda extends to clients is ood	28	32	60.0	22	9	18	-	18.0
INCA Uganda requires clients) make weekly deposit in order) avoid default.	0.0	54	54.0	20	11	22	2	24.0
ometimes management uses egal means when all other fforts have failed.	22	58	80.0	0.0	0.0	0.0	20	20.0
.VERAGE	21.4	41.0	62.4	15.2	7.6	15.2	6.8	22.2

Source: *Primary data, 2016*

According to the table above, findings show that 68% unanimously agreed that FINCA considers client's character before extending the loan and 16% of them were not sure while 16% of the respondents were in disagreement with the statement but then poor loan recovery has continued to increase, it means FINCA needs to review the implementation, monitoring and evaluation of its credit policies to revive its glory.

The analysis showed that all respondents agreed with the statement that FINCA Uganda considers customer's collateral before extending the loan to them. This is in a bid to safeguard their money extended to clients through loans. Because clients can at any time default or change location hence this is a better control measure in the loan recovery.

The table above shows that 42% of the respondents agreed that economic conditions are considered. 26% were not sure, 32% disagreed. The results from the respondents show that they were ignorant and illiterate about the question. However, although FINCA considers this factor, loan repayment was still a problem. In order to ensure repayment from clients, these conditions such as political and economic factors need to be considered.

It was observed that 46% of the respondents were not sure if FINCA considers the customer's financial status in order to loan to them. 30% disagreed, 24% of the respondents agreed. The analysis shows that the majority clients were ignorant about the question. However, all in all FINCA considers client's financial position before extending the loan to them in an attempt to reduce bankruptcy exposures and also reduce advancing credit to unworthy clients.

From the table above, the majority of the respondents (72%) agreed. It was followed by 20% who disagreed while 8% of the respondents were not sure. The credit officer assessed by looking at clients past records such as earnings, debt load and savings. However, findings revealed that where clients were not able to pay back the loan in time, their pledged property (personal assets) or tangible businesses could be sold in a bid to regain the principal. Besides this, legal actions such as imprisonment could be taken against the borrower.

From the analysis, it can be seen that 82% of the respondents agreed, 14% disagreed while 4% were not sure. The findings on the other hand revealed that despite the application forms which are not comprehensive enough to cater for all attributes of credit screening, there is no formal trust assessment mechanism in place.

The results summarized in the table above show that 42% of the respondents agreed with the fact that customers are comfortable with the loan period extended to them, 48% disagreed, while 10% were not sure about it. The 42% besides being comfortable with the loan period, they also expressed that discounts were allowed to customers with prompt settlement of the loan this serves as an incentive to pay promptly.

From the table above, it is shown that majority of the respondents (60%) agreed, 22% were not sure while 18% disagreed. This implies that clients are satisfied with the size of the loans extended to them since it was commensurate with their standards of living and at the same time they are able to meet to loan obligations.

From the table, the majority (54%) agreed that clients are required to make weekly deposit in order to avoid default and concluded that the weekly deposit were not favorable. They further expressed dissatisfaction with attending meetings immediately the loan is advanced to them, these were time consuming and so their businesses were affected, weekly meetings did not give the opportunity to use credit to organize their businesses. 24% disagreed while 22% were not sure. However, weekly meetings and deposits are meant to guarantee and enhance loan repayment together with interest rate payment.

The table above shows that majority of the respondents (80%) agreed that legal means were sometimes employed. while 20% strongly disagreed. Never the less it has continued to register an increasing low loan recovery rate despite the use of legal means this was attributed to management laxity to effect legal actions after due dates.

4.3 How Loans Are Recovered in FINCA Uganda

In order to find out what influences the performance of loans, respondents were asked on the views on requirements on collateral security, these was portrayed as below.

