THE ROLE OF CREDIT RISK MANAGEMENT ON THE PERFORMANCE OF MICRO FINANCE INSTITUTIONS

A CASE STUDY PRIDE MICRO FINANCE UGANDA (KABALAGALA BRANCH)

BY

NAMAKULA POLINE
BBA/ 11412/ 61/ DU

A RESEARCH REPORT SUBMITTED TO THE FACULTY OF BUSINESS ADMINISTRATION IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A BACHELOR OF BUSINESS ADMINISTRATION OF KAMPALA INTERNATIONAL UNIVERSITY

2009

DECLARATION

I Namakula Poline, here by declare that the material contained in this report/dissertation is entirely my work.

Hence, it has never been presented for any academic award at any institution of learning.

Any errors/mistakes contained in this dissertation is solely my responsibility.

Signature ...Namakula Poline........................

NAMAKULA POLINE

(STUDENT)

APPROVAL

This is to certify that this report has been submitted with my approval as University supervisor.

Signed..

MR. MUSANA MICHAEL

(SUPERVISOR)

DEDICATION

I dedicate this piece of work to my lovely mother Mrs. Golooba Ronnie, my father Mr. Golooba Vicent, my lovely daughter Tricia Kiyega, my brothers Andrew, Vicent, Richard and my sister Irene.

I love them so much.

ACKNOWLEDGEMENT

As the saying goes " never give up", for some say it is impossible. I find It hard to believe that. I eventually managed to stand the test of time. However, not an atom of these would be possible without the support of so many people.

I wish to pay special tribute to Mr. Musana Michael for his Invaluable supervision of my research project, through his constructive advice and criticism.

My fellow classmates and friends and my dearest Mariam for the prayers she has given me.

Further more, I must thank my lovely mother Mrs. Golooba Ronnie for the moral, spiritual courage she has given to me. Without her I would not have existed.

TABLE OF CONTENTS

ACRONYMS

PML PRIDE Micro Finance Limited

SGL Salary Guaranteed Loans

MFU Micro finance Uganda

MFI Micro finance Institution

SPSS Statistical Package for Social Scientists.

ISAE Institute of Statistics and Applied Economics

SG Salary Grouper

LIF Loan Insurance Fund

SSL Solo Salary Loan.

RR Relative Risk

ANOVA Analysis of Variance

EPI-INFO Epidemiological Information

MEC Major economic classification

OR Odds Ratio

ABSTRACT

The study covers the "role of credit risk management on the performance of microfinance institutions", in Uganda a case study of PRIDE MICRO FINANCE
The scope of research included, the funding of MFI, the role of MFI, the challenges lending policies, how credit risk measurements , the credit of risk management and hoe the credit risks affect the resources of MFI in terms of planning, controlling, directing and organizing.

Objectives included to establish the various methods which PRIDE micro finance uses to extend credit to it's customers, to find out the presence of credit risk in Pride Microfinance, to establish the extent of credit risk in Pride microfinance, to identify factors influencing credit risk in PRIDE micro finance limited and to establish how best credit risk can be managed in Pride Microfinance.

Data was collected using primary data and secondary data. Primary data by use of questionnaires and interviews While secondary data by reading and analyzing Published data, it was processed by using different analysis. The findings were that credit risk is reduced in Pride Uganda micro finance due to the measurements put in place.

The recommendation of the research findings will help institutions currently operating in Uganda to improve on their methods of delivery, performance and those that are trying to expand to avoid costly mistakes.

The researcher fills has not exhausted all findings to the topic and therefore recommends up coming others researchers to carry out research on Management of resources and the procedures taken by the management incase a client fails to pay back the loan.

CHAPTER ONE

1.0 Introduction

Credit risk is generally defined as the potential that a bank borrower or counter part will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximize a bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long term success of any banking organization. The breadth, depth, and scope of outreach of the microfinance industry have grown significantly during the last two decades. The Asia and Pacific region accounts for the bulk of this growth.

According to the Micro credit. Summit Campaign (2006:24), by 31 December 2005, some 3,133 micro credit institutions reported reaching 113.26 million clients with a current loan, and about 97 million of these clients were in the Asia and Pacific region. Of the total number of clients reached by these institutions, about 82 million were among the poorest when they started with the program, and 91% or about 74 million of the poorest families reported are in Asia where over two thirds of the world's poor people live. The erstwhile micro enterprise-credit-only institutions are now providing a broader range of credit products. Their loans are no longer confined to shorter working capital loans but now also include loans with relatively longer maturities, and those intended for other purposes such as acquiring fixed assets. Some microfinance institutions (MFIs) even venture into the financing of agricultural operations. Other MFIs have expanded their deposit services, thus contributing to the expansion of the scope of outreach. Grameen Bank, for example, has achieved impressive results in mobilizing voluntary savings through its new deposit products offered under the Grameen Pension Scheme to the members, and other deposit products offered to both members and nonmembers (Rutherford

2006). The last two decades have also seen a significant increase in the diversity of institutions providing financial services to the poor and low-income households. The previous predominance of non government organizations (NGOs) in the retail markets of many countries has been challenged by new developments such as the transformation of some pioneering NGOs into fully or partially regulated financial entities, the emergence of specialized.

Microfinance banks, the entry of commercial banks into microfinance, and the increased involvement of cooperatives and rural banks. The increasing involvement of no financial institutions such as telecommunication companies in microfinance is adding to this diversity.

1.1 Back ground

Micro financing in Uganda has gained momentum since the early 1990's as a means of assisting the poor to fight against poverty and achieving development.

Micro finance institutions develop to fill the gap that was created after restructuring Uganda Commercial Bank. According to Presto study (1997), the organizations are performing more in urban areas than in rural areas. This poses a question of eradication of poverty eradication as most people live in rural areas.

Micro financing institutions expanded in the early 1990's when the government owned "Uganda Commercial Bank" restructured its operation and reduced on the number of branches leaving a gap in the financial services especially among the small-scale sector. Uganda economy has had tremendous improvement since 1987 when the government and the international monetary policy instituted a wide range of stabilization and structural adjustment programs. As a result the economy has been growing at a rate of 6.5% per annum.

Inflation has since been brought down form around 200% in 1987 to a manageable level of 8.2% t at the end of December 1997 (MFPED, 1998)

Despite these impressive figures, Uganda still remains one of the poorest countries in the world with per capital GDP standing at US $270(MFPED,1998) life expectancy is 48 years as compared to Malaysia with 70years in 1991.

According to UNDP, Uganda Human Development reports 1998,the literacy rates as a percentage of total population was 61.8% access to safe drinking water was 48.5% health services was 49% and malnutrition among children stood as 31.8 and all these show that the quality of life in Uganda is still poor and effort is needed to improve on the income of the population.

The current backs and other credit institutions fear risks involved in micro lending. Micro borrowers are considered risky and commercial backs do not considered risky and commercial banks do not consider them credit worthy or capacity to utilize productively the funds given and it is expensive to administer and recover(christen,1997)

Grima (1996) says that the lower literacy levels of education hinder the borrower's utilization of loan money. She goes further to say that the basic training in the areas of small business management and book keeping is thought of improving the loan utilization and overall management of the small scale enterprise, so the educational attainment of borrowers is believed to have an impact in loan money utilization this becoming a risk to the micro finance institution.

1.2 Problem statement

Small and micro enterprise development has been identified as important if Uganda is to achieve sustainable economic development and poverty reduction. Most micro and small scale enterprise have got a number of difficulties in accessing credit to expand their activities. Despite the focus put on micro financing, there exists high risk in small enterprise and rural lending yet there is serious need to credit.

Most of the financial institutions have run away from the small scale enterprise and rural lending, yet there is serious need for credit financing mainly due to high transaction costs and risks of extending credit to these sectors. Micro financing has been identified as the most cost-effective way of extending credit to rural and small-scale sector, despite the many institutions of micro finance; many have been concentrated in urban and peri-urban areas making little effort to penetrate to rural areas. Thus the study helped in identifying the underlying factors causing credit risk and availability. This could help in improvement of the credit delivery system.

1.3 Purpose of the study

The major objective was to identify the causes of high credit risk in the operations and performance of micro finance institutions and the different types of micro financing institutions.

1.4 Specific objectives of the study

The challenging aspect is to assess the potential tradeoffs between MFIs and selecting a set of objectives and strategies for reaching those objectives

- To establish the various methods which PRIDE micro finance uses to extend credit to its customers.
- To identify how credit risk is measured in Pride Microfinance.
- To identify factors influencing credit risk in PRIDE micro finance limited.
- To identify challenges faced by Pride Microfinance.

1.5 Research Questions

- What methods are used in credit risk management?
- To what extent do Microfinance institutions measure their credit risks?
- What factors do influence credit risks management in microfinance institutions?
- What are the challenges faced by MFIs in their services as they struggle to meet the customer's interests?

