

# **THE IMPACT OF RISK ASSESSMENT ON COMMERCIAL BANK LENDING TO THE PRIVATE SECTOR**

**A CASE STUDY OF BARCLAYS BANK KAMPALA**

BY  
MMASI ANNA MICHAEL  
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## DECLARATION

I **MMASI ANNA MICHAEL** declare that the work presented in this book is my original work. It has never been presented by any other researcher to any other university for the Award of a Degree.

Signature: ..... *Michael* .....  
**MMASI ANNA MICHAEL**

Date: ..... *31 / MARCH / 2009* .....

## APPROVAL

This proposal has been prepared and moderated through profound commitment of the supervisor and the student and has been submitted for examination with my approval as the supervisor.

Sign: 

Date: 31/03/09

**Mr. RUTEGANDA MICHAEL**

Supervisor

## **DEDICATION**

I dedicate this project to my parents, Mr. Michael Mmasi and Mrs. Juliana Michael as well as my siblings, Fides, Esther, Priscilla, Susana and Castrol. You have been my pillar of support and encouragement.

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# **CHAPTER ONE**

## **INTRODUCTION**

### **1.0 Background of the study**

The adoption of financial liberalization as an economic policy by many sub-Saharan African countries has made private sector investment crucial in propelling economic growth in Uganda, the ministry of finance planning and economic development considers private sector as the engine of growth and its immediate objective is to support the private sector objects to become a powerful engine of economic growth to attain this objective, private sector projects require finance for both acquisition of fixed assets and working capital. The level of development in financial sector which is composed of commercial banks, development banks and insurance companies have a major role to play in promoting private sector by providing financial resources for investment and working capital. Commercial banks mobilize these resources mainly from deposits and subsequently channel them to viable borrowers.

### **1.1 Background to the Case Study**

Barclays operations in Uganda started in 1972 with 3 branches in Central and Eastern Uganda. In 1969, the bank was incorporated as an independent subsidiary of the Barclays PLC. Barclays Uganda's growth of market share focused on the Corporate and High Net Worth (HNW) until 2006. At the end of February 2007, Barclays Uganda completed the acquisition of Nile Bank Uganda Limited. Nile Bank is now fully integrated into the Barclays Group as part of Barclays Bank of Uganda. This gives the bank an advantage to capitalise on retail banking within the country. As at 29th February 2008, Barclays in Uganda has grown from 7 to over 40 branches and from 17 to over 60 ATMs.

Barclays Uganda commands approximately 14.25% of the market share in terms of customer deposits in Uganda banking industry. Barclays Bank Uganda provides a wide range of banking products. In 2007, Barclays introduced the mass-market Customer Value Proposition (CVP), Mortgages and Vehicle Asset Finance (VAF) products. Products and customer propositions planned for 2008 include: Premier Banking CVP, Business instalment Loans and Auto Loans.

## **The Vision**

To be the best retail and commercial bank in Uganda for every product, every customer, every time.

## **The Mission**

To build one of the most admired customer centric banks in the global financial services, contributing material earnings and rapid growth to the group.

## **1.2 Statement of the problem**

Commercial banks act as the main financial intermediaries between surplus spending units and deficit spending units in the economy. In execution of this intermediary function they are faced with various risks namely:

Liquidity risks, Credit risks and environmental or market risks. They have to borrow from savers to maintain enough liquidity to meet the savers' cash demand and at the same time lend to investors (borrowers) at a margin to cover their cost of borrowing (interest on deposits) intermediation costs, default risks, premiums and also make a profit. In conducting the lending function they also have to consider change in environment that affects their banking barriers (e.g. foreign exchange market inflation and exchange rates)

## **1.3 Purpose of the study**

The study aimed to establish the risks the commercial banks face when lending to private sectors and ways of controlling them.

## **1.4 Research Objectives**

### **1.4.1 General objective**

To analyze the impact of various commercial bank risks on lending to the private sector.

### **1.4.2 Specific objectives**

- To ascertain the impact of liquidity risks and liquidity risk management has had on commercial banks lending to private sector.

- To establish the impact of credit risk and loan asset management has had on commercial banks lending to private sector.
- To establish the effect that the following external/environmental risk factors have had on commercial bank lending to private sector including; Treasury bills rates, inflation and exchange rates.