Table 11: How Loans Are Recovered in FINCA Uganda

m	SA%	A%	A+SA (%)	NS	%	D%	SD%	D+SD (%)
regulatory framework influences omers to repay the loan.	10	34	44.0	26	52	4	0.0	4.0
nent of loan in time in FINCA nda is determined by the reminders istomers.	26	38	64.0	18	36	0.0	0.0	0.0
overy of loans is influenced by est rates charged on clients.	34	0.0	34.0	23	46	0.0	20	20.0
loan period given to customers t loan recovery in FINCA Uganda.	10	30	40.0	20	40	20	0.0	20.0
loan amount extended to customers ts the loan recovery in FINCA nda.	0.0	34	34.0	24	48	18	0.0	18.0
officers in FINCA Uganda are ed to recover loans from clients.	40	20	60.0	10	20	20	0.0	20.0
RAGE	20	26	46	20.2	40.3	10.3	3.3	13.7

Source: *Primary data, 2016*

From the table above, 52% of the respondents were not sure whether regulatory framework influences repayment of loans and this was the majority. 44% agreed, while 4% disagreed. It was seen that proper regulatory body could determine the obligation set by the body for example to suit their client's needs.

The table above shows that 64% of the respondents agreed with the statement that payment of loan in time in FINCA Uganda is determined by the reminders to customers, and 36% of them were not sure about the statement.

From the table above, finding show that 46% of the respondents were not sure whether the loan period given to customers affect loan recovery in FINCA Uganda, 34% of them agreed, and 20% disagreed with the statement.

Findings show that 48% of the respondents were not sure whether the loan amount extended to customers affects the loan recovery in FINCA Uganda, 38% of them agreed with the statement, and 18% of them disagreed.

According to the table above, 60% of the respondents agreed that the loan officers are trained, 20% disagreed while 20% of the respondents agreed; it was the same percentage as those who were not sure and those who disagreed.

4.4 Relationship between Credit Policy and Loan Recovery

In finding out the relationship between credit policy and loan recovery of FINCA, the researcher performed a correlation analysis using SPSS. The Pearson correlation coefficient (r) was used to establish the relationship between credit policy and loan recovery as follows.

Table 12: The relationship between credit policy and loan recovery

Correlations		**Credit policy**	**Loan recovery**
Credit policy	Person correlation	1.000	0.722**
	Sig. (2. tailed)		.012
	N	50	50
Loan recovery	Pearson correlation	0.722**	1.000
	Sig. (2-tailed)	.012	.
	N	50	50

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

Source: statistical package for the social scientists (SPSS) output.

The results revealed a significant positive relationship between credit policy and loan recovery (r = 0.722**, Sig. = .012). This implies that the more efforts that FINCA channels towards favorable credit policies, the better the loan recovery it shall realize. The Pearson coefficient 'r' reflects the degree of linear relationship between the two variables, it ranges from negative one and positive one that is $-1<=r<=1$. If r=0, then, there is no relationship between the two variables, if r ranges between +/-0.1 to +/-0.4 the relationship is weak, if r ranges between +/-0.4 to +/-0.6 the relationship is moderate and if r lies between +/-0.6 to+/-0.9 the relationship is strong. Besides if r=+/-1 there is perfect relationship between the two variables. However, since the correlation coefficient (r=0.722**) lies between +/-0.6 to +/-0.9 the researcher concluded that credit policy and loan recovery are significantly related. Hence a strong relationship between credit policy and loan recovery of FINCA

CHAPTER FIVE

SUMMARIES OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter gives a summary of findings, conclusion and recommendations that are in line with the study objectives and questions.

5.1 Discussion of the Major Findings

5.1.1 Demographic Information

The study revealed that a larger proportion of the respondents were aged between 25-30 years. Most of them were married females. Majority of the respondents had attained degrees and had worked with FINCA for 3 – 4 years hence were knowledgeable about the subject matter.

5.1.2 Credit Policies in FINCA Uganda

The study revealed that most of the FINCA clients have a positive perception about the existence of credit policies applied in order to manage exposures or risks of loan default. This is in compliance with the view made by Pandey I.M(1995) that lending institutions employ a combination of three decision variables namely credit standards, credit policy and collection efforts in order to have optimal recovery from debtors and diffuse loan default exposures.