1.6 Scope of the study

The study covers the role of credit risk management on the performance of microfinance institutions which included, the funding of MFI, the role of MFI, the challenges lending policies, how banks measure their credit risk , the credit of risk management and hoe the credit risks affect the resources of MFI in terms of planning, controlling, directing and organizing.

1.6.1 Geographical scope

The study concentrated on Pride Microfinance Uganda Limited, focusing on Kabalagala branch with in Kampala Central.

1.6.2 Time Scope

This covered a period beginning from 2005 -2009.

1.7 Significance of the study.

The finding and recommendation of the study will benefit the management of micro finance institutions to determine and compute the credit risks thus how much they will be risking in losses and be aware of finding out the possible solution to overcome such losses.

The study also identifies the best ways of managing credit risks for MFI thereby improving on the services resulting to efficient productivity, hence helping their customers by high lighting the role of credit risk and how it is managed.

The study will also provide literature to academicians and other researchers to widen their scope of knowledge of the subject so that they can compare the outcomes.

1.8 Conceptual Framework.

Both independent and dependent factor have influence on credit risk. Independent factors include, Credit risk management (Lending policy, Security, evaluation of credit worthiness and variety of regulation) and dependent factors include (increase in customers, decrease in the rate of defaulters, increase in assets and increase in revenue) for their good influence leads to expansion of the services, increase in employee, increase in working hours so as to ease work in Pride Micro finance institution and give satisfaction to their clients.

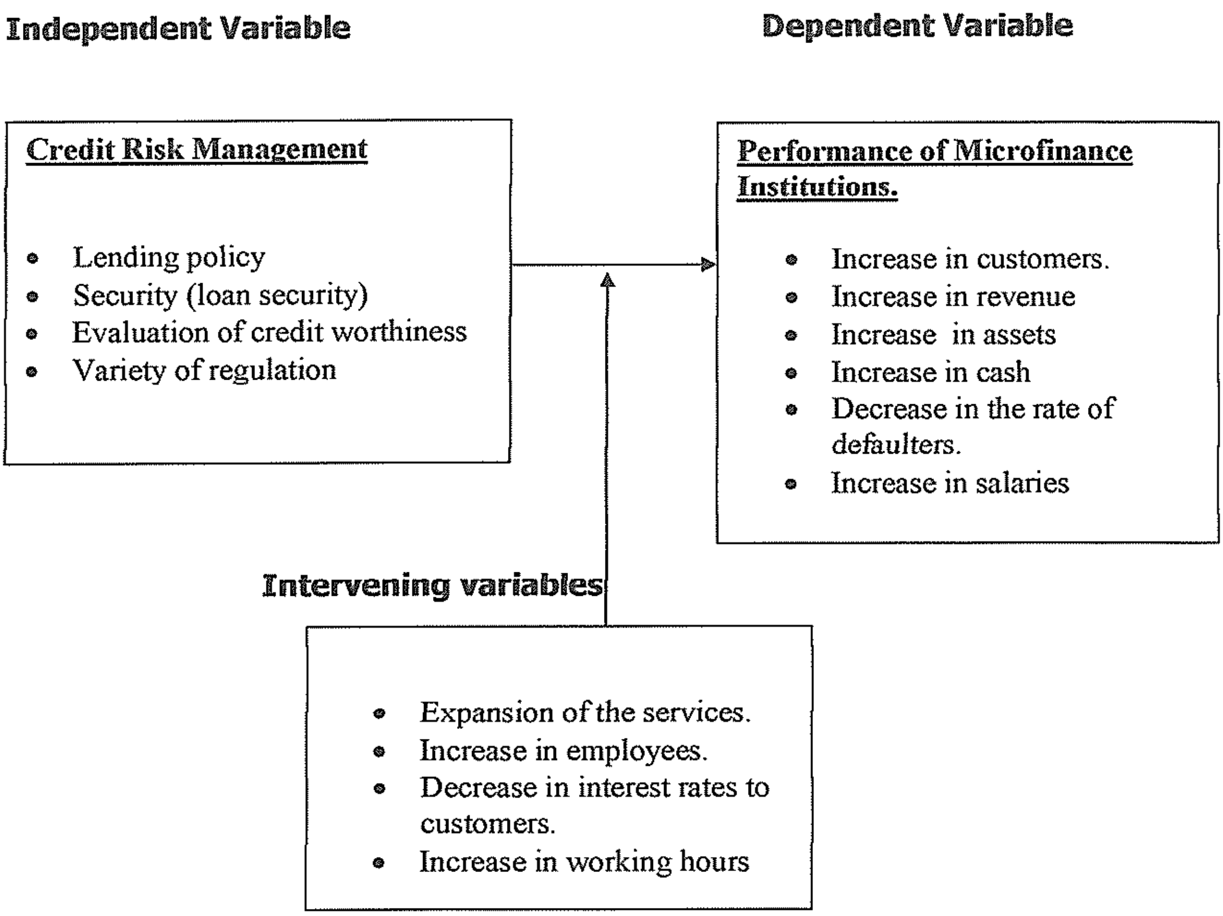


Figure 1 conceptual Frame work

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

Micro financing refers to the lending of very small sums of money to individuals under the security of group involvement for small business start up at a very low level, (Johnson, 1997), the idea is to assist small-scale enterprise that cannot access credit in the formal financial sector.

Micro finance institution as we know began in the 1970's with the Grameen bank in Bangladesh and Accoin international in Latin America (Christen, 1997), these institutions have developed lending methodologies that have ensured recovery rates of more than 95% in situations where the poor were considered as high risk individuals with a formal finance practice who usually divert credit to consumption. In small credit markets, there is general lack of collateral security, complementary infrastructure like telecommunications are lacking, literacy rates are low, and all of which combine to make the conditions rather difficult for banks to operate.

2.1 FUNDING OF MFIS

The MFIs get their funds from Donor funds, retained earning, Own secured physical assets, Compulsory savings, voluntary savings, loans from commercial sources, paid-in-equity, Local donations and contributions.

The government is another source of capital, particularly loan capital for MFIs in the form of revolving funds and rural farmers support schemes. Funds from government and donors are obtained at concessional terms. However, the underlying danger with donor funds is that these funds may dry up in future and the MFIs may find it difficult to mobilize funds from other sources. Therefore, most MFIs consider possible strategies to ensure their sustainability. (Justine N. and James February 2004)

However, the conventional view is that low-income depositors transact more frequently than holders of larger accounts and more prone to income disruptions from the natural disasters, health issues crime and other factors, this perception makes the financial institutions stepping into under served low income space worry about whether they can use small deposits to funds their lending operations. The research finds that under normal circumstance aggregate balances for low income accounts move gradually, and they are not prone to abrupt month by month swings. This should make liquidity management easier because it gives the institutions enough time to adjust to changes in deposit supply over several months.

Financial institutions cannot take for granted that any of their deposits are stable, long term sources of funds until they have carefully analyzed typical savings patterns in their portfolio of deposit products. This analysis informs their liquidity management and their funding strategy. Deposit taking MFIs should use the same type of analysis on their deposit products, and refine their liquidity planning and funding operations accordingly. (Julia Abakaeva and Jasmina GlisovicMezieres, June 2009)

Microfinance institutions are attracted by a flood of new money from investors and big commercial banks. There are so many investment funds that specialize in microfinance, some of which are established by individual investors. These funds are small and highly concentrated in the leading institutions within the country but their pool of capital available is growing fast. Big banks also get in the game, others deploy their structuring and fund-management skills to offer investment products that appeal to a broad range of investor-risk profiles and social motivations .(Elizabeth Littlefield chief executive officer of the consultative group to assist the poor and director of world bank. 12.20.07, 6:00 pm et)

However, public commercial-investment agencies, such as the World Bank's IMF, IFC and European Investment Bank, are the largest investors in microfinance. IFC, for example, currently has $640 million in outstanding commitments to microfinance and plans to double this amount. These investors offer equity, loans and guarantees and are a natural follow-on from the early grant money that helped build microfinance institutions into credit-worthy investments. Several are now providing local currency loans.

Thus a heated and healthy debate has emerged over whether these public-sector investments are now "crowding out" the private-investment funds by flocking to the same successful institutions. So what is the role of public agencies when so much investment capital is flowing in.

Traditional public donors are the angel investors of microfinance in its formative period, providing the seed capital for fledgling microfinance institutions, often through grants. Now, decades later, there are still critical gaps that the traditional aid agencies are best placed to fill despite the flood of new money:

Foreign funding was initially dominated by non profit investors followed by socially responsible investors and commercial investors.

Many investors and intermediaries are testing the feasibility of engagement in MFI domestic currencies. International investors add more value to microfinance development if they are able to tolerate more risks and work with less well-established MFIs.

2.2 THE ROLE OF MICRO FINANCE INSTITUTIONS

The role of microfinance institutions as dedicated providers of credit and other financial services to the economically active poor is very strong and urgent in the post-disaster context. The question, therefore, is not what role MFIs should play in the disaster-hit areas, the issue is how to go about playing this role under abnormal circumstances when the entire client base (the target group) has no going business to show and no assets to restart the businesses it was engaged in before the disaster hit.

