# THE IMPACT OF CREDIT APPRAISAL ON LOAN RECOVERY IN MICROFINANCE INSTITUTIONS IN UGANDA; A CASE OF FINCA MICRO FINANCE KATWE BRANCH

BY

NAKITENDE SHELLINAH

1163-05014-06602

A RESEARCH REPORT SUBMITTED TO THE COLLEGE OF ECONOMICS AND MANAGEMENT IN PARTIAL FULF-ILLMENT OF THE REQUIREMENTS FOR THEAWARD OF A BACHELOR'S DEGREE OF BUSINESS ADMINISTRATION OF KAMPALA INTERNATIONAL UNIVERSITY

JUNE, 2019

## DECLARATION

I declare that, the material in this report has never been submitted to any university or institution of higher learning for any academic award. This report is result of my own independent research, effort and investigations.

Signature........................................ Date..28th/06/2019..............................

NAKITENDE SHELLINAH

1163-05014-06602

## APPROVAL

This research report has been submitted for examination with my approval as the university supervisor.

Signature.............................................. Date 19/07/2019..............................................

MR. MASEMBE MUZAMIL

# DEDICATION

I dedicate this report to my beloved mum Mrs. Namagambe Judith thanks for the tremendous support entrusted into me.

## ACKNOWLEDGEMENT

Firstly, I need to thank God for the gift of knowledge and enabling me complete this report in time.

Secondly, I would like to acknowledge my supervisor Mr. Masembe Muzamil for his fatherly guidance he rendered to me when doing this work.

My appreciation goes to my uncle Kabanda Moses, My friend Nakintu Prisca Violah, my mum Mrs. Namagrmbe Judith

More thanks are extended to the staff of Finca Micro Finance Limited for their cooperation during my research.

Lastly, I cannot forget to thank the staff and administration of Kampala International University for having given the chance to figure out my future. Thank you.

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## LIST OF ABBREVIATIONS

| | | |
|---|---|---|
| PMFUL | - | Pride microfinance limited |
| NPART | - | Non-Performing Asset Recovery Trust |
| FIS | - | Financial Institutions Statute |

## ABSTRACT

The purpose of the study was to analyze the contribution of credit appraisal on loan recovery in microfinance institutions, Katwe branch using the objectives to examine the practice of credit assessment in Finca, Katwe Branch, to find out the challenges faced in recovering loans in Finca, Katwe Branch and to establish the relationship between credit assessment and loan recovery. The researcher used sample survey research design in the study. The study used a sample size of 70 respondents. The researcher used interviews and questionnaires for collecting data for the study. The findings revealed that on the practice of credit assessment, the biggest percentage of respondents that was 63(90%) of the respondents strongly agreed that finding out whether a client or a company has unpaid loan in another institution is one of the practice of credit assessment, on the relationship between credit assessment and loan recovery, the biggest percentage of respondents that was 65(93%) of the respondents strongly agreed that Examining the clients credit worthiness before giving out a loan makes recovering it easy and finally on the challenges faced in recovering loans, the biggest percentage of respondents that was 56(80%) of the respondents strongly agreed that failure to track and reconcile accounts makes collection of money from some borrowers difficult and tough economic conditions which are unfavorable to the borrower and sometimes to the lender makes loan recovery a big challenge where 50(71.4%) of the respondents strongly agreed. A big number of the respondents also disagreed that weak credit policies is a big challenge to paying back loans. The researcher recommended that pride micro finance should do frequent checks and follow-ups on customers that had borrowed, credit department be properly resourced and facilitated to visit the customers regularly and finally in order to select potential and risk taking applicants the micro finance institutions should have adequate applicant screening criteria such as credit discipline or repayment history current capacity to repay loan personnel behavior and business experience should be considered at the time of applicant screening.

# CHAPTER ONE:
# INTRODUCTION

## 1.0 Introduction

This chapter covers the back ground to the study, statement of the problem, purpose of the study, objectives of the study, research question, Scope of the study, conceptual framework significance of the study and definition of terms.

## 1.1 Background

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).

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. Micro finance institutions employ 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 determining 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. Micro finance institutions have 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(ies). According to Michael Malan the managing director of compuscan 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. According to Mugisa (1995) bad quality loans (assets) 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.

Pride Microfinance was founded in 1995, as a Non-governmental organization (NGO), with the support of the Norwegian Agency for Development Cooperation (NORAD). Its major objective was to offer credit to the poor, targeting those in the agricultural sector. In 1999, it was incorporated as a limited company and changed names to *Pride Africa Uganda Limited.* In 2003, the Uganda government acquired 100% shareholding in the enterprise, changing the name to Pride Microfinance Limited (Mbanga, 2008). In 2005, it attained the status of an MDI according to the Banking Act of 2003. It is licensed and supervised by the Bank of Uganda, Uganda's Central Bank. It is a member of the *Association of Microfinance Institutions in Uganda* (AMFIU).

PMFL is a Microfinance Deposit-taking Institution (MDI). It provides financial services to that segment of the Ugandan population who are not served or are unable to access financial services through the Ugandan commercial banks. PMFL's focus is the micro, small and medium size entrepreneurs. The institution also offers money transfer services through Western Union and Money Gram. As an MDI, PMFL is a Tier III Financial Institution. It is therefore prohibited from dealing in foreign exchange and cannot issue checking accounts. Currently, the institution has 35 branches all over Uganda with its head office in Metropole House on Entebbe Road, in the central business district of Kampala, Uganda's capital and largest city. It is 100% owned by the government of Uganda.