The study was also supported by Girma (1996) who asserted that through such credit policies the institutions are enabled on how to analyze credit request from customers and provide them with a decision criteria for accepting or rejecting applications.
Ssewagudde (2000) also stressed that these credit policies provide parameters, define procedures and directives through which loans are disbursed.

5.1.2 How loans are recovered in FINCA Uganda

Findings revealed that regulatory framework influences repayment of loans. This is in line with Shafiques, (2000) who argued that lack of proper regulatory frame work has made micro finance institutions face a high non-loan repayment. Poor regulatory system determines a minimum standard of operation through self-regulatory body of micro finance saving mobilization of fixed interest rates operation overlapping can be looked in to by regulatory body. Micro finance institutions must set a low in order to deal with defaulters to recover loans.

5.1.3 Relationship between credit policy and loan recovery

The finding of the study indicated a strong positive relationship between credit policy and loan recovery. According to the findings using Pearson correlation coefficient, the relationship was found to be significant with a correlation coefficient of 0.722 implying a strong relationship between the two variables. If FINCA channels more efforts towards favorable credit policies, the better it will be in as regards loan recovery is concerned. Ssewagudde (2000) pointed out that if such policies are carefully formulated, administered from top and well understood at all levels of the institution, proper credit standards and elimination of excess risk will be achieved.

5.2 Conclusions

5.2.1 Credit Policies in FINCA Uganda

The study was about credit policy and loan recovery in FINCA Uganda. It aimed at identifying better approaches to credit policy management and improve efficiency in loan recovery. For instance the study revealed that credit officers carried out close monitoring and loan management.

The collection procedures were carried out mostly by personal visits by loan officers on weekly basis and during these visits meetings are organized, clients were not in favor of weekly meetings because it interfered with their businesses. The clients were required to make weekly deposit in order to avoid defaults. Clients were not happy with the short loans given out because it affected their repayment in time.

5.2.2 How loans are recovered in FINCA Uganda

Finding revealed that the loan period given to customers affect loan recovery in FINCA Uganda. Therefore the researcher concludes that when client are given a short loan period, they are not given enough time to look for the money to repay back the loan.

5.2.3 Relationship between Credit Policy and Loan Recovery

From the findings, the researcher concluded that credit policy has a significant impact on loan recovery of FINCA Uganda; therefore, it should be very selective in choosing credit policies which will yield desired results and fit in its resources and at the same time choose credible and trained officers to carry out monitoring and supervision of loaned amount.

5.3 Recommendations

- To make clients appreciate the credit policies and recovery procedures. FINCA has to educate the clients and also listen to their grievances. Education background was found out to have an impact on the client's understanding of policies and recovery procedures.
- The interest rate should be reduced by FINCA like other lending institutions. The grace period should be extended to at least a month from when loan should be repaid
- The loan amount or size should at least be increased from 700,000-10,000,000 million depending on the financial need and capacity to repay.
- The weekly deposits affects the payback period, FINCA should either extend the payback period from one year to at least two years or extend weekly deposit to monthly deposits so as to increase the percentage of payback from 50%-75% to 75%-100%. FINCA must look into scrutinize the customers who borrow loans thoroughly before loan is issued.
- Since the cost of loans does influence loan portfolio performance, the study recommends that commercial banks in Uganda should assess their clients and charge interest rates accordingly, as ineffective interest rate policy can consequently improve the performance of loan portfolio.

- Given that the amount of interest rates charged on loans dictates on the ability and flexibility of borrowers to repay loans, the study recommends that microfinance should have a mixed interest rate policy as each type has its advantage and disadvantage.

- The central banks should apply stringent regulations on interest rates charged by banks so as to regulate their interest rate spread. Microfinances should also apply rigorous policies on loan advances so as loans are awarded to those with ability to repay and mitigate moral hazards such as failure of borrowers to repay and costs incurred by the bank to follow up loan defaulters.