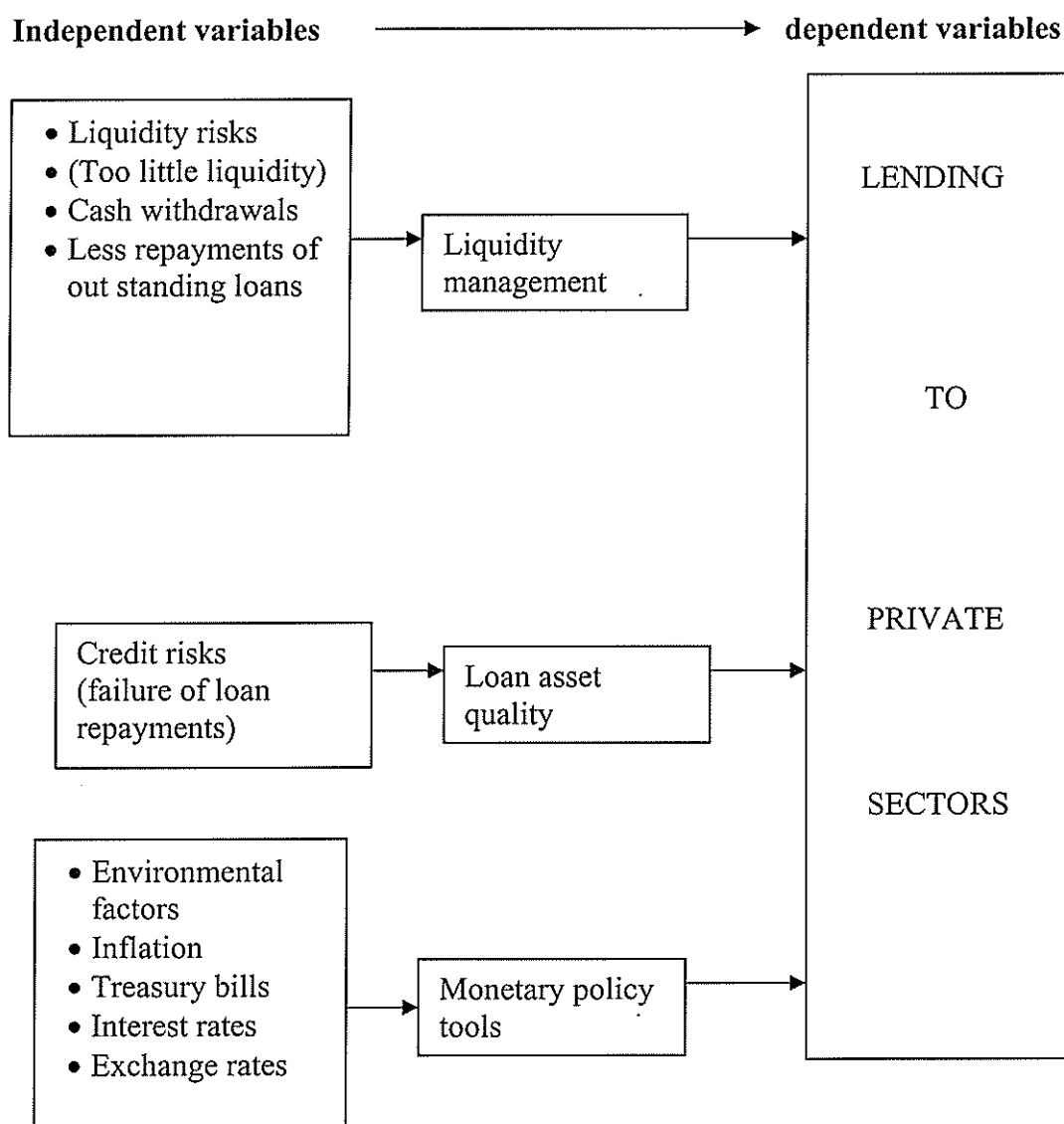
## **1.5 Research questions**

- What impacts does liquidity risks and liquidity risk management has on commercial banks lending to private sector?
- What impact does credit risk and loan asset management (credit risk management) have on commercial banks lending to private sectors?
- What effects do external/environmental risk factors have on commercial banks lending to private sectors?

## 1.6 Conceptual frame work

Conceptual frame work assumed that commercial banks lending to private sectors depend on the risk assessment, example: Credit risks, liquidity risks, and external factors namely: Inflation, Exchange rates and treasury bill interest rates which are minimized and controlled by liquidity management, Loan asset management and monetary policy tools by the commercial banks.

### CONCEPTUAL MODEL



Liquidity risk examples: adverse clearings, cash withdrawals, less repayments of outstanding loans are independent variables which work with intervening variables such as the liquidity management. The intervening variable works with the independent variables to control the dependant variable which is lending to the private sector. Project risks like failure to pay back loans to the commercial banks are independent variables and are controlled by the credit

management which is an intervening variable. The intervening variable controls the effect of credit risks on lending by the commercial bank to the private sector.

Environmental factors like inflation, treasury bills interest's rates and exchange rates are independent variables and are controlled by monetary tools which are intervening variables. The intervening variables controls the effects of independent variables on the dependant variables (lending to the private sector).

## **1.7 Justification/Significance**

### **i. To the Government**

This study will contribute towards government effort to develop policies that will promote private sector development through increased access to finance as a major contributor to economic growth.

### **ii. To the Banking Industry**

This research will provide insight into the impact that liquidity and loan asset quality management measure/control have had on bank lending to the private sector.

## **1.8 The Research Scope**

The study was carried out at the Barclays Bank head office on Kampala Road in Uganda. Credit managers were targeted as respondents to the administered and guided questionnaires as well as workers and 50 commercial bank clients in the private sector.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter provided a critical review of the issues that were explored and studies both theoretically and empirically in the existing literature on management.