## 1.2 Statement of the Problem

Credit assessment is the examination of credit worthiness of a borrower (Mbanga, 2008). It ensures that credit providers evaluate the clients ability to afford a new loan, eliminate unnecessary risks, increases profitability of credit portfolio, reduces operational costs and finally leads to efficient customer prospecting (Ssewangude, 2000; Mbanga, 2008).

Although Finca Microfinance Limited carries out credit assessment of its clients, there has been continued failure to recover the loans advanced to clients on schedule. This has, been evidenced by loan portfolio shifting from 0.38% to 0.58 % (Pride Microfinance annual report, 2013). If this situation is not given attention, pride micro finance may run bankrupt, loose clients and automatically lead to its closure.

## 1.3 Purpose of the study

To analyze the contribution of credit assessment on loan recovery in Finca, Katwe Branch

## 1.4 Objectives of the study

i. To examine the practice of credit assessment in Finca Micro Finance Limited, Katwe Branch.

ii. To find out the challenges faced in recovering loans in Finca Micro Finance Limited, Katwe Branch.

iii. To establish the relationship between credit assessment and loan recovery in Finca Micro Finance Limited

## 1.5 Research Questions

i) What is the practice of credit assessment on recovery used by Fince Micro Finance Limited?

ii) What are the challenges in loan recovery in Finca Micro Finance Limited?

iii) What is the relationship between credit assessment and loan recovery in Finca Micro Finance Limited?

## 1.6 Scope of the Study

This consisted of the content scope, geographical scope and finally time scope as discussed below;

### 1.6.1 Content Scope

The study covered the contribution of credit assessment on loan recovery in Finca Micro Finance Limited. In this, it rotated at the credit assessment practice, challenges in loan recovery and finally the relationship between credit assessment and loan recovery.

### 1.6.2 Geographical Scope

The study was carried out in Finca Micro Finance Limited, Katwe Branch. The institution offers a wide range of products and services across the sectors targeting micro, small and medium entrepreneurs as well as salary earners involved in a wide range of economic activities.

### 1.63 Time Scope

The study was carried between January 2019 to June, 2019. From January to march, the researcher wrote a proposal, from April to May 2019, the researcher collected data, and then in June, the researcher carried out data analysis and wrote a report and finally submitted the report in June, 2019.

### 1.7 Significance of the study

The results may benefit policy makers by providing information on the credit assessment process, challenges to loan recovery and the relationship between credit assessment and loan recovery which will aid the smooth operation of micro finance institutions in future.

To scholars and other researchers, the findings may be used for reference to narrow down the knowledge gap and provide fresh insight for future research.

The research may be used in partial fulfillment of the requirement for the award of bachelor's degree of business studies of Islamic University in Uganda.

### 1.8 Definitions of Terms

**Credit worthiness:** An assessment of a consumer's past credit behavior that allows a potential lender to decide whether or not to extend credit.

**Credit Assessment:** An assessment of the credit worthiness of a borrower in general terms or with respect to a particular debt or financial obligation.

**Credit Appraisal:** This involves gathering, processing and analyzing of quality information as a way of discerning the client's credit worthiness and reducing the incentive problems between the lenders as principals and the borrowers as agents.

**Portfolio Management:** It involves the administration of the credit facility to ensure orderly and full payment, monitoring of the credit facilities as well as the workout strategies in situations when the credit actually deteriorates.

**Loan Recovery:** Refers to collection of amount due. The normally recovery depends on the purpose, time and condition, business running process etc

# CHAPTER TWO
# LITERATURE REVIEW

## 2.0 Introduction

This chapter reviews the literature related to credit assessment and loan recovery in microfinance institutions. It covered what other authors have written on the practice of credit assessment, challenges to loan recovery in microfinance institutions and Relationship between credit assessment and loan recovery.

## 2.1 Practice of credit assessment

According to Nsereko (1995), Credit assessment is the first stage in the lending process. It is the process through which the credit applicant presents the necessary documentations to the bank in order to obtain a loan. Credit assessment refers to a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest (Feder & Just 1980). It is also an accounting entry that either decreases assets or increases liabilities and equity on the company's balance sheet. Pandey(2008), highlighted that on the company's income statement, a debit will reduce net income, while a credit will increase net income.

According to Beams (2001), the credit assessment pratice begins with a thorough analysis of the borrower's creditworthiness, or capacity and willingness to repay the loan. The examiner should find an assessment by the credit officer of the borrower's current and expected financial condition, the borrower's ability to withstand adverse conditions or "stress, the borrower's credit history and a positive correlation between historical and projected repayment capacity, the optimal loan structure, including loan amortization, covenants, reporting requirements – the underwriting elements, Collateral pledged by the borrower – amount, quality and liquidity; bank ability to realize the collateral under the worst case scenario and Qualitative factors, such as management, the industry and the state of the economy.

This process begins with the collection, analysis and evaluation of information required to determine the creditworthiness of the borrower seeking credit from the bank. After the credit analysis is completed and borrower has been determined to be an acceptable risk, the credit officer proposes a loan structure for approval that preserves the strengths and protects against identified weaknesses of the borrower. The process ends with determination of a risk rating for the credit and loan approval (or rejection). The bank's credit policy, lending standards and procedures create the parameters for this process, thereby establishing the bank's appetite for risk, conservative or aggressive.