The credit quality of the borrowers therefore has deteriorated tremendously, from a lender's point of view, to makes them unacceptable credit risks. Under these circumstances, the socially oriented NGOs are ideally suited to hit the ground running for executing grant funded MF programs in the post disaster areas. The primary objective of these grant funded programs should be to replenish some of the equity and working capital lost by the economically active poor so that they could restart the businesses immediately. These replenishments should be seen as a kind of insurance payments, with the proviso that the end use of disbursed funds should be monitored very closely by the NGOs. As soon as these people have restarted their businesses and repaired their credit profile somewhat, the NGO programs should be weaned out quickly and replaced with market based micro lending. The mandate of the NGOs should include to transfer these borrowers to market based micro lenders within six months, at the latest.

Given that Greenfield MF institution building is a time consuming, costly, and slow process, whereas the credit needs of the effected people are urgent and large, the local commercial banks' branches offer the best option to replace the NGO programs by down scaling their lending operations to include lending to micro and small enterprises. The international donor community can help local banks jump start micro lending operations, by providing the banks with the requisite expertise for the setting up of and managing the specialized Micro Loan Windows. This expertise, in addition to establishing micro lending operations at the banks, would also train local staff to gradually take over operations from experts: thus creating permanent capacity at the commercial banks. This expert support would be required for around two years. While the specialized micro loan windows would lend on full cost recovery basis, the initial cost of capacity building (through experts) could be financed with grant funds from the donor agencies, to make the new line of business economically attractive to the local commercial banks. By creating permanent MF capacity at local commercial banks, the long term sustained availability of credit and other financial services to micro enterprises can be assured. To provide additional comfort to the banks and enhance the credibility of the micro lending business, MFIs can partially guarantee the credit risk of the borrowers during the initial portfolio build up phase, till the banks become familiar and comfortable with the credit quality of the micro borrowers. At a later stage, if the banks find these MF portfolios to be too small and taking disproportionately a large amount of bank management time and systems resources, the micro loan portfolios could be spun off into a separate dedicated MF institution owned by the banks. MFIs can enhance the credibility of the new institution by participating as shareholder and financier, as well as by bringing in credible MF operator to manage the new company.

2.3 CHALLENGES OF MICROFINANCE

Fifteen years ago, microfinance programs were isolated experiments, struggling to learn how to minimize some idiosyncratic risks of lending: attempting to understand the ability and to shape the willingness of individual borrowers to repay loans not guaranteed by fixed assets as collateral. Today, microfinance programs struggle to become significant components of formal financial systems and, with these systems, MFIs are more vulnerable to systemic risk.

Microfinance may thus emerge from the increased worldwide volatility of financial systems (Perry and Lederman, 1998). Many MFIs may not be prepared to deal with this new source of risk (Holtmann, 1998; McGuire and Conroy, 1998). Some of the successful MFIs have shown, however, flexibility and resilience during the recent Asian crises (Ito, 1998; Patten, 1998; Reille and Gallmann, 1998; Yaron, 1998). For too long, nevertheless, microfinance has ignored the threats of systemic risk.

Fifteen years ago, leading microfinance programs were virtual monopolies. Today, the more threatening competition to existing MFIs is not coming from informal moneylenders as in the past; it is coming from private commercial banks and other regulated financial intermediaries, i.e., from those commercial banks that had shown no interest whatsoever in lending to the target clientele (Marulanda, 1998)

Microfinance may thus emerge from increasing competition and client demands resulting from the arrival of new actors, some of them operating on market terms, some of them not, the saturation of the original (probably easier) market locations; and challenges from the aging of portfolios and the maturing of client relationships, where established clients have begun to demand additional services, more difficult to supply.

Microfinance is not regulated. Today, almost everybody has a regulatory itch, but not every regulation is appropriate. Repressive and inappropriate regulation may be worse than no regulation at all.

Microfinance thus emerge from inappropriate regulation due to, regulatory technologies that are not a good match for the new lending technologies; and Attempts to use the regulatory framework to pursue objectives other than the avoidance of excessive risk (Chaves and Gonzalez-Vega, 1994. Microfinance may thus emerge from a return of the state based on the wrong assumptions that: the frontier of microfinance can be expanded by decree (i.e., by government will); lack of funds is the binding constraint to an expansion of sustainable microfinance; and a system composed of many MFIs, most of which would probably be weak, is more politically correct than a system composed of a few, strong and sustainable, MFIs. This is the best of times for microfinance. Although they are only a few, several MFIs have shown that it is possible to offer services in a sustainable manner, even at a profit. This is the worst of times for microfinance. Formidable new challenges are threatening this recently acquired sustainability. These new challenges are, in part, the consequence of success.

First, success, and particularly profits, attracts entry into a particular market niche, and entry increases competition. Increased competition is always welcome, because competition spurs technical efficiency, competition spurs improvements in the quality of outreach and in the variety of services offered, and competition spurs actions to reduce costs that, in turn, allow lower interest rates. This has clearly happened in Bolivia (Dorado, 1998).

Increased competition encourages efficiency but it also increases risk, however, and it may force some MFIs out of the market. When exit is due to entry of better actors in the market, it is a healthy outcome. When exit is due to negative externalities generated by market actors willing to behave opportunistically, which increases systemic risk, there is a social loss (Chaves and Gonzalez-Vega, 1996). Moreover, even when it is healthy, increased competition makes the already difficult tasks of MFIs even harder. When the client has too many options, it is more difficult to create a structure of incentives for repayment of loans without collateral. When the client has too many options, the monitoring of borrowers by overseeing the repayment record of the client becomes less reliable, because the client may use a loan from another lender to repay the loan from the MFI. To address the risks, MFIs may be forced to revise their policies about products offered and about market niches attacked.

Second, success also attracts new sponsors. The most important, but also the most dangerous of the new sponsors is the state itself. When politicians want to become the godfathers of any MFI that is already successful, the MFO is in grave danger. Most likely sustainability is not among the objectives of these latecomers, who are trying to board the train of microfinance when it is already speeding.

Moreover, politicians tend to promote MFIs that do not operate on market terms. This behavior generates another negative externality, as MFIs seeking sustainability find it hard to compete with subsidized and subsidizing MFIs. The new challenges are in part a consequence of changes in the environment. One of these changes is increased systemic risk. Systemic risk results from events that simultaneously hurt most of the clients of one intermediary or most of the financial intermediaries in a given sector. Example of systemic risk are macroeconomic disequilibria, political instability, natural phenomena such as La Nina, or the deterioration of a country's terms of trade (Gavin and Hausmann, 1996). These events have a national impact; similar events may have regional or sectorial impacts (e.g., a flood, commercial reform, municipal regulation.) Stronger MFIs, with well-established financial links to pre-arranged lines of credit for liquidity emergencies and with a national outreach and broad sectorial scope for portfolio diversification, stand a better chance of surviving these systemic shocks (Gonzalez-Vega, 1997c).

Particularly risky is a rapid expansion of the availability of loanable funds throughout the system: such a flood of funds may result from the excessive enthusiasm of government and donors. Access to credit that is too easy devalues the client relationships that are at the core of the incentives to repay of existing MFIs (Conning et al., 1998; Lavie, 1998). Similar damage to the culture of repayment needed for the successful operation of microfinance may result from the emergence, in the same market niche, of new lending technologies that have ample tolerance for arrears/default. Microfinance as it has developed requires a zero tolerance of default (Christen, 1998). In countries with mature financial systems, however, commercial banks and consumer financiers with a large tolerance for arrears may enter this market niche, and only highly competitive (best practice/best service) MFOs will survive. Earlier, I favored many experiments that would search for innovations in microfinance. Today, my recommendations to tilt the balance of government and donor support in favor of the quality, not the number of organizations (Gonzalez-Vega, 1998b).

Another change in the environment is the prudential regulation and supervision of MFIs (Trigo, 1998). This is an important innovation, which adds to the institutional infrastructure needed to develop the microfinance market, but it is also a potential threat. As with competition, prudential regulation is generally a desirable feature of financial markets. If, however, the institutional framework is incomplete, competition and regulation pose new challenges that must be addressed. Everybody wants to regulate MFIs, most of the time for the wrong reasons. Some regulatory frameworks want to force MFIs to work against the market, not with the market. Some MFIs may seek regulation only because it provides access to subsidized funds from a government apex organization (Navajas and Schriener, 1997). These are not good reasons to regulate. In general, government regulation is justified only for deposit-taking institutions and for very specific reasons that justify a departure from market regulation (Chaves and Gonzalez-Vega, 1996).

If large numbers of not-deposit-taking MFIs are actually regulated, at worst, repressive regulation may slowly creep back into the industry; at best, costly, wasteful activities will be needed to regulate a multitude of small MFOs that do not mobilize deposits (Llanto, 1998). Even worse, regulation that is not enforceable or that is not enforced is always harmful, but most regulatory authorities do not have the resources and the skills needed to undertake this task effectively. Thus, prudential regulation and supervision are useful mostly for those strong deposit-taking MFIs that have become full financial intermediaries. Different forms of oversight, if any, may be desirable in all other cases to monitor the use of public funds, but this should not be confused with prudential regulation.