#### **2.2 Liquidity risks and liquidity management in commercial banking**

In banking, **asset liability management** is the practice of managing risks that arise due to mismatches between the assets and liabilities (debts and assets) of the bank. Banks face several risks such as the liquidity risk, interest rate risk, credit risk and operational risk. Asset Liability management (ALM) is a strategic management tool to manage interest rate risk and liquidity risk faced by banks, other financial services companies and corporations. (Crockford, 1986)

Banks manage the risks of Asset liability mismatch by matching the assets and liabilities according to the maturity pattern or matching the duration, by hedging and by securitization. Much of the techniques for hedging stem from the delta hedging concepts introduced in the Black-Scholes model and in the work of Robert C. Merton and Robert A. Jarrow. The early origins of asset and liability management date to the high interest rate periods of 1975-6 and the late 1970s and early 1980s in the United States. Van Deventer, Imai and Mesler (2004), chapter 2, outline this history in detail.

According to Akerlof G. (1999), Modern risk management now takes place from an integrated approach to enterprise risk management that reflects the fact that interest rate risk, credit risk, market risk, and liquidity risk are all interrelated. The Jarrow-Turnbull model is an example of a risk management methodology that integrates default and random interest rates. The earliest work in this regard was done by Robert C. Merton. Increasing integrated risk management is done on a full market to market basis rather than the accounting basis that was at the heart of the first interest rate sensitivity gap and duration calculations.



Liquidity can thus be defined as having cash when needed or meeting financial obligations as they fall due to a reasonable cost. In the banks, it's the ability of the bank to meet or banks depositors' requirements and also makes the statutory liquidity obligation. Banks usually get liquidity risks which leads to lower liquidity in the bank's reserves and it is a result of lower deposits due to increase in cash withdrawals, adverse clearance, less repayments of outstanding loans, low spread margin.

To minimize and control this risk the bankers plan for liquidity through their assets portfolio, constructing them so that assets can be liquidated as funds are needed, and also increase their liabilities – that is by borrowing or buying of funds at market rates.

Banks need cash for:

- i) Carrying out their transactions
- ii) Precautionary, commercial banks manage deposits that are liquid in nature and constitute of over 70% of banks liabilities to the bank these liabilities that can be used to fund loans and investment (Rose, Korari and Fraser 1992).

## **2.3 Credit risks and loan asset management in commercial banking**

A credit risk is the failure of borrowers to carry out their obligation of paying back the loans when they fall due and this failure is called a default. Loan asset management is the minimizing of risks by acquiring assets that have low rates of default (Lopez, 2001) risk and by diversifying asset holidays. Credit risk is essentially the possibility that a bank's loan portfolio will lose value if borrowers become unable to pay back their debts in full (Mugume and Obwona, 2001) (Craig Churchill, 1999) says the main ways the traditional financial institutions managers controls credit risks is by acquiring: Collateral, Information and Credit policies.

### **Liquidity risk**

**Liquidity risk** arises from situations in which a party interested in trading an asset cannot do it because nobody in the market wants to trade that asset. Liquidity risk becomes particularly important to parties who are about to hold or currently hold an asset, since it affects their ability to trade.

Manifestation of liquidity risk is very different from a drop of price to zero. In case of a drop of an asset's price to zero, the market is saying that the asset is worthless. However, if one party cannot find another party interested in trading the asset, this can potentially be only a problem of the market participants with finding each other. This is why liquidity risk is usually found higher in emerging markets or low-volume markets.

Liquidity risk is financial risk due to uncertain liquidity. An institution might lose liquidity if its credit rating falls, it experiences sudden unexpected cash outflows, or some other event causes counterparties to avoid trading with or lending to the institution. A firm is also exposed to liquidity risk if markets on which it depends are subject to loss of liquidity. Liquidity risk tends to compound other risks. If a trading organization has a position in a long term asset, its limited ability to liquidate that position at short notice will compound its market risk. Suppose a firm has offsetting cash flows with two different counterparties on a given day. If the counterparty that owes it a payment defaults, the firm will have to raise cash from other sources to make its payment. Should it be unable to do so, it too will default. Here, liquidity risk is compounding credit risk.

A position can be hedged against market risk but still entail liquidity risk. This is true in the above credit risk example—the two payments are offsetting, so they entail credit risk but not market risk. Another example is the 1993 *Metallgesellschaft* debacle. Futures were used to hedge an OTC obligation. It is debatable whether the hedge was effective from a market risk standpoint, but it was the liquidity crisis caused by staggering margin calls on the futures that forced *Metallgesellschaft* to unwind the positions.

Accordingly, liquidity risk has to be managed in addition to market, credit and other risks. Because of its tendency to compound other risks, it is difficult or impossible to isolate liquidity risk. In all but the most simple of circumstances, comprehensive metrics of liquidity risk do not exist. Certain techniques of asset-liability management can be applied to assessing liquidity risk. A simple test for liquidity risk is to look at future net cash flows on a day-by-day basis. Any day that has a sizeable negative net cash flow is of concern. Such an analysis can be supplemented with stress testing. Look at net cash flows on a day-to-day basis assuming that an important counterparty defaults.