- Microfinances should also take the performance of the real economy into account when extending loans given the reality that loan delinquencies are likely to be higher during periods of economic downturn. Microfinances should also constantly review the interest rates on loans since loan delinquencies are higher for banks which increase their real interest rates.

- The management of microfinance should ensure that they carry out a research on consumer needs so as to establish ideal interest rates to be charged. This will go a long way in helping them to know the needs of the consumers so as to be competitive in giving out loans because most borrowers prefer being charged low interest rates hence will go for the lowest interest provider on credit facilities.

- The government should enact legislation which regulates the microfinances. This legislation should ensure that microfinance and other lending institutions charge affordable interest rates on borrowers. Stringent loan requirements like provision of collateral should be removed

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APPENDICES

APPENDIX I: QUESTIONNAIRES

Dear respondents, I am **Kantono Miria,** a student of Kampala International University pursuing a Bachelor Degree of Business Administration, carrying out an academic Study on ***"Credit Policies and Loan Recovery in Microfinance Institutions: A Case Study of FINCA Uganda, Branch".***

You are kindly requested to answer this simple questionnaire. The questions included are purely for academic purposes. I totally guarantee confidentiality of all the information given.

Please tick appropriately and fill in the gaps provided.

A. Personal Data

Name (Optional)……………………………………………….

1. Gender (Tick where appropriate)

Female ☐ Male ☐

2. Marital Status

Married ☐ Single ☐ Separated ☐

Widowed ☐ Divorced ☐

3. Age

18-24 ☐ 25-35 ☐ 36-45 ☐ Above 45 ☐

4. Level of Education

No formal education ☐ PLE ☐ O-Level ☐ Diploma ☐

Bachelor Degree ☐ Other (specify)……………………………..

5. Position in the organization

Manager ☐ Credit officer ☐ Team leader ☐ Client ☐

6. Duration of Service with FINCA

Less than one year ☐ 1-5 years ☐ 5 years and above ☐

SECTION B: Credit Policies in FINCA Uganda

7. Please indicate some of the credit policies employed by FINCA Uganda

…………………………………………………………………………………………………

……………………………………………………………………………………………….

Please tick appropriately and fill in the gaps provided.

8. What is the length of the Loan period?

Less than 4 weeks	4 months	Less than 8 months	1 year	Above 1 year

9. What loan amount do clients ask for?

Less than 100,000	Between 100,000 – 400,000	Between 400,000 – 700,000	Between 700,000 – 1,000,000	Above 1,000,000

10. How do you describe the interest rate charged by FINCA Uganda?

Very high ☐ High ☐ Fair ☐ Low ☐ Very low ☐

11. How often do Customers reminded by FINCA Uganda in case of a default?

Weekly ☐ After 2 weeks ☐ Monthly ☐ End of loan period ☐ Not at all ☐

12. FINCA Uganda uses the following methods to communicate and remind its clients.

	Very common	**Common**	**Not common**	**No opinion**
Letters				
Telephone				
Personal visit				

13. Can customers face penalties if they don't pay the loan in time?

Less than 50% ☐ 50% ☐ between 50-75% ☐ between 75-100% ☐

14. Of the loan disbursed to customers, they pay back

Less than 50% ☐ 50% ☐ between 50-75% ☐ between 75-100% ☐

NB: For the following sections tick your level of agreement or disagreement as most appropriate to your view.

SD- Strongly Disagree, D –Disagree, NS- Not Sure, A –Agree and SA- Strongly Agree

No.	Question	SD	D	NS	A	SA
15.	FINCA Uganda considers client's characters before extending a loan.					
16.	FINCA Uganda considers customer's collateral before extending the loan to them.					
17.	To qualify to credit, prevailing economic conditions are considered					
18.	To access capital it considers the customer's financial status in order to loan to them.					
19.	FINCA Uganda assesses customer's capacity to pay back in order to qualify for the loan.					
20.	FINCA Uganda considers the trustworthiness of customers before extending a loan to them.					
21.	customers comfortable with the loan period that FINCA Uganda extends to them					
22.	The loan size that FINCA Uganda extends to clients is good					
23.	FINCA Uganda requires clients to make weekly deposit in order to avoid default.					
24.	Sometimes management uses legal means when all other efforts have failed.					