The credit policy and standards should define acceptable loan purposes, types of loans and loan structures, and industries to which the bank is willing to lend, as well as the types of information the lender is required to obtain and analyze. The policy and standards help to create the framework, requirements and tolerance limits for lending in which all bank credit personnel will engage. The lender must understand the bank's credit risk management system and his/her role in it, as s/he engages in lending activities – analysis, underwriting and monitoring.

In order to assess Client Loans, the following is considered; The Credit Department should deal with the assessment and monitoring of the consumer loans and borrowers. The risk mana gement of consumer lending contains 2 main aspects; the assessment and monitoring of every single borrower and the assessment and monitoring of the portfolio containing all the borrowers, the assessment and monitoring of the market of the borrower. Does the borrower belong to a sustainable social group? Does he have a regular income job or other company income? Furthermore the department screens business viability to pay back the loan, find out whether the person or a business has a history of bankruptcy, finds out whether a business pays its suppliers in time, consider the credit rating of a client or company before advancing the loan, and also find out whether a client or a company has unpaid loan in another institution

The assessment and monitoring of the borrower is the important aspects to be assessed among others the kind of customers being sought the applicant's credit history, income/employment verification, income stability, employment stability, residence stability and debt- to-income ratio.

The assessment should not take much time. one has to check thoroughly the personal and family situation of the borrower : age, nationality (only inhabitants of the country should be entitled to borrow), steady job and regular income (monthly salary), marital status (number of children),steady residence, bank account with bank, no tax or rent payments in arrears, no other debts outstanding with other banks or financial institutions, no other people who rely on the applicant financially (parents) ,the applicant should not act as a guarantor for someone else's' debts and no criminal record

## 2.2 Challenges faced in recovering loans in microfinance institutions

Kakuru (2003) observes that in loan recovery by different financial institutions, there are various limitations and among these, he noted failure to track and reconcile accounts, according to Kakuru, it is impossible to execute timely and effective recalling and recycling of accounts – the movement of an account from one DCA to another if the current status of the account is uncertain. Yet this unnecessary problem is exactly the challenge many creditors experience with their recoveries systems. The research identified that, because of this issue, some creditors have large numbers of accounts which are stuck in a state of 'limbo', where no collection activity is being undertaken at all.

In addition to the above, Kakuru argues that inability to test new collection strategies is also a key feature of top performing debt collection teams is the continual ability to develop, test and execute new recoveries strategies. Unfortunately many systems struggle to support testing –especially the setting-up and monitoring of multiple test and control groups. Systems need to provide the flexibility to append new external data sources, adjust portfolio segmentation rules and support detailed performance tracking. The inability of systems to support the development, testing and application of new strategies can severely hinder the opportunity to maximize collections.

Odongo, W. (2004) suggests that perhaps the greatest cause of customer dissatisfaction is the failure to react in a timely manner to queries and complaints. Much of the debt collection industry continues to rely on manual processing of queries between the customer and the different organizations involved in the recoveries process. Apart from obvious reputational and regulatory risks, creditors also incur the cost of managing the resultant operational activities. Research also found that failing to respond to queries impacts the ability to collect. Recent trials have shown that automated query management can increase collection levels on these accounts by as much as 400%.

Garber (1997) states that there is lack of data and insight by financial institutions. The importance of having access to good data to drive insight on performance cannot be over-stated. In fact, this insight is the enabler for all other performance enhancing activities.

Unfortunately, many creditors complain they are 'flying-blind', hampered by the inability of their systems to deliver quality management information. When data is available it is often only a historic view, which restricts the ability to forecast and manage ongoing DCA performance.

Furthermore many creditors' systems are unable to receive or interrogate DCA activity-level data, which shows what specific collection activity has taken place on a particular account. As a result creditors cannot directly control or track the activity being applied to their accounts.

There is a challenge of high interest rates. The higher the interest rate, the more income to bank 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 can not 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. 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 and low incentive to save, Uganda has a very low domestic saving to gross domestic product (GDP) of 6-8% (Bureau of labor statistics 2010).

There is also a challenge of high inflation rates; over the broad sweep of history, serious inflation is most often the fourth horseman of an economic apocalypse, accompanying stagnation, unemployment, and financial chaos. The key reason serious inflation often accompanies serious economic difficulties is straightforward: Inflation is a form of sovereign default. Paying off bonds with currency that is worth half as much as it used to be is like defaulting on half of the debt. And sovereign default happens not in boom times but when economies and governments are in trouble (Mutebile, 2005)

Most analysts today even those who do worry about inflation ignore the direct link between debt, looming deficits, and inflation. "Monetarists" focus on the ties between inflation and money, and therefore worry that the Fed's recent massive increases in the money supply will unleash similarly massive inflation. The views of the Fed itself are largely "Keynesian," focusing on interest rates and the aforementioned "slack" as the drivers of inflation or deflation. The Fed's inflation "hawks" worry that the central bank will keep interest rates too low for too long and that, once inflation breaks out, it will be hard to tame. Fed "doves," meanwhile, thinks that the central bank can and will raise rates quickly enough should inflation occur, so that no one need worry about inflation now.

High taxation; Bankruptcy is one way the law deals with people unable to pay their debts. Following an order of bankruptcy, a Trustee is appointed who takes possession of your assets towards payment of your debts fairly between your creditors, according to certain rules. Bankruptcy also imposes a number of restrictions on what you can do. For detailed information on bankruptcy obtain advice from an adviser from the list of contacts in section 11 of this guide. Being made bankrupt by HMRC is broadly similar to being made bankrupt by a commercial creditor, but you will need to be aware of the following additional factors.