Analyses such as these cannot easily take into account contingent cash flows, such as cash flows from derivatives or mortgage-backed securities. If an organization's cash flows are largely contingent, liquidity risk may be assessed using some form of scenario analysis. A general approach using scenario analysis might entail the following high-level steps:

- Construct multiple scenarios for market movements and defaults over a given period of time
- Assess day-to-day cash flows under each scenario.

Because balance sheets differ so significantly from one organization to the next, there is little standardization in how such analyses are implemented.

Regulators are primarily concerned about systemic implications of liquidity risk.

### **Interest rate risk**

**Interest rate risk** is the risk that the relative value of an interest-bearing asset, such as a loan or a bond, will worsen due to an interest rate increase. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa. Interest rate risk is commonly measured by the bond's duration, the oldest of the many techniques now used to manage interest rate risk. Asset liability management is a common name for the complete set of techniques used to manage risk within a general enterprise risk management framework.

### **Calculating interest rate risk**

Interest rate risk analysis is almost always based on simulating movements in one or more yield curves using the Heath-Jarrow-Morton framework to ensure that the yield curve movements are both consistent with current market yield curves and such that no riskless arbitrage is possible. The Heath-Jarrow-Morton framework was developed in the early 1990s by David Heath of Cornell University, Andrew Morton of Lehman Brothers, and Robert A. Jarrow of Kamakura Corporation and Cornell University.

There are a number of standard calculations for measuring the impact of changing interest rates on a portfolio consisting of various assets and liabilities. The most common techniques include:

- Marking to market, calculating the net market value of the assets and liabilities, sometimes called the "market value of portfolio equity"

- Stress testing this market value by shifting the yield curve in a specific way. Duration is a stress test where the yield curve shift is parallel
- Calculating the Value at Risk of the portfolio
- Calculating the multiperiod cash flow or financial accrual income and expense for N periods forward in a deterministic set of future yield curves
- Doing step 4 with random yield curve movements and measuring the probability distribution of cash flows and financial accrual income over time.
- Measuring the mismatch of the interest sensitivity gap of assets and liabilities, by classifying each asset and liability by the timing of interest rate reset or maturity, whichever comes first.

### **Banks and interest rate risk**

Banks face four types of interest rate risk:

1. Basis risk is the risk presented when yields on assets and costs on liabilities are based on different bases, such as the London Interbank Offered Rate (LIBOR) versus the U.S. prime rate. In some circumstances different bases will move at different rates or in different directions, which can cause erratic changes in revenues and expenses.
2. Yield curve risk is the risk presented by differences between short-term and long-term interest rates. Short-term rates are normally lower than long-term rates, and banks earn profits by borrowing short-term money (at lower rates) and investing in long-term assets (at higher rates). But the relationship between short-term and long-term rates can shift quickly and dramatically, which can cause erratic changes in revenues and expenses.
3. Repricing risk is the risk presented by assets and liabilities that reprice at different times and rates. For instance, a loan with a variable rate will generate more interest income when rates rise and less interest income when rates fall. If the loan is funded with fixed rated deposits, the bank's interest margin will fluctuate.
4. Option risk is presented by optionality that is embedded in some assets and liabilities. For instance, mortgage loans present significant option risk due to prepayment speeds that change dramatically when interest rates rise and fall. Falling interest rates will cause many borrowers to refinance and repay their loans, leaving the bank with uninvested cash when interest rates have declined. Alternately, rising interest rates cause mortgage

borrowers to repay slower, leaving the bank with relatively more loans based on prior, lower interest rates. Option risk is difficult to measure and control.

### **Hedging interest rate risk**

Interest rate risks can be hedged using fixed income instruments or interest rate swaps. Interest rate risk can be reduced by buying bonds with shorter duration, or by entering into a fixed-for-floating interest rate swap.

### **Credit risk**

**Credit risk** is the risk of loss due to a debtor's non-payment of a loan or other line of credit (either the principal or interest (coupon) or both)

#### **Faced by lenders to consumers**

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 careful setting of credit limits. Some products also require security, most commonly in the form of property.

#### **Faced by lenders to business**

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:

- Limit the borrower's ability to weaken his 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.

A recent 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.

### **Faced by business**

Companies carry **credit risk** when, for example, they do not demand up-front cash payment for products or services (Bluhm et al, 2002). 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 Moody's 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.

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).

## **Faced by individuals**

Consumers may face credit risk in a direct form as depositors at banks or as investors/lenders. They may also face credit risk when entering into standard commercial transactions by providing a deposit to their counterparty, e.g. for a large purchase or a real estate rental. Employees of any firm also depend on the firm's ability to pay wages, and are exposed to the credit risk of their employer (Darrel et al, 2003).

De Servigny et al (2004) add that in some cases, governments recognize that an individual's capacity to evaluate credit risk may be limited, and the risk may reduce economic efficiency; governments may enact various legal measures or mechanisms with the intention of protecting consumers against some of these risks. Bank deposits, notably, are insured in many countries (to some maximum amount) for individuals, effectively limiting their credit risk to banks and increasing their willingness to use the banking system.