The greatest recent threat to microfinance is the return of the state. Governments had left development finance when fiscal crises had made it impossible to continue funding the losses of special credit programs. Governments had left development finance when unhappy donors had refused to recapitalize and bail out bankrupt development banks. The failure of those interventions can be traced to a wrong choice of tools: credit is not a panacea, and cheap credit is the wrong tool to pursue most of the goals of the old programs (Gonzalez-Vega, 1994). In this sense, the train of the old development finance had square wheels: it could not go easily where government and donors wanted to take it. Government and donors, however, kept pushing this train with fiscal transfers and donor programs. The more they pushed, the quicker the wheels (being square and not round) broke.

Eventually, too much pushing derailed the train. When this happened, a vacuum was created, and the children of regulatory avoidance, the NGOs that would become MFIs, began to build a new train. Because they were not regulated, the new MFIs could experiment a lot: there were no restrictions on what types of activities they could undertake. Because they were not regulated, the new MFIs were able to charge sufficiently high interest rates to begin to cover their costs. Because they were not regulated, the new MFIs could attempt to respond to client demand rather than to the planning priorities of governments. The microfinance revolution had erupted.

Soon, the new train of microfinance began to take speed. Today, in several countries, it runs smoothly and briskly, conquering new territory and expanding frontiers. Because there are many and powerful new train operators, passenger safety may indeed require some prudential regulation. Governments, however, watch with envy the rapidly passing train: they want to board it, they want to add their name to it, and they want to control it and to take it where it would serve their purposes. But government is a heavy passenger; uphill, it may slow down progress; downhill, it may accelerate derailment.

This is the most dangerous time for microfinance. The best MFIs may be able to survive systemic shocks, intense competition, and constraining prudential regulation and supervision, but the microfinance industry will not be able to survive the excessive enthusiasm and impatience of government and donors.

2.4 LENDING POLICY

Lending institution's statement of its philosophy, standards, and guidelines that its employees must observe in granting or refusing a loan request. These policies determine which sector of the industry or business will be approved loans and which will be avoided, and must be based on the country's relevant laws and regulations.

The continuum of institutions providing microfinance cannot develop fully without a regulatory environment conducive to their growth. Without such an environment, fragmentation and segmentation will continue to inhibit the institutional transformation of microfinance institutions.

The approach to the external regulation, one takes into account the different types of microfinance institutions, the products they offer and the markets they provide. This approach can be useful in designing regulatory standards that recognize the basic differences in structure of capital, funding, and risks faced by different kinds of microfinance institutions.

In contrast to commercial banks, micro-lending institutions usually refrain from taking collateral. Instead they follow a model called the Self Help Group Model or Group Lending Model. In this model an MFI lends a small loan to an individual, who belongs to a group of 5 to 20 people. As soon as the individual borrower proves reliable, credit is extended to additional people within the group. This procedure creates an incentive for the group to monitor each other's behavior and to ensure borrower discipline, as the group is jointly liable for the failure of any single member to repay her micro loan. The average loan size starts from USD 100 and can reach several hundred dollars.

As the market matures, there are now MFIs that follow the individual lending model taking into account the fact that there are different products possible for different needs – such as urban settings and small businesses. The increased demand of microfinance and the returns that the business offers has attracted a number of players into the segment. (*Vishal Sehgal, February 2008)*

2.5 Credit Risks

Most lenders employ their own models (credit scorecards) to rank potential and existing customers according to risk, and then apply appropriate strategies. With products such as unsecured personal loans or mortgages, lenders charge a higher price for higher risk customers and vice versa. With revolving products such as credit cards and overdrafts, risk is controlled through the setting of credit limits. Some products also require security, most commonly in the form of property. (Brigo, Damiano and Andrea Pallavicini 2007)

Lenders will trade off the cost/benefits of a loan according to its risks and the interest charged, but interest rates are not the only method to compensate for risk. Protective covenants are written into loan agreements that allow the lender some controls. These covenants may include;

- Limit the borrower's ability to weaken their balance sheet voluntarily e.g., by buying back shares, or paying dividends, or borrowing further.
- Allow for monitoring the debt requiring audits, and monthly reports
- Allow the lender to decide when he can recall the loan based on specific events or when financial ratios like debt/equity, or interest coverage deteriorate.

The innovation to protect lenders and bond holders from the danger of default are *credit derivatives, most commonly in the form of a credit default swap.* These financial contracts allow companies to buy protection against defaults, from a third party, the protection seller. The protection seller receives a periodic fee (the credit spread) as compensation for the risk it takes, and in return it agrees to buy the debt should a credit event ("default") occur. (Duncan H. Meldrum 1999)

Credit scoring models also form part of the framework used by banks or lending institutions grant credit to clients. For corporate and commercial borrowers, these models generally have qualitative and quantitative sections outlining various aspects of the risk including, but not limited to, operating experience, management expertise, asset quality, and leverage and liquidity ratios, respectively. Once this information has been fully reviewed by credit officers and credit committees, the lender provides the funds subject to the terms and conditions presented within the contact (as outlined above).

Companies carry credit risk when, for example, they do not demand up-front cash payment for products or services.[1] By delivering the product or service first and billing the customer later - if it's a business customer the terms may be quoted as net 30 - the company is carrying a risk between the delivery and payment.

Significant resources and sophisticated programs are used to analyze and manage risk. Some companies run a credit risk department whose job is to assess the financial health of their customers, and extend credit (or not) accordingly. They may use in house programs to advise on avoiding, reducing and transferring risk. They also use third party provided intelligence. Companies like Standard & Poor's, Moody's, Fitch Ratings, and Dun and Bradstreet provide such information for a fee.

For example, a distributor selling its products to a troubled retailer may attempt to lessen credit risk by tightening payment terms to "net 15", or by actually selling fewer products on credit to the retailer, or even cutting off credit entirely, and demanding payment in advance. Such strategies impact sales volume but reduce exposure to credit risk and subsequent payment defaults. (Arnaud and Olivier Renault (2004).

Credit risk is not really manageable for very small companies (i.e., those with only one or two customers). This makes these companies very vulnerable to defaults, or even payment delays by their customers.

The use of a collection agency is not really a tool to manage credit risk; rather, it is an extreme measure closer to a write down in that the creditor expects a below-agreed return after the collection agency takes its share (if it is able to get anything at all).

2.6 CREDIT RISK MANAGEMENT

While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties. This experience is common in both G-10 and non-G-10 countries.

Credit risk is most simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization.

For most banks, loans are the largest and most obvious source of credit risk; however, other sources of credit risk exist throughout the activities of a bank, including in the banking book and in the trading book, and both on and off the balance sheet. Banks are increasingly facing credit risk (or counterparty risk) in various financial instruments other than loans, including acceptances, inter-bank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the extension of commitments and guarantees, and the settlement of transactions.

Since exposure to credit risk continues to be the leading source of problems in banks world-wide, banks and their supervisors should be able to draw useful lessons from past experiences. Banks should now have a keen awareness of the need to identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred.

With confidence in credit market at an all-time low, it is critical for banks to engage in better credit risk management practices that can optimize risk-adjusted pricing and returns throughout the organization. Access and aggregate credit data across disparate systems and sources, seamlessly integrate credit scoring or internal rating with credit portfolio risk assessment, accurately forecast measures to monitor and report potential credit risk exposures across the entire organization on both counterparty and portfolio levels, allowing seamless integration of credit scoring with credit risk evaluating alternative strategies for pricing, hedging or transferring credit risk, optimize allocation of regulatory capital and economic capital to meet the reporting and risk disclosure requirements of regulators and investors for a wide variety of regulations in managing the entire lifecycle of a loan from origination, to the service of collection of recovery.

The sound practices set out in this document specifically address the following areas, establishing an appropriate credit risk environment; (ii) operating under a sound credit-granting process, maintaining an appropriate credit administration, measurement and monitoring process; and, ensuring adequate controls over credit risk. Although specific credit risk management practices may differ among banks depending upon the nature and complexity of their credit activities, a comprehensive credit risk management program will address these four areas. These practices should also be applied in conjunction with sound practices related to the assessment of asset quality, the adequacy of provisions and reserves, and the disclosure of credit risk, all of which have been addressed in other recent Basel Committee documents.

While the exact approach chosen by individual supervisors will depend on a host of factors, including their on-site and off-site supervisory techniques and the degree to which external auditors are also used in the supervisory function, all members of the Basel Committee agree that the principles set out in this paper should be used in evaluating a bank's credit risk management system. Supervisory expectations for the credit risk management approach used by individual banks should be commensurate with the scope and sophistication of the bank's activities. For smaller or less sophisticated banks, supervisors need to determine that the credit risk management approach used is sufficient for their activities and that they have instilled sufficient risk-return discipline in their credit risk management processes.