## 2.3 Relationship between credit assessment and loan recovery.

Kakuru (2003) observes that for financial institutions to recover the advanced loans, there is need for credit standards that will be observed and effectively evaluate the clients before giving out such loans. He indicates that it is vital to first assess the ability of the client to pay back the loan. He also indicates that it is only through getting the collateral security and ascertaining the client's ability to pay a loan that financial institutions will be able to experience increased loan repayment from its clients.

Mutebile (2005) argues that credit policies such ascertaining the clients financial background (viability) helps financial institutions to give guidelines and procedures which will always be used while extending loans to the clients. According to him, the standard will help to offer uniform terms to all clients and assess the conditions under which standard will help to offer uniform terms to all clients and assess the conditions under which the loan is offered.

Bendrey and West (1997) agree that the loan repayment increase of a financial institution can be achieved the examination of clients character before giving out a loan. According to financial institution, policies will always indicate that such standards will be continuously followed if the right client will have to be chosen in the way of offering the loans. It is through identification of the right clients that will enable financial institutions to have their money paid back.

Beams (2001) adds that financial institutions have not been examining the clients credit worthiness before giving out a loan and this makes recovering it not easy and this explains why financial institutions have been performing poorly in terms of loan repayment. He adds that the failure of financial institutions to determine the right clients through identifying the client's capacity and character leading to failure of the client to pay back the borrowed money as loans. Therefore, according to him, credit policies help financial institutions to increase on loan repayment as they guide financial institutions to advance the loan to the collateral, capital, capacity, character and working in a conducive environment to pay back the loan.

## 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 researcher used a sample survey to seek the opinion of different microfinance officials and customers on the relationship between credit assessment and loan recovery in microfinance institutions. It combined both qualitative and quantitative approaches. Qualitative approaches included use of interviews, documentary review and observations. These provided details that come from direct quotations from the exact words said by respondents as suggested by Kakooza (2002). Quantitative approaches involved use of descriptive statistics that were generated with frequency tables and pie charts. These approaches were adopted to enable the researcher collected and analyzed relevant information about the assessment of budgetary controls on the performance of small scale businesses.

### 3.2 Study Population.

The study was carried out in Pride Micro Finance Limited. The study population consisted of 85 respondents and these involved managers, staff of the human resource department, audit and finance, cashiers and clients who took loans from Pride Micro Finance Limited.

### 3.3 Sample Size and Selection Method.

The researcher used a sample size of 70 respondents to represent the employees, employers and clients of pride microfinance limited. The researcher used convenient sampling to come up with 70 respondents of pride microfinance limited. Respondents were chosen from the various departments by simple random sampling method and purposive sampling technique. In each department, the researcher selected one general manager, nine (21) loan officers, Audit and finance staff (8), cashiers (17) and Clients (23). This will make a sample size of 70 respondents from the various departments of pride microfinance limited.

**Table 3. 1: Showing the study population and distribution**

| **Category** | **Population** | **Sample size** |
|---|---|---|
| Managers | 2 | 2 |
| Loan officers | 27 | 22 |
| Audit and finance staff | 12 | 9 |
| Cashiers | 14 | 12 |
| Clients | 30 | 25 |
| **Total** | **85** | **70** |

*Source: Krejcie and Morgan (1970)*

## 3.4 Sampling techniques

The researcher used simple random sampling for getting 70 respondents from the sample frame of 85 respondents. These were staff and customers of pride microfinance limited. The staff that was sampled was from Credit Department, Corporate Relationship managers and Customer Advisors. On the other hand, the customers were those who failed to service their loans in time as agreed.

## 3.5 Data collection methods

The study based on data that was collected from two major categories of sources; primary and secondary.

### 3.5.1 Primary data

Primary source of data involved the use of questionnaire to collect more information and clarify on some information. It constituted of structured and open-ended questions focusing on the research objectives and control questions to check correctness and consistency.

### 3.5.2 Secondary data

The secondary data source involved mainly the organization's financial and management reports, text books and journals .This record inspection was carried out in relevance to the study objectives.

## 3.6 Data collection Instruments/tools

The researcher used questionnaires and interview guides in the collection of data.

### 3.6.1 Questionnaires

The researcher used questionnaires which were administered to respondents and tick on appropriate answers as well as writing the collect answer where necessary. This was because questionnaires are convenient to both the researcher and the respondents to articulate their ideas on the topic. The questionnaires were later collected from the respondents after being answered and the data was compiled, analyzed, interpreted and presented. The questionnaire was designed in 5-likert key.

### 3.6.2 Interviews

The researcher conducted oral face to face interviews using an interview guide. This enabled the researcher to get first hand information and hence a higher degree of accuracy. The information that was got from the respondents was recorded, analyzed, interpreted and presented.

## 3.7 Data analysis and presentation

Data was analyzed using both qualitative and quantitative means. After collecting data, the researcher used tables and percentages in tabulated forms. The data was later edited and coded. Editing was done to ensure completeness of questionnaires and knowing numbers so as to derive at statistical meaning of the data that was collected.