## **Operational risk**

An **operational risk** is a risk arising from a company's business functions and from the practical implementation of the management's strategy. As such, it is a very broad concept including e.g information risks, fraud risks, physical or environmental risks, etc. The term operational risk is most commonly found in risk management programs of banks that must organize their risk management program according to Basel II. In Basel II, risk management is divided into credit, market and operational risk management. The definition doesn't talk about strategic risks at all. In many cases, credit and market risks are handled through a company's financial department, whereas operational risk management is perhaps coordinated centrally but most commonly implemented in different operational units (e.g. the IT department takes care of information risks, the HR department takes care of personnel risks, etc)

More specifically, Basel II defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Although the risks apply to any organisation in business, this particular way of framing risk management is of particular relevance to the banking regime where regulators are responsible for establishing safeguards to protect against systemic failure of the banking system and the

economy. The Basel II definition talks only about *operational risks* or risks arising from basic operations and practical execution of strategy, but excludes strategic risk: i.e. the risk of a loss arising from a poor strategic business decision. This definition also excludes reputational risk (damage to an organisation through loss of its reputation or standing) although it is understood that a significant but non-catastrophic operational loss could still affect its reputation possibly leading to a further collapse of its business and organisational failure.

## **2.4 Environmental factors and monetary policy actions in commercial bank lending**

According to Mugume and Obwona, (2001), in economies where the credit markets function smoothly policy actions and fiscal policy influence the level of private sector credit from the bank system through interest channel. Interest rates are sensitive to monetary policy actions and may be decreased or increased depending on the market forces in the banking system.

### **2.4.1 Environmental Factors**

#### **Inflation**

This is the increase in prices due to the increase in money supply in the economy since money loses value. When money loses value the bank tends to lose because the loans paid back in money forms are of less value and so the borrower tends to gain since he pays less. This is a risk to the bank. The bank controls this risk by using a monetary policy tool of raising the interest rates to reducing borrowing and also cover the losses of money losing value.

#### **Treasury Bills Interest Rates**

Treasury bills are short term assets which are highly liquid and so their interest rates tend to fluctuate according to the existing market conditions. This is risky because commercial banks use treasury bills as source of liquidity. As demand for loans increases, banks, to satisfy their customers' demands for funds, sell these treasury bills at the prevailing prices which can be very high and so they lose and leads to less in the bank's reserves which is not enough for loan formation.



## **Exchange Rates**

The exchange rate is determined by the demand for and supply of foreign currency and this determines the balance of payments. The demand and supply of foreign exchange usually varies because it can decrease or increase. If the demand for foreign currency increases more than its supply, this will lead to unfavorable balance of payments and it will cause both external and internal values of the currency to fall in relation to the foreign currency, consequently the exchange rate falls. When the domestic currency value reduces, the commercial banks tend to lose when they lend out loans because when they are paid back to the commercial banks they will be of low value and so it will be cheaper for the borrowers to pay back the loans and commercial banks will lose because income they get from loans paid back to commercial banks is of low value and so can not make profits (Mugume and Obwona, 2001).

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.1 Introduction**

This chapter addressed the research design, study population, sample design and data collection methods and instruments.

#### **3.2 Research design**

The research used a case study of Barclays bank; explanatory, analytical, quantitative as well as qualitative. The research analyzed changes in the independent variables over a period of time against changes in the dependant variable which showed the extent to which risks do influence the lending of loans.

#### **3.3 Study Population**

The study was centered on Barclays Bank, head office in Kampala seeking responses from management, staff and customers.

#### **3.4 Sample size**

A representative sample was obtained by using a population of (50) fifty respondents. This was intended to facilitate the attainment of more objective results. The sample was selected from the bank management, staff and customers from the private sectors.

#### **3.5 Data collection**

##### **3.5.1 Sources of Data**

The data that was used for the purpose of the study comprised of both Primary and Secondary.

##### **i) Primary data**

The primary data used in this research was collected from credit managers of Barclays bank at the Kampala Road Branch and individual persons including staff and bank customers using self administered and guided questionnaires.

## **ii) Secondary data**

The time series secondary data composing consolidated balance sheet and income statements that were used in this research were collected from available statistics on commercial banks, financial journals and from monetary survey reports in Uganda. Other sources are journals government publications, the bank financial statements (Income statements and Balance sheets), other internal records, internet and review of the literature on the subject lending. Secondary data will be used to supplement the primary data in an attempt to answer the research question.

## **3.6 Data collection Methods**

### **3.6.1 Primary data collection methods**

#### **a) Questionnaire**

These were preformatted written set of questions to which the respondents record their answers. They were preferred because they give straight forward answers, easy to evaluate and they can be stored for future reference.

#### **b) Interviews**

In this technique the researcher carried out a face to face interaction with the respondent about various aspects of the research objectives. This method was preferred because it offered the opportunity for the researcher to have direct conversation with the respondents and be able to ask probing questions relevant to the study.