SECTION C: HOW LOANS ARE RECOVERED IN FINCA UGANDA

SD- Strongly Disagree, D –Disagree, NS- Not Sure, A –Agree and SA- Strongly Agree

No.	Statement	SD	D	NS	A	SA
25.	The regulatory framework influences customers to repay the loan.					
26.	Payment of loan in time in FINCA Uganda is determined by the reminders to customers.					

27.	Recovery of loans is influenced by interest rates charged on clients.					
28.	The loan period given to customers affect loan recovery in FINCA Uganda.					
29.	The loan amount extended to customers affects the loan recovery in FINCA Uganda.					
30.	Loan officers in FINCA Uganda are trained to recover loans from clients.					

SECTION D: RELATIONSHIP BETWEEN CREDIT POLICY AND LOAN RECOVERY

31. How do you rate credit policy and loan recovery in FINCA Uganda from 2013-2015?

Very high default ☐ High default ☐ Moderate ☐ Low default ☐

Very low default ☐

SD- Strongly Disagree, D –Disagree, NS- Not Sure, A –Agree and SA- Strongly Agree

No.	Statement	SD	D	NS	A	SA
32.	FINCA Uganda credit policy is set in order to recover the loan.					
33.	Is there any direct relationship between credit policy and loan recovery?					

34. What problems do customers face in repaying the loan?

(i) ....

(ii)..

(iii)..

35. What steps should FINCA Uganda take in order to improve on its credit policy and ensure high loan recovery?

(i) ....

(ii)..

(iii)..

APPENDIX II: INTERVIEW GUIDE

Dear respondents, I am **Kantono Miria,** a student of Kampala International University pursuing a Bachelor Degree of Business Administration, carrying out an academic Study on ***"Credit Policies and Loan Recovery in Microfinance Institutions: A Case Study of FINCA Uganda, Branch".***

You are kindly requested to answer this simple question. The questions included are purely for academic purposes. I totally guarantee confidentiality of all the information given.

1. What are the credit policies employed by FINCA Uganda?
2. How do you describe the interest rate charged by FINCA Uganda?
3. How are loans recovered in FINCA Uganda?
4. What problems do customers face in repaying the loan?
5. What steps should FINCA Uganda take in order to improve on its credit policy and ensure high loan recovery?

APPENDIX III: INTRODUCTORY LETTER

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COLLEGE OF ECONOMICS AND MANAGEMENT
DEPARTMENT OF ACCOUNTING AND FINANCE

May, 24th 2018

To whom it may concern

Dear Sir/Madam,

**RE: INTRODUCTORY LETTER FOR KANTONO MIRIA
REG NO 1153-05014-02512**

This is to introduce to you the above named student, who is a bonafide student of Kampala International University pursuing a Bachelor's Degree in Business Administration, Third year Second semester.

The purpose of this letter is to request you avail her with all the necessary assistance regarding her research.

Topic: - **CREDIT POLICIES AND LOAN RECOVERY IN MICROFINANCE INSTITUTIONS.**

Case Study: - **FINCA UGANDA, KAMULI BRANCH.**

Any information shared with her from your organization shall be treated with utmost confidentiality.

We shall be grateful for your positive response.

Yours truly,

KAMPALA INTERNATIONAL UNIVERSITY
MAY 2018
COLLEGE OF ECONOMICS AND MANAGEMENT
P.O. BOX 20000, KAMPALA

DR. JOSEPH B.K. KIRABO
HOD – ACCOUNTING AND FINANCE
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