The Committee stipulates in Sections II through VI of the paper, principles for banking supervisory authorities to apply in assessing bank's credit risk management systems. In addition, the appendix provides an overview of credit problems commonly seen by supervisors.

A further particular instance of credit risk relates to the process of settling financial transactions. If one side of a transaction is settled but the other fails, a loss may be incurred that is equal to the principal amount of the transaction. Even if one party is simply late in settling, then the other party may incur a loss relating to missed investment opportunities. Settlement risk (i.e. the risk that the completion or settlement of a financial transaction will fail to take place as expected) thus includes elements of liquidity, market, operational and reputation risk as well as credit risk. The level of risk is determined by the particular arrangements for settlement. Factors in such arrangements that have a bearing on credit risk include: the timing of the exchange of value; payment/settlement finality; and the role of intermediaries and clearing houses.

2.7 Micro financing in Uganda

The study investigates the effect of credit risk in a continuous time stochastic asset allocation model in microfinance institutions, since the traditional dynamic framework does not provide credit risk flexibility. The traditional dynamic efficiency framework by explicitly deriving the optimal value function for the infinite horizon stochastic control problem via a weighted volatility measure of market and credit risk. The optimal strategy is then compared to that obtained from a benchmark dynamic optimization framework to determine which specification adequately reflects the optimal terminal investment returns and strategy under credit and market risks. The paper shows that an investor's optimal terminal return is lower than typically indicated under the traditional mean-variance framework during periods of elevated credit risk. Hence the traditional dynamic mean-variance approach may indicate the ideal, in the presence of credit-risk it does not accurately reflect the observed optimal returns, terminal wealth and portfolio selection strategies.

Although almost every district in Uganda has an organization involved in micro credit, their operations and coverage are still limited to urban centers and rural trading centers (MFPED), 1998). Currently micro finance institutions are targeting small and micro entrepreneurs engaged in off farm activities. A few micro finance institutions are extending credit to farmers but have had to adjust their operations to suit the needs of their clients while not having the fundamental principles in their operations. Most of the micro finance institutes in Uganda are multi purpose providing services to their clients.

2.8 Categories of micro finance institutions in Uganda

Micro finance in Uganda has a wide range oaf legal status, scale and scope of their operations. A large number operate informally and lack capacity. Broadly in Uganda they can be categorized as government supported institutions, formal financial institutions, Non-governmental organizations and community based organizations (CBO) and co-operative societies. There are several Non-governmental organizations involved in the credit delivery business targeting small and micro enterprises. Non-governmental organizations involved in micro credit are mainly foreign like Pride Uganda, F.I.N.C.A, MED- net, which is an affiliate of world vision.

Credit provision to informal and small-scale sector ha s been noted as important for the development of the economy and ensuring sustainable growth, (MPED, 1997). The development of micro financing has been seen as the cost effective way of advancing credit to the small-scale sector.

Micro financing refers to lending of small sums of money (between US$20 to US$2000), to individuals under the security of community involvement. For small business start-ups at very low level (Johnston, 1997)

Often micro businesses are often located in the around markets, trading centers, often are housed in semi-permanent structures or have no fixed business premises (MC Cord, 1998).

Most of them are labour intensive and their products are of simple technologies through utilization of available simple inputs. This contributes highly to the reason why the sector employs a lot people and few tools with little working capital needed to begin.

Micro financing institutions often base their methodologies on the borrowers' willingness and ability to pay other than the quality of their collateral. Often their risk assessment is an prior credit performance, starting new clients with small loans graduating to bigger loans and often involves the community knowledge in the process of selection, administrations and collection (christen 1992). Social capital is the major basis for Micro finance institutions success. Micro finance institutions are community based where creditors and borrowers know each other very well. This makes defaulting socially costly and difficult.

World Bank (1990) noted that farmers were not selling their produce at profitable prices resulting in the farmers failing to benefit from these credit programs. Often there is lack of storage facilities forcing farmers to sell off their produce at give away prices lest they loose their total harvest. Poor transport facilities, poor markets and inadequate credit extended were found to hinder effective and good utilization resulting into poor loan repayment.

As a measure to build on the individual's credibility, collateral items such as land titles, logbooks, external guarantors and any valuable asset may be required. The officers in the branches usually advise on the required collateral depending on the loan size.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter presents the methods that were used during the study. These include research design, study area, population, sampling design and procedures, data processing and procedures, analysis, data presentation, limitations of the study and how they were overcome

3.1 Research Design

The study was the survey of MFIs so as to achieve the objectives set out to analyze the role of credit risk management in the performance of microfinance institution. The research was both quantitative and qualitative in nature because there was use of many figures in percentages relating to particular items in Pride Microfinance institution and also assessing the role of credit risk management on performance of Microfinance.

3.2 Study Population

The research was conducted in Makindye Division using Kabalgala branch of Pride micro finance limited. The population of interest consisted of all clients of Pride Uganda in Kabalagala branch. To obtain the sampling frame which is the complete listing of all elements in the universe the research managed to get these complete and updated lists from Kabalagala branch that had all the Major Economic Classification (MEC) groups.

3.3 Sampling procedure

3.3.1 Sampling size

The sampling size was 65 respondents selected using simple random sampling. Five members were selected by the researcher from each of the MEC groups.

3.4 Source of Data

3.4.1 Primary Data

Primary data was collected using questionnaires and interview guides distributed to the management of PMF and their clients through actual visits to their premises.

3.4.2 Secondary Data

Secondary data was used. Data was collected from library text books and from the internet (Google search engine). Libraries include Kampala International University, Makerere University Business School, Graduate Research Center and new papers.

3.5 Data collection instrument

3.5.1 Questionnaires

Questionnaires were sent to targeted clients of Pride Microfinance institution and to identify the challenges they face during the accessibility of their services. They were self administered and collected after completion.

3.5.2 Interviews

Interviews were conducted with top managers, staffs and some of the clients of Pride Microfinance.

3.6 Data processing

This involved editing, coding, entry of data and tabulation which were done for quantitative data using computers, Data was then tabulated and split into averages, percentages, means, ratios, correlation and testing of hypothesis (see chapter four)

3.6.1 Data Editing

Data editing involved perusing through all the completely filled questionnaires and checking for mistakes that were made during the interview in recording the response. Some cases of missing information were corrected in the field.

3.6.2 Data Coding

Coding the questionnaire involved allocating numerical values to the response or answers to open – ended questions for the case of data entry.

3.7 Data analysis

Data was analyzed by making inference to the available literature. The analysis will be comparisons and contrasts made in relation of work of different scholars. This exposed gaps in the existing literature upon which recommendations were based.

3.8 Data Presentation

Under this sub section the researcher presented the research finding in relation to research objectives and questions. The background of the information used in presentation of the finding in relates to information from different sources.

3.9 limitation of the study

3.9.1 Timing

The researcher had limited time to carry out the research and she had planned to use secondary data and waited for the approval of her letter by the officials of Pride and it took quite some time and the researcher could not wait any more for the secondary data and resorted to primary data.

3.9.2 Language Barrier

The researcher had a problem of translating the questionnaire into local languages, as most of the clients could not understand English. This brought mis-specification errors. Some respondents refused to give answers for some particular questions saying that it was confidential.

3.9.3 Financial Constraints

The researcher had limited funds, she was told to pay 100,000/= but the researcher had a client who was made of that institution and the fee was reduced to 50,000/= which she paid to get only the sampling frame and the number of defaults which could not easily be calculated from such aggregate data.

CHAPTER FOUR

PRESENTATION OF RESULTS

4.1Background Characteristics of Respondents in Pride Microfinance Kabalagala Branch

٤,١,١ *Gender of clients*

٤,١,٢

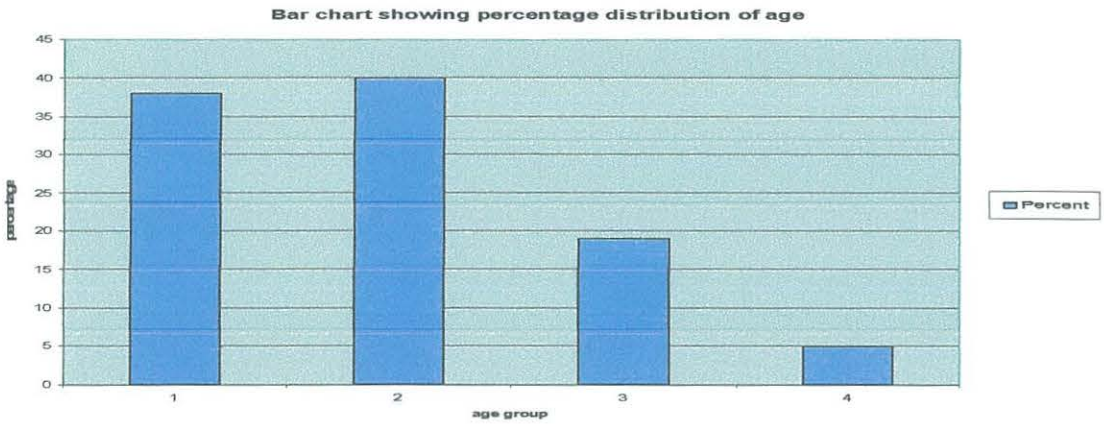
Figure 1 Figure 1 shows the sex distribution of pride microfinance clientele of Kabalagala branch.