#### **c) Observation**

This is collecting data without having to ask questions by simply observation people in their natural work environment and recording their behaviors and the quality of their performance. Observation helps to understand complex issues through direct observation and where necessary ask questions to seek clarification on certain issues.

### **3.6.2 Secondary Data collection**

This was obtained from financial reports and other documentary reviews. They were obtained from Libraries, articles and Internet.

### **3.7 Data analysis technique**

The data was edited, coded, arranged and analyzed using percentages, ratios, measures of variability (i.e.) correlations for relationships using conceptual frame work. Tables, pie-charts and graphs were also used.

### **3.8 Limitations**

- **Finance**

The researcher faced a problem of adequate funding and had to postpone trips to the institution until funds were available. To facilitate the smooth completion of the study, the researcher obtained grants from relatives.

- **Accessibility**

It was not easy to access information from individual clients of the bank as the majority were both skeptical and suspicious of the intentions of the researcher. This was combated by explaining to the willing respondents the nature and purpose of the study. The researcher was then able to acquire the sought after information.

## CHAPTER FOUR

### DATA PRESENTATION AND ANALYSIS

#### 4.1 Introduction

This chapter presented the data collected during the study. The data has been presented using tables, pie charts bar graphs. This data has been analyzed using qualitative and quantitative techniques.

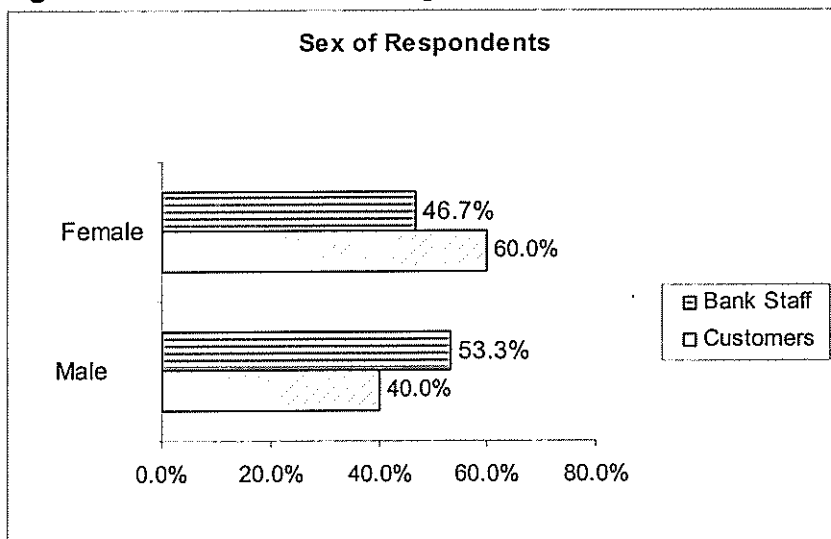
The researcher has presented the data in a categorical manner beginning with the background information of the respondents (sex, job position and academic qualification) and then the research questions; What impacts does liquidity risks and liquidity risk management have on commercial banks lending to private sector?, What impacts does credit risks and loan asset management (credit risk management) have on commercial banks lending to private sectors?, What effects do external/environmental risk factors have on commercial banks lending to private sectors?.

The data is presented categorically as follows:

#### 4.2 Background Information

##### 4.2.1 Sex of Respondents

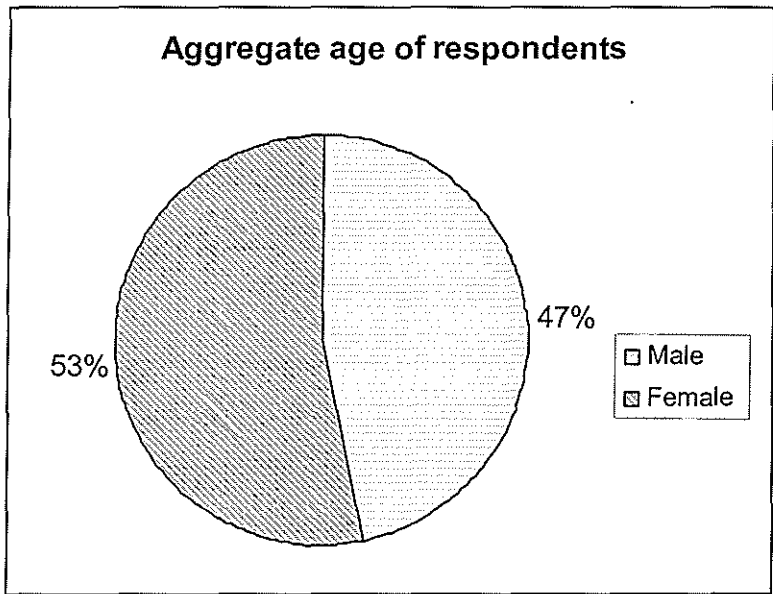
**Figure 1: Bar Chart Showing Sex of Respondents**



Source: Primary Data

The data findings in Figure 1 show that the majority of the respondents were females who comprised 60% amongst the bank staff and 46.7% amongst respondents. This is further showed by the results in the pie chart below;