## 3.8 Ethical Considerations

The study put research ethical standards at the centre of the study. The researcher got a letter from the university which she presented to the pride micro finance in order to allow her conduct research. After being allowed, she approached the respondents, sampled and sought for informed consent from the respondents prior to data collection. The researcher assured them of confidentiality of their responses since this was a sensitive matter and that information was not used for anything else but for academic purpose. She further let them know that their individual identification was eliminated to respect the need for anonymity and guarantee confidentiality in reporting responses.

## 3.9 Limitations of the Study

Finca Micro Finance Limited was not willing to give me their critical data because they feared that their partners in the business would use for outcompeting them but the researcher assured them on the confidentiality of the data.

The employees were very busy but the researcher tried as much as possible to talk with the management in order to allow its employees talk with her for some few minutes.

# CHAPTER FOUR
# DATA PRESENTATION, DISCUSSION AND ANALYSIS OF FINDINGS

## 4.0 Introduction

This chapter covered data presentation that was generated, its interpretation and analysis. The data was analyzed and interpreted in line with the objectives of the study that were to examine the practice of credit assessment, to find out the challenges faced in recovering, Katwe Branch and finally to establish the relationship between credit assessment and loan recovery in Finca Micro Finance Limited, Katwe Branch.

## 4.1 Background information of the respondents;

In this section, the back ground information of the respondents was presented basing on the Gender, Age, educational background and the number of years an individual has finished in an organization.

**Table 4.1: Showing the gender of respondents**

| **Gender** | **Frequency** | **Percentage (%)** |
|---|---|---|
| Female | 40 | 57% |
| Male | 30 | 43% |
| **TOTAL** | **70** | **100** |

***Source: Primary Data (2019).***

According to table 2 above, the research findings showed that out of the 70 respondents interviewed, 40(57%) of the respondents were females while males had 30(43%). Therefore, the number of women was slightly bigger than that of men. This showed that financial institutions hire more women than men since they claim that women give more customer care than men.

**Table 4.2: Showing the age group of respondents**

| **Age Bracket** | **Frequency** | **Percentage (%)** |
|---|---|---|
| 20-30 years | 13 | 19 |
| 31-40 years | 36 | 51 |
| 41 years and above | 21 | 30 |
| **TOTAL** | **70** | **100** |

***Source: Primary Data (2019)***

According to the research findings in table 3 above, out of the 70 respondents interviewed, 13(19%) were in the age group of 20-30 years, 36(51%) were in the age group of 31-40 years while 21(30%) were in the age group of 41 years and above. Therefore, the biggest percentage of respondents that was 36(51%) were in the age group of 31-40 years. This was majorly because the institution recruitment policy which target mature and educated employees of ages between 31-40 years of age.

**Table 4.3: Showing the education level of the respondents**

| **Marital status** | **Frequency** | **Percentage (%)** |
|---|---|---|
| Certificate | 08 | 11 |
| Diploma | 10 | 14 |
| Degree | 32 | 46 |
| Masters | 20 | 29 |
| **TOTAL** | **70** | **100** |

***Source: Primary Data (2019).***

According the research findings in table 4 above, out of the 70 respondents interviewed 08(11%) had certificates, 10(14%) had diplomas, 32(46%) had degrees and finally 20(29%) had masters.

Therefore, the biggest percentage of respondents had studies up to degree level and above implying that the institution employs mostly technical and knowledgeable people to run its business.

**Table 4. 4: Shows how long a respondent has worked in the organization**

| **Years** | **Frequency** | **Percentage (%)** |
|---|---|---|
| Less than 2 years | 02 | 03 |
| 2 -5 years | 07 | 10 |
| 5-8 years | 40 | 57 |
| More than 8 years | 21 | 30 |
| **TOTAL** | **70** | **100** |

***Source: Primary Data (2019).***

According to the research findings on how long the respondent had worked in the organization, 02(03%) said that that they worked for less than two years, 07(10%) worked for 2-5 years, 40(57%) worked for 5-8 years and finally 21(30%) worked for 8 years and above. Therefore, the biggest percentage of respondents worked for 5-8 years. This implies that pride micro finance have a high retention capacity for its employees.

## 4.2 Practice of credit assessment

**Table 4.5: Practice of credit assessment**

| STATEMENT | | SA | A | SD | D | NS | TOTAL |
|---|---|---|---|---|---|---|---|
| Pride microfinance screens business viability to pay back the loan | Frequency<br>Percentage | 52<br>74.3 | 10<br>14.3 | 00<br>00 | 08<br>11.4 | 00<br>00 | 70<br>100 |
| Pride microfinance takes measures to find out whether the person or a business has a history of bankruptcy | Frequency<br>Percentage | 31<br>44.3 | 29<br>41.4 | 10<br>14.3 | 00<br>00 | 00<br>00 | 70<br>100 |
| Pride microfinance takes measures to find out whether a business pays its suppliers in time | Frequency<br>Percentage | 07<br>10 | 00<br>00 | 43<br>61 | 20<br>29 | 00<br>00 | 70<br>100 |
| Pride microfinance considers the credit rating of a client or company before advancing the loan | Frequency<br>Percentage | 50<br>71 | 14<br>20 | 00<br>00 | 06<br>9 | 00<br>00 | 70<br>100 |
| Pride microfinance takes measures to find out whether a client or a company has unpaid loan in another institution | Frequency<br>Percentage | 63<br>90 | 07<br>10 | 00<br>00 | 00<br>00 | 00<br>00 | 70<br>100 |

According to the research findings in the table above, out of the 70 respondents interviewed about whether screening business viability to pay back the loan is one of the process in credit assessment, 52(73.3%) of the respondents strongly agreed, 10(14.3%) agreed while 08(11.4%) disagreed.