Male (%)	Female (%)
34	66

The composition of the respondents by gender indicates more females (66%) than males (34%) and this will lead to effective performance in Pride microfinance since females are statically more then males hence the increase in loans will lead to the expansion of the services.

4.2 Age distribution of clients

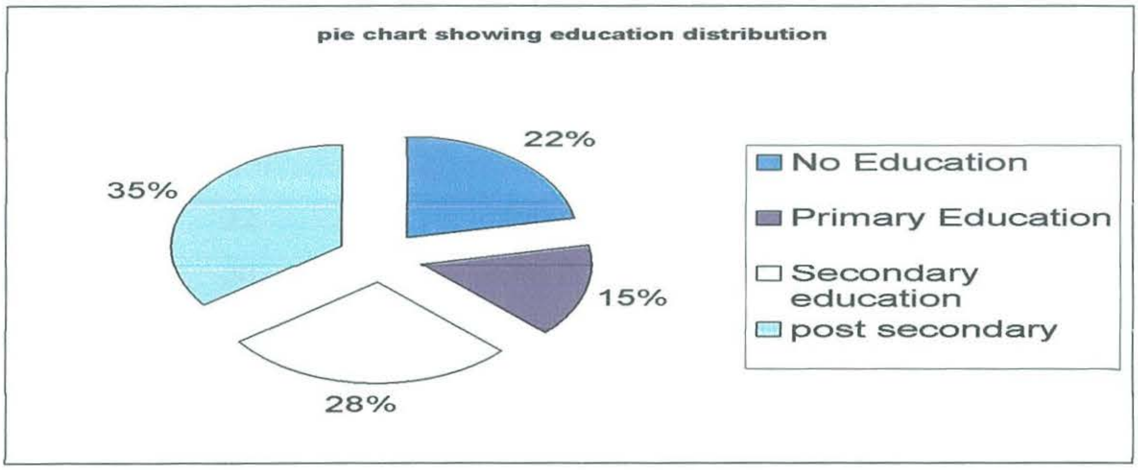
Figure 2 shows the sex percentage distribution of the clientele.



The researcher's findings from the table 2 shows the composition of the respondents by age distribution shows that the majority of the respondents were in the age group of 30-39 (40%) since this age group are adult who wide ideologies in business expansions hence leading to the reduction of credit risk thus increase on the roles of pride microfinance. This is followed by age group 19-29 with (39.9%) these are in the age group of youth and this age group can lead to the inefficiency in microfinance institution since they experience is low concerning on business thus increase in credit risks, followed by age group 40-45 with (18.5%) this is the age group that is loosing interest in starting and expanding of business this is so because this is an aging group which see no use of acquiring loans to expand their businesses leading reduction on performance of Pride micro finance.

4.3 Education of the clients

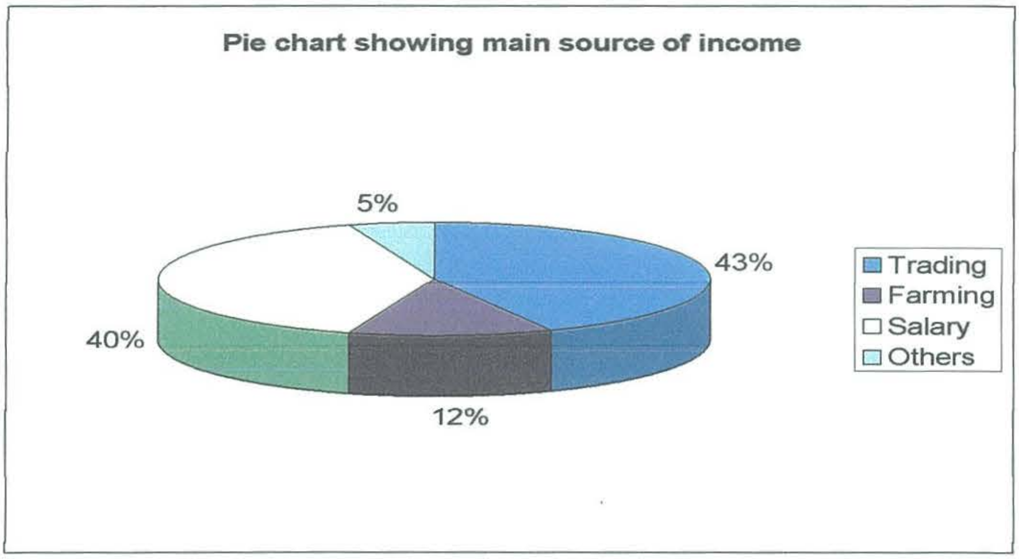
Figure 5 showing education distribution of clients enumerated.



most of the clients interviewed had ever gone to school were 78% which made the work easy and have real information that is needed this also leads increase on the performance of pride microfinance, 22% had never gone to school hence making the work too difficulty due to uneducated people who don't even bother to know their business statistical status hence causing loses and wasting much time for the pride microfinance since the initiative is taken to give them complete education thousand has 14.1% this shows that saving are declining so for Pride microfinance to remain in business have to get loans from donors, commercial banks and government so that to run the business. Those with the savings level of 200 thousands and above follow with 12.5% and this indicates that that Pride microfinance performance is declining since they will have few funds to give to their clients and lastly those with the savings level of 151-200 thousands with 7.8% shows that no funds to give out hence running out of business.

4.5 The main source of income

Figure 6 showing the main source of income.



The majority of the clients get their income from trading 43% and this indicates that the credit risk is low since clients will be running business and they will be able to pay back their loans and interest rates charged on them. This is followed by the salary earners having 40% of the total clients enumerated and with this Pride micro finance will be able to give salary loans to the clients since they have jobs and this lead to the reduction of credit risk hence increase performance of management. Those who get most of their income from farming and others not classified are 12% and 5% respectively these clients are under poverty line and this may lead to increase on credit risk since the client will not be in position to pay back loans acquired hence leading to poor performance of Pride micro finance management .

4.5.1 Clients source of funds in starting the enterprises

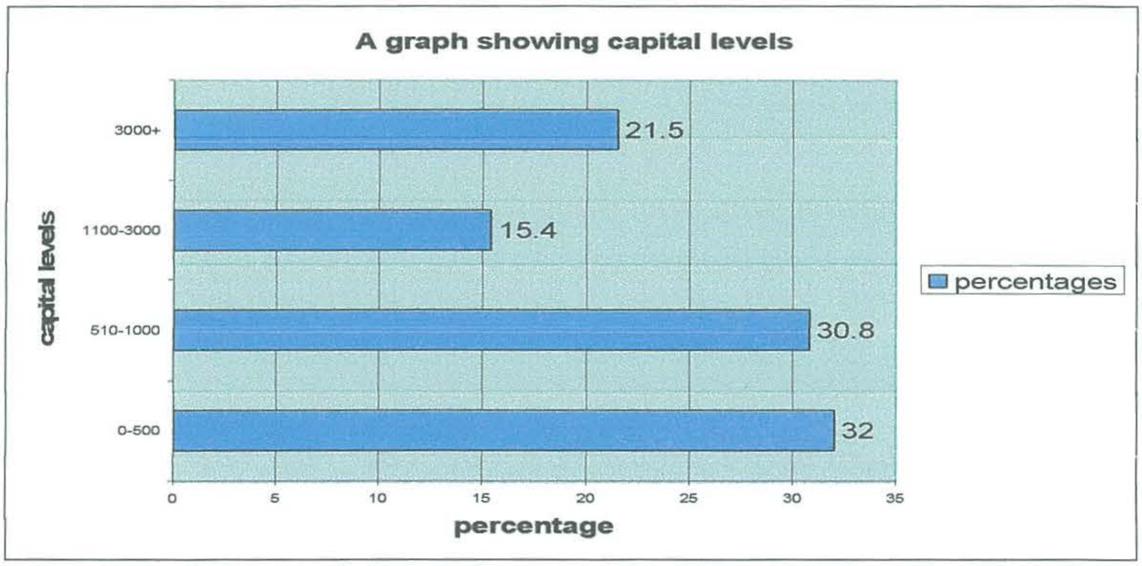
Table 4.2.3 Clients source of funds in starting the enterprises

Source of funds

Savings Group	**Frequency**	**Percentage**
Own savings	12	18.5
Loan	28	43.1
Others	25	38.5
Total	**65**	**100.0**

From the table above the main source of funds in starting the enterprises people are engaged in are loans with a percentage of (43.1). This is followed by other source like inheritance, friends, and donations e.t.c with a percentage of (38.5). People who started their enterprises with only savings were 18.5%. This shows that the people have poor saving habits. It also signifies that their incomes are low to be saved and invested. Amount of capital invested in the enterprise