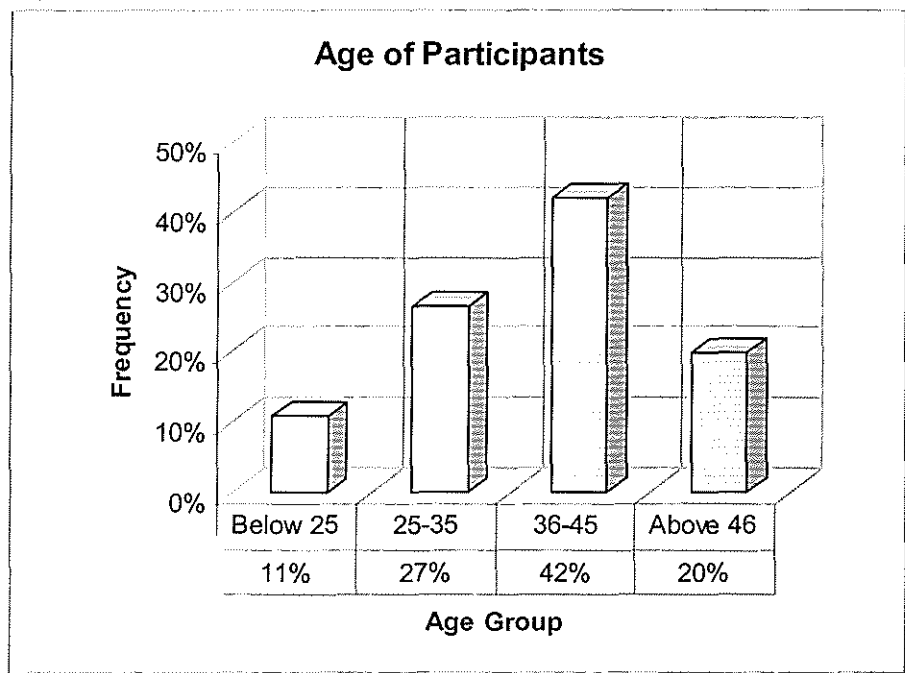
Figure 2: Pie Chart showing aggregate age of respondents



Source: Primary Data

4.2.2 Age of Respondents

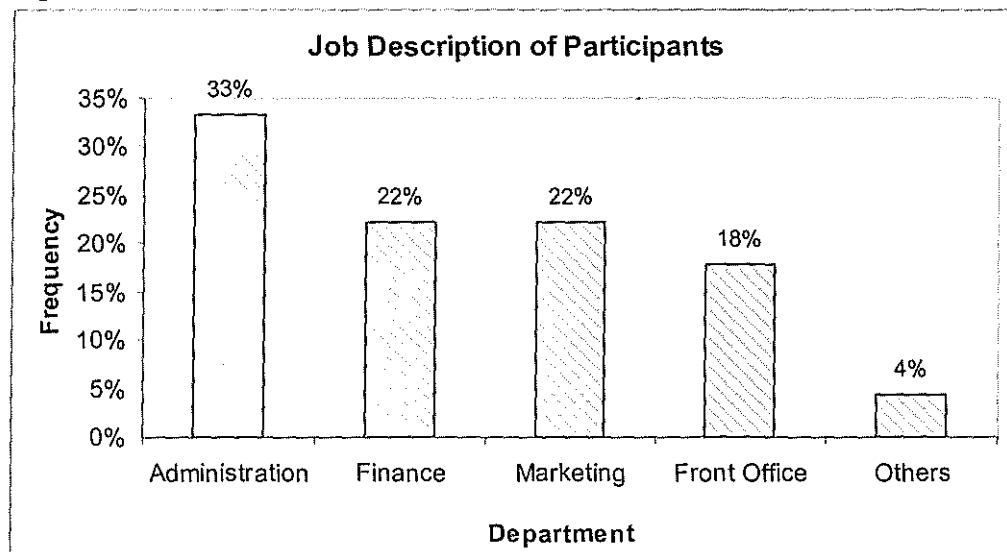
Figure 3: Bar chart showing age of respondents



Source: Primary Data

The data findings in the bar chart above show that the majority of respondents were aged between 36-45 years (42%) while those aged between 25-35 years comprised 27% of the respondents. Twenty (20%) of the respondents were aged above 46 years while only 11% were aged below 25 years.

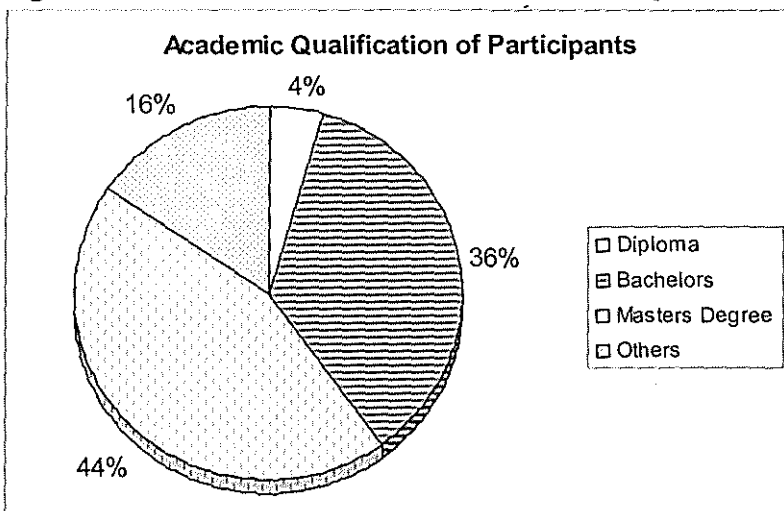
4.2.3 Job position of participants  
Figure 4: Job Position of Participants