On whether finding out whether the person or a business has a history of bankruptcy, 31(44.3%) of the respondents strongly agreed, 29(41.4%) agreed and 10(14.3%) of the respondents disagreed.

When respondents were asked about finding out whether a business pays its suppliers in time as one of the steps in credit assessment, 07(10%) of the respondents strongly agreed, none of the respondents agreed, 43(61%) of the respondents strongly disagreed while 20(29%) of the respondents disagreed.

Furthermore, when respondents were asked whether considering the credit rating of a client or company, 50(71%) of the respondents strongly agreed,14(20%) of the respondents agreed, no respondents strongly disagreed while only 6(9%) of the respondents disagreed.

And finally on finding out whether a client or a company has unpaid loan in another institution as a process in credit assessment, 63(90%) of the respondents strongly agreed, 07(10%) agreed. None of the respondents disagreed.

Therefore, on the practice of credit assessment, the biggest percentage of respondents that was 63(90%) of the respondents strongly agreed that finding out whether a client or a company has unpaid loan in another institution is one of the practice of credit assessment. This is in line with Beams (2001) who stated that the credit assessment practice begins with a thorough analysis of the borrower's creditworthiness, or capacity and willingness to repay the loan. The examiner should find an assessment by the credit officer of the borrower's current and expected financial condition, the borrower's ability to withstand adverse conditions or "stress, the borrower's credit history and a positive correlation between historical and projected repayment capacity, the optimal loan structure, including loan amortization, covenants, reporting requirements – the underwriting elements, Collateral pledged by the borrower – amount, quality and liquidity; bank ability to realize the collateral under the worst case scenario and Qualitative factors, such as management, the industry and the state of the economy.

## 4.3 Challenges faced in recovering loans

**Table 4.6: Challenges faced in recovering loans**

| STATEMENT | | SA | A | SD | D | NS | TOTAL |
|---|---|---|---|---|---|---|---|
| Failure to track and reconcile accounts makes collection of money from some borrowers difficult | Frequency<br>Percentage | 56<br>80 | 14<br>20 | 00<br>00 | 00<br>00 | 00<br>00 | 70<br>100 |
| Inability to test new collection strategies leads to inefficiency in collecting money from borrowers | Frequency<br>Percentage | 07<br>10 | 00<br>00 | 41<br>59 | 22<br>31 | 00<br>00 | 70<br>100 |
| Customer dissatisfaction as a result of failure to react in a timely manner to queries and complaints is a challenge to loan recovering | Frequency<br>Percentage | 02<br>3 | 07<br>10 | 44<br>63 | 17<br>24 | 00<br>00 | 70<br>100 |
| Insufficient information from clients makes tracking and locating clients difficult | Frequency<br>Percentage | 37<br>53 | 30<br>43 | 00<br>00 | 03<br>4 | 00<br>00 | 70<br>100 |
| Weak credit policies is a big challenge to paying back loans | Frequency<br>Percentage | 10<br>14.3 | 00<br>00 | 48<br>68.6 | 12<br>17.1 | 00<br>00 | 70<br>100 |
| Tough economic conditions which are unfavourable to the borrower and sometimes to the lender makes loan recovery a big challenge | Frequency<br>Percentage | 50<br>71.4 | 17<br>24.3 | 00<br>00 | 03<br>4.3 | 00<br>00 | 70<br>100 |

According to the research findings on the table above, out of the 70 respondents interviewed on whether failure to track and reconcile accounts makes collection of money from some borrowers difficult whereby 56(80%) of the respondents strongly agreed and 14(20%) of the respondents agreed.

On whether inability to test new collection strategies leads to inefficiency in collecting money from borrowers, 07(10%) of the respondents strongly agreed, no respondents agreed, 41(59%) of the respondents strongly disagreed while 22(31%) of the respondents disagreed.

Additionally, respondents were asked whether customer dissatisfaction as a result of failure to react in a timely manner to queries and complaints is a challenge to loan recovering, 02(3%) of the respondents strongly agreed, 07(10%) agreed while 44(63%) of the respondents strongly disagreed and finally 17(24%) of the respondents disagreed.

Furthermore, when respondents were asked whether insufficient information from clients makes tracking and locating clients difficult, 37(53%) of the respondents strongly agreed, 30(43%) agreed, none of the respondents strongly agreed and finally 03(4%) of the respondents disagreed.

When respondents were asked whether weak credit policies is a big challenge to paying back loans, 10(14.3%) of the respondents strongly agreed, none of the respondents agreed, the biggest percentage that was 48(68.6%) strongly disagreed and finally 12(17.1%) of the respondents disagreed.

Finally, when respondents were asked whether tough economic conditions which are unfavourable to the borrower and sometimes to the lender makes loan recovery a big challenge, 50(71.4%) of the respondents strongly agreed , 17(24.3%) agreed , none of the respondents strongly disagreed while only 3(4.3%) of the respondents disagreed.