4.6 Figure 7 showing the capital levels of pride clientele in thousands

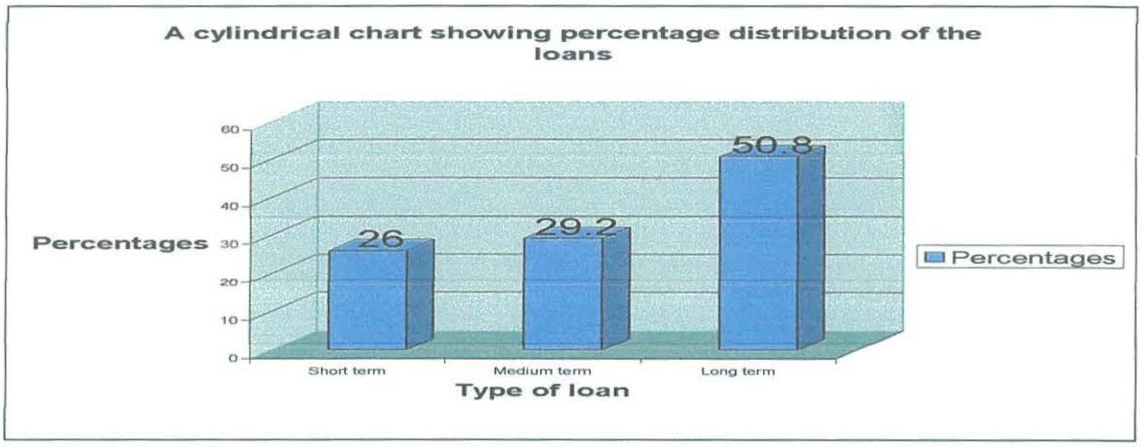


From the graph it is clear that the majority of the clients have capital ranging from 0-500 thousand because of the petty business they are engaged in. this is followed by capital levels of 510-1000 thousand with 30.8%. People with capital levels of 3000 thousands follow with 21.5%. Those borrow mainly on short term basis to finance immediate expenditure like clearing goods, paying taxes and they expect to get revenues soon to finance the loan. Lastly those with in the capital level of 1100-30000 thousand with 15.4% show that credit risk will be high because these will not be in position to run their business successful hence failure to pay back their loans.

4.7 Pride micro finance activates

٤,٣,١ Type of loans given to the clients

Figure 8 shows the percentage distribution of the loans given. There are three types of loans were considered short term, medium and long term loans.



From the figure above it is clearly evidenced that the majority of the people were going for long term loans 50.8% and this indicates that Pride micro finance is doing well since client of long term loans, they interest fee is high thus leading to good performance of Pride Micro finance. This was followed by medium type with 29.2% this shows that credit risk is reducing since client get loans which they in position to pay back and only 20% of the clients enumerated got short term loans shows that people are not doing well in business and they is need of micro finances to educate people about the goodness in getting loans and by doing this will lead to good performance of microfinance.

4.8 Type of security

Table 4.3.2 shows the type of security for the loan, the number of people per type of security and their percentage.

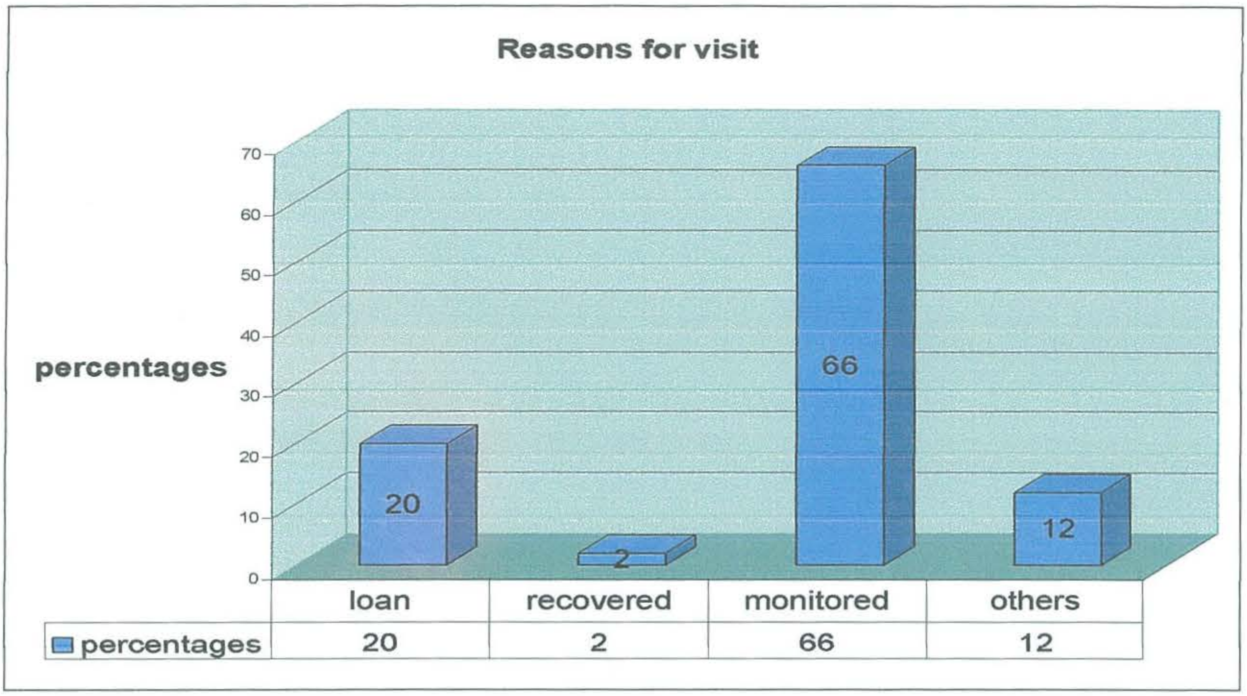
Type of security	Frequency	Percentages
Guarantor	39	60
Chattel items	24	36.9
Others	2	3.1
Total	**65**	**100**

From the table above it is clear that pride Uganda needs no security items. Guarantors from the top security requirement having 60% and this indicates that there is reduction in credit risk leading to good performance of pride micro finance followed by chattel items with 36.9% and other forms of security have only 3.1%

4.9 Visiting of clients

The loan officers visited clients among other to monitor the loans given to clients, to see whether the loans were used for intended purpose, loan extension, recovery, etc.

Figure 9 shows the various reasons the officers visited in percentages.



From the graph above the main reason for visiting clients is to monitor the loans with 66% and this shows that management of Pride micro finance performance was good since there was time to monitor their clients, followed by loan repayment with 20% people acquiring loans are few this indicates that microfinance institutions are earning little profits. Other reasons for visiting clients follow with 12% Loan recovery has only 2% this is because it is the members in the MEC group who have to pay when one of the members fails to pay.

4.10 Measurements put by Pride microfinance to control credit risk.

4.10.1 Credit vision

PML shall mobilize funds, manage these funds with safety and on –lend them on a sound basis. It is therefore necessary for all concerned parties to excise prudence and sound judgment in allocation of these funds.

4.10.2 Credit creation

The credit creation role that is central to PML's operations must be done judiciously. PML shall decide who can be trusted with the money and as such credit Officers concerned with the credit creation must ensure that every loan granted contributes positively towards the overall objective of PML and ensure PML's own long – term viability as an MDI.

4.1.3 Quality of loan portfolio

Creation of credit shall take quality portfolio as the end result. If the steps/procedures outlined in this credit policy and procedures manual are diligently followed then PML will ensure viable portfolio quality and long run viability.

4.10.3 Credit overall objective

PML is no longer greatly dependent on donor funds and as a results, its overall objective is to make money. All other objectives are secondary to this one since without profitability, the business wills not survive for long. It is therefore necessary that as an MDI, the spread or the difference between the interest income and interest expense is sufficient to finance its operations. /Such a spread will only be sufficient if PML maintains a viable portfolio at lower cost.

4.10.4 Insider lending

PML shall avoid inside lending. The total amount lent out to Directors, Management and major shareholders or any other related party, shall not exceed 1% of PML's core capital except on terms similar to those offered to any other borrower or as required by the MDI Act.

(a) PML shall not grant to a single borrower, directly or indirectly unsecured credit facilities or credit facilities on terms, which are preferential (in respect to creditworthiness, repayment period, interest rate and value of the collateral).

(b) PML shall not grant or permit to be outstanding to anyone person or to any group of persons under the control or influence of any one person, any credit facility if the aggregate amount of such credit facilities exceeds 1% of its core capital for an individual borrower; 5% of the core capital of the entity for a group borrower.

(c) PML shall not grant any credit facility against the security of its own shares and debt instruments or those of a company affiliated to it.

(d) PML shall not grant to any of its officers other than a director or its employees or other persons, being persons receiving remuneration from PML (other than any persons remuneration from the company in respect of their professional services) unsecured credit facilities which in the aggregate and outstanding at any one time exceed one year's emoluments of that officer or employee or person.