Source: Primary Data

The study sample population was comprised of participants from administration 33%, finance 22%, marketing 22%, front desk and cashiers 18% and others 4%.

4.2.4 Academic qualification of participants  
Figure 5: Academic Qualification of Participants

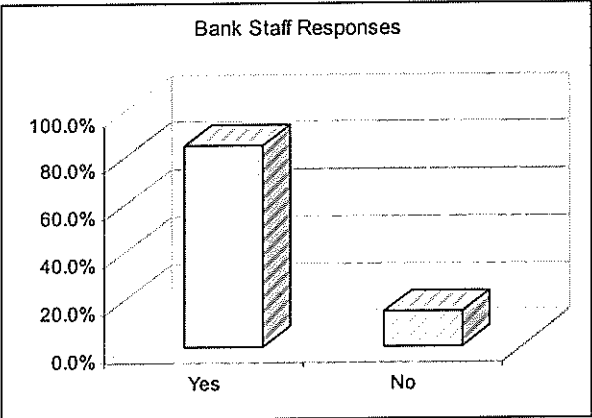


Source: Primary Data

The academic qualification of the respondents was investigated and the results showed that 44% of the participants held a master degree, 36% held bachelors degrees, 16% held other degree titles while only 4% held diplomas. It was discovered that those that held other degrees where PhD holders and post graduate diploma holders who comprised 16% of the respondents.

**4.3 Impact of Liquidity Risks and Liquidity Management Have on Commercial Banks Lending to Private Sectors**

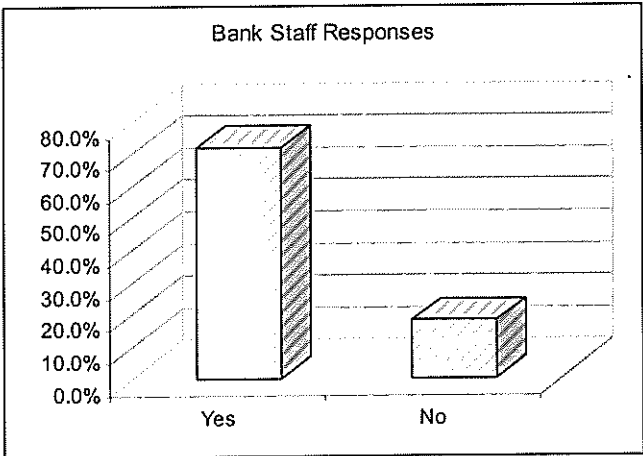
**Figure 6: Showing Bank responses as to whether the bank uses a risk management policy**



Source: Primary Data

The bank staffs were interviewed to establish whether the bank uses a risk management policy. The results showed that the majority of the respondents 89% believed the bank used a risk management policy while only 11% did not think so.

**Figure 7: Bar graph showing staff responses as to whether the liquidity risk validation of customers delays loan processing**

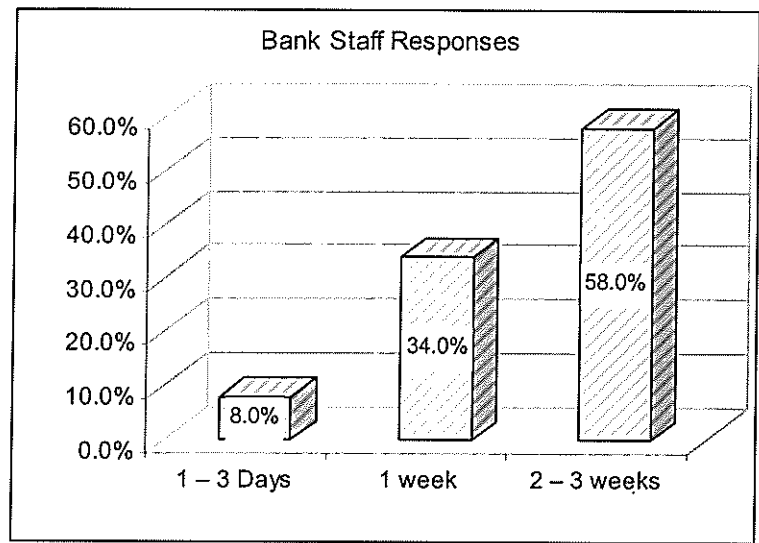


Source: Primary Data



The bank staff were further queried whether the liquidity risk verification delays loan processing and the results showed that 78% of respondents thought the verification of customer liquidity risk delayed the loan processing.