Therefore, on the challenges faced in recovering loans, the biggest percentage of respondents that was 56(80%) of the respondents strongly agreed that failure to track and reconcile accounts makes collection of money from some borrowers difficult and tough economic conditions which are unfavorable to the borrower and sometimes to the lender makes loan recovery a big challenge where 50(71.4%) of the respondents strongly agreed. A big number of the respondents also disagreed that weak credit policies is a big challenge to paying back loans. This is in line with Kakuru (2003) who observes that in loan recovery by different financial institutions, there are various limitations and among these, he noted failure to track and reconcile accounts, according to Kakuru, it is impossible to execute timely and effective recalling and recycling of accounts – the movement of an account from one DCA to another if the current status of the account is uncertain yet this unnecessary problem is exactly the challenge many creditors experience with their recoveries systems

## 4.4 Relationship between Credit Assessment and Loan Recovery

**Table 4.7: Relationship between Credit Assessment and Loan Recovery**

| STATEMENT | | SA | A | SD | D | NS | TOTAL |
|---|---|---|---|---|---|---|---|
| Getting a worthwhile collateral security from a client makes paying the loan easier | Frequency<br>Percentage | 68<br>97 | 02<br>03 | 00<br>00 | 00<br>00 | 00<br>00 | 70<br>100 |
| identification of the right clients makes paying back the loans easy | Frequency<br>Percentage | 48<br>69 | 22<br>31 | 00<br>00 | 00<br>00 | 00<br>00 | 70<br>100 |
| Effective credit policies increase loan repayment from its clients. | Frequency<br>Percentage | 49<br>70 | 09<br>13 | 00<br>00 | 12<br>17 | 00<br>00 | 70<br>100 |
| It is vital to first assess the ability of the client to pay back the loan before disbursing it | Frequency<br>Percentage | 60<br>86 | 10<br>14 | 00<br>00 | 00<br>00 | 00<br>00 | 70<br>100 |
| Examination of clients character before giving out a loan makes recovering it easy | Frequency<br>Percentage | 51<br>73 | 09<br>13 | 00<br>00 | 10<br>14 | 00<br>00 | 70<br>100 |
| Examining the clients credit worthiness before giving out a loan makes recovering it easy | Frequency<br>Percentage | 65<br>93 | 05<br>7 | 00<br>00 | 00<br>00 | 00<br>00 | 70<br>100 |

According to the research findings in the table above, out of the 70 respondents interviewed on whether getting a worthwhile collateral security from a client makes paying the loan easier, 68(97%) of the respondents strongly agreed, 02(03%) of the respondents agreed and finally no respondent disagreed.

When respondents were asked whether identification of the right clients makes paying back the loans easy, 48(69%) of the respondents strongly agreed while 22(31%) of the respondents agreed. None of the respondents disagreed.

On whether effective credit policies increase loan repayment from its clients, 49(70%) of the respondents strongly agreed, 09(13%) of the respondents agreed while 12(17%) of the respondents disagreed.

Additionally on whether it is vital to first assess the ability of the client to pay back the loan before disbursing it, 60(86%) of the respondents strongly agreed and 10(14%) of the respondents agreed. None of the respondents disagreed.

Furthermore, on whether examination of client's character before giving out a loan makes recovering it easy, 51(73%) of the respondents strongly agreed, 09(13%) agreed while 10(14%) of the respondents disagreed.

Finally, respondents were asked on whether examining the client's credit worthiness before giving out a loan makes recovering it easy, 65(93%) of the respondents strongly agreed, while only 05(7%) of the respondents agreed.

Therefore, on the relationship between credit assessment and loan recovery, the biggest percentage of respondents that was 65(93%) of the respondents strongly agreed that Examining the clients credit worthiness before giving out a loan makes recovering it easy. This is in line with Beams (2001) who states that financial institutions have not been examining the client's credit worthiness before giving out a loan and this makes recovering it not easy and this explains why financial institutions have been performing poorly in terms of loan repayment. He adds that the failure of financial institutions to determine the right clients through identifying the client's capacity and character leading to failure of the client to pay back the borrowed money as loans

# CHAPTER FIVE

# SUMMARY, CONCLUSION AND RECOMMENDATIONS

## 5.0 Introductions

This chapter presents a summary of the major findings of the study; provide recommendations and areas for further research. A revelation of both the theoretical and empirical issues that underline the credit assessment and loan recovery in micro finance institutions was made in the proceeding chapters

## 5.1 Summaries of major findings

### 5.1.1 Findings on the practice of credit assessment

On the practice of credit assessment, the biggest percentage of respondents that was 63(90%) of the respondents strongly agreed that finding out whether a client or a company has unpaid loan in another institution is one of the practice of credit assessment

### 5.1.2 Findings on the challenges to loan recovery

On the challenges faced in recovering loans, the biggest percentage of respondents that was 56(80%) of the respondents strongly agreed that failure to track and reconcile accounts makes collection of money from some borrowers difficult and tough economic conditions which are unfavorable to the borrower and sometimes to the lender makes loan recovery a big challenge where 50(71.4%) of the respondents strongly agreed. A big number of the respondents also disagreed that weak credit policies is a big challenge to paying back loans

### 5.1.3 Findings on the relationship between loan credit assessment and loan recovery

On the relationship between credit assessment and loan recovery, the biggest percentage of respondents that was 65(93%) of the respondents strongly agreed that Examining the clients credit worthiness before giving out a loan makes recovering it easy.

## 5.2 Conclusion

It was noted that information on customers' existing borrowing in other financial institutions could not be validated by credit assessment official. The loans advanced to the customers took a week or so to process. Upon approval, commitment fees are paid by all customers irrespective of whether the customer had a loan with pride micro finance institutions or not.

On level of default, the study concludes that the bank uses fixed monthly repayment schedule for customers to repay their loans. This method did not favour customers. It further concludes that the bank did not monitor and follow up on loans given to customers.

## 5.3 Recommendations

Based on the conclusion, the following are recommended for management decision so as to help the micro finance institutions to improve its loan recovery performance;

Information on borrowers, pride micro finance lacks credible sources of information on borrowers. It relied on information provided by customers about their previous borrowing. Such information was hard to validate because most customer did not disclose all their existing borrowings in other financial institutions. The study recommends that pride micro finance should pool together possibly under the auspices of the Uganda Bankers' Association (UBA) and establish a credit information bureau to which reference can be made before a loan is disbursement.

Monitoring and Follow-up, It was noted from the study that pride micro finance does not do frequent checks and follow-ups on customers that had borrowed. The study recommends that the credit department be properly resourced and facilitated to visit the customers regularly.

In order to improve the quality of project appraised reports and to provide sufficient technical instance of borrowers, the micro finance institutions should allocate sufficient budget or find funds to upgrade the knowledge and skill of its staff.

In order to select potential and risk taking applicants the micro finance institutions should have adequate applicant screening criteria such as credit discipline or repayment history current capacity to repay loan personnel behavior and business experience should be considered at the time of applicant screening.

The micro finance institutions should revise and update the loan processing parameters and formats that are used by lending department so as to clearly understand able to the clients.

The micro finance institutions should set conditions that enforce clients, especially clients with big project, to present project execution contact document and recent managerial and technical staff or their project.

Finally, the researcher strongly recommends further detail research in loan operation specifically credit recovery performance of the bank which are problem areas and core activities of the micro finance institutions.

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# APPENDICES

## Appendix 1: Questionnaire

Dear respondent;

I am a student of Kampala International University pursuing a bachelor's degree of business administration. I am carrying out research about The impact of credit assessment and loan recovery in microfinance institutions. I kindly request for your cooperation in answering the following questions. The data collected will be kept with utmost confidentiality and will be used for academic purpose only. Thank you.

### SECTION A: BIO DATA OF RESPONDENTS

*Instruction: please tick the appropriate box*

1. **Gender**

Male ☐

Female ☐

2. Age group

20-30 years ☐ 31-40years ☐ 41 and above ☐

3. Educational Background

Certificate ☐ Diploma ☐

Bachelors degree ☐ Masters degree and above ☐

Other (Specify)...............................................................................................

4. For how many years have you been in this institution?

Less than 2 years ☐ 2-5 years ☐

5-8 years ☐ more than 8 years ☐

## SECTION B : PRACTICE OF CREDIT ASSESSMENT

***Instruction;***

Tick in the space provided below

| STATEMENT | Strongly | Agree | Not Sure | Disagree | Strongly |
|---|---|---|---|---|---|
| Pride microfinance screens business viability to pay back the loan | | | | | |
| Pride microfinance takes measures to find out whether the person or a business has a history of bankruptcy | | | | | |
| Pride microfinance takes measures to find out whether a business pays its suppliers in time | | | | | |
| Pride microfinance considers the credit rating of a client or company before advancing the loan | | | | | |
| Pride microfinance takes measures to find out whether a client or a company has unpaid loan in another institution | | | | | |

## SECTION C: CHALLENGES IN RECOVERING LOANS

| STATEMENT | Strongly Agree | Agree | Not Sure | Disagree | Strongly |
|---|---|---|---|---|---|
| Failure to track and reconcile accounts makes collection of money from some borrowers difficult | | | | | |
| Inability to test new collection strategies leads to inefficiency in collecting money from borrowers | | | | | |
| Customer dissatisfaction as a result of failure to react in a timely manner to queries and complaints is a challenge to loan recovering | | | | | |
| Insufficient information from clients makes tracking and locating clients | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| | difficult | | | | | |
| | Weak credit policies is a big challenge to paying back loans | | | | | |
| | Tough economic conditions which are unfavourable to the borrower and sometimes to the lender makes loan recovery a big challenge | | | | | |

## SECTION D: CREDIT ASSESSMENT AND BANK LOAN RECOVERY

| | **STATEMENT** | Strongly Agree | Agree | Not Sure | Disagree | Strongly |
|---|---|---|---|---|---|---|
| | Getting a worthwhile collateral security from a client makes paying the loan easier | | | | | |
| | identification of the right clients makes paying back the loans easy | | | | | |
| | Effective credit policies increase loan repayment from its clients. | | | | | |
| | It is vital to first assess the ability of the client to pay back the loan before disbursing it | | | | | |
| | Examination of clients character before giving out a loan makes recovering it easy | | | | | |
| | Examining the clients credit worthiness before giving out a loan makes recovering it easy | | | | | |

***Thank you very much for your responses. May God bless you.***

## Appendix 2: Interview Guide for key Informants

Dear respondent;

I am by names Nakitende Shellinah a student of Islamic university in Uganda, Kampala Campus pursuing a bachelor's degree of business studies. I am carrying out research about credit assessment and loan recovery in microfinance institutions. I kindly request for your cooperation in answering the following questions. The data collected will be kept with utmost confidentiality and will be used for academic purpose only. Thank you.

1. What is credit assessment?
2. What is loan recovery?
3. Explain the practice of credit assessment?
4. Explain the challenges of recovering loans in microfinance institutions?
5. Explain the relationship between credit assessment and loan recovery?