4.10.5 Unsecured credit

PML shall not grant, directly or indirectly unsecured credit facilities which in the aggregate and outstanding at any time exceed 1% of its core capital except on terms which are non preferential in all respects. Including credit worthiness, repayment period, interest rate and the value of the collateral-

(a) To any of its directors, staff members or their associates whether those credit facilities are obtained by them jointly or severally;

(b) To a firm in which the company or any of its directors, staff members or their associates has an interest as a partner, manager or agent, or to any individual or firm of whom or of which any of its directors is a guarantor;

(c) To a company in which any of its directors, staff members or their associates whether legally or beneficially owns more than 50% of the issued capital or in which any of its directors controls the composition of the board of directors.

4.11 **Table 1 Table 2.1 loan levels and terms**

These stages are meant to cater for increased funding needs due to systematic growth of a client's business. The repayment term of loan 6 to 9 shall be fixed at 50 weeks, but may be varied up to 80 weeks deemed fit by Management.

Loan level	Loan ceilings (shs)	Period (weeks)	Weekly repayment in shillings				
			P	I	Subtotal	Saving	Total
1	150,000	25	6,000	900	6,900	2,200	9,100
2	300,000	30	10,000	1,800	11,800	2,200	14,000
3	500,000	40	12,500	3,000	15,500	2,200	17,700
4	800,000	50	16,000	4,800	20,800	2,200	23,000
5	1,100,000	50	22,000	6,600	28,600	2,200	30,800
6	1,500,000	50	30,000	9,000	39,000	2,200	41,200
7	2,500,000	50	50,000	12,500	62,500	2,200	64,700
8	4,000,000	50	80,000	20,000	100,000	2,200	102,200
9	6,000,000	50	120,000	30,000	150,000	2,200	152,2000

Source PRIDE Uganda

4.11.1 Loan Repayment:

Due date and grace period: The fist installment of the loan repayment shall fall due one week after the date of disbursement and subsequent repayments shall be one week apart during the MEC meetings. Two weeks Grace period is allowed for GGLS loans greater or equal to 2.5 million and four weeks for loan greater or equal to 4 million.

4.11.2 Responsibility for installments: it is the responsibility of the individual members and his/her EG and MEC to ensure that loan installments due shall be fully paid during the respective MEC meeting.

4.11.3 Indirect payments: in the event where a member fails to pay is/her installment and members contribute funds to pay installments for a defaulting member, such contributions shall be termed "Indirect Payments" and marked "I" on the deposit projection listing.

4.11.4 Management o f Arrears/ Delinquency

At the time of training of new clients, PML officials shall sensitize clients that the primary responsibility for repayment of PML loans rests with the client but the group guarantee loans as a safety net in the event of default. Any arrears in a MEC will hut the defaulting client as well as the MEC members because it lowers their credit rating and slows down disbursement of loans to the MEC members at large. Due to this ripple effect, MEC members are excepted to be very vigilant in monitoring their members in order to prevent arrears in their MEC.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of research findings

The study examined some back ground characteristics of respondents. It was revealed that the sample mainly composed of those aged between 30-39 years. The background characteristics which were examined included: Gender, age, level of education, types of loan, loans terms and levels. These are shown in chapter three.

The researcher found out various factors that have to lead to an increase in clients and methods used by micro finance to extend credit to its customers. These were established due to good performance of Pride Uganda management and also there is no collateral security required when clients are going to acquire loan.
The main source of security is one to act as a grantee for the other. This makes it easier to acquire loans in that no formal education is required to acquire a loan.

Pride has increased the incomes of its clients from loans borrowed. The nature of loans given in this branch is long term short term and medium term. The majority of the clients go for long term loans. The interest on these loans are so low to cover the expenses of microfinance institutions and to adjust the interest rates, the micro finance institution would then deviate from their principal objectives.

5.2 Conclusion

Micro finance institutions have made tremendous progress implementing economic capital methodologies. But relatively little has been done to advance the level of sophistication of credit risk data management. While regulatory pressure tends to get people's attention, fundamental business drivers are really behind the need for better risk assessment.

5.3 Recommendation

The research findings will help institutions currently operating in Uganda to improve on their methods of delivery, performance and those that are trying to expand to avoid costly mistakes.

In the proceeding paragraphs the researcher is suggesting ways micro finance institutions especially PRIDE Uganda should use so as to reduce the credit risk in their institutions.

- Micro finance institutions should shift from a flat rate to a declining balance as a basis for change to encourage more savings and reduce defaults.

- To reduce the interest rate micro finance institutions should mobilize savings which provide a sustainable source of funds at lower cost and also has the social benefit of motivating MFIs encourage savings other than borrowing from commercial banks which charge high interest rates which are posed on to the customers.

- Better education on when to borrow/not to borrow and when saving is a better strategy.

- Better information to clients by requiring financial institutions to disclose interest rates and fee.

5.4 Recommendations for further research

The study has not been exhaustive and conclusive enough due to the limited time that was available to the researcher. However the study identified a number of areas demanding further research. They include;

- Management of resources in Micro Finances Institutions.

- The procedures taken by the management incase a client fails to pay back the loan.

BIBLIOGRAPHY

Christen (1997): Banking services for the poor: Managing for financial success. An Expanded and revised guide book for micro finance institutions.

Determinants of loan repayment in Uganda. Insights from CCS experience. paper presented for graduate seminar in EPP, MUK. Feb, 1996

FAO " Financial sector Adjustment". FAO/ADB co-perative programmes, Report n. 91/93, ADB, Uganda, 1993.

United Nations development programme (1998) Human Development Report 1998 New York UNDP, World Bank, (1993). Uganda: Growing out of poverty. Washington D.C. The World Bank

Adams, Dale W (1983), A Mobilizing Household Savings through Rural Financial Markets," in J.D.

Adams, Dale W (1998), The Decline of Debt Directing: An Unfinished Agenda,@ paper presented at the Second Annual Seminar on New Development Finance, Frankfurt, September.

Chaves, Rodrigo A. and Claudio Gonzalez-Vega (1996), A Principles of Regulation and Prudential.

Christen, Robert P., Elisabeth Rhyne, Robert C. Vogel, and Cressida McKean (1995), Maximizing the Outreach of Microenterprise Finance: The Emerging Lessons of Successful Programs, @USAID Program and Operations Assessment Report No. 10, Washington, D.C.: AID Center for Development Information and Evaluation.

APPENDIX I

The loan menu

Loan (UG shs.)	Weekly principle (UG shs)	Loan term week
150,000	9100	25
300,000	14,000	30
500,000	17,700	40
800,000	23,000	50
1,100,000	30,800	50
2,500,000	64,700	50
4,000,000	102,200	50
6,000,000	152,200	50

Source Pride Uganda

Appendix II

Budget

ITEM/ ACTIVITY	**COST**
Type setting, printing & photocopying	30,000
Phone calls	20,000
Transport	10,000
literature search and compilation	20,000
Miscellaneous costs	30,000
Flash Disk	40,000
Binding	10,000
Preparation of final report	30,000
Total Cost	**190,000**

APPENDIX III

Time Frame of the study

Activity	Duration (Weeks)								
	1	2	4	5	6	7	8	9	10
Definition of the problem									
Writing and presenting proposal									
Data collection									
Data analysis									
Compiling data									
Report writing									
Submission of the final report									

QUESTIONNAIRE

Credit risk in micro finance institutions.
Case study (Pride Micro Finance Kabalagala Branch)

Study Objectives

- Ta access methods PRIDE Micro finance use to extend credit to its customers.
- To identify factors influencing credit risk in Pride micro finance limited.

STRICTLY CONFIDENTIAL

A student of Kampala International University is conducting this analysis in order to attain the above objectives. The data provided will be for academic purposes and will be treated with UTMOST CONFIDENTIALITY

AREA OF RESIDENCE...

INDETIFICATION NUMBER

APPENDIX IV

QUESTIONNAIRES

Questionnaires design on the role of credit risk management on the performance of micro finance institutions.

1. What do you understand by the term microfinance institution?

....

....

2. Outline roles of credit risk management on the Microfinance institutions

.

I ....

II ....

III ....

IV ....

3. What is the Magnitude of MFI basing on number of clients it serves

Number of clients

1-50	☐
500-100	☐
100 – 1000	☐
1000-above	☐

4. What is the procedure of getting loans from MFIs

....

....

....

....

5. (a) How many microfinance institutions are there in your area?

1 – 2	2 – 4	4 – above	None
☐	☐	☐	☐

(b) If the range is not specified in here state your possible range

....

6. How in your view would you define the terms?

I. Credit risk

....

....

II. Microfinance institution

....

....

7. A state the requirements for setting up an MFI

....

....

....

b. Explain the process of starting a MFI

....

....

....

....

8. What are the consequences faced by the loan obtainers in case they failure to payback these loans.

....

....

....

....

9. Name any two MFIs you know in Uganda.

....

....

10. What is the government's contribution to MFIs in Uganda?

....

....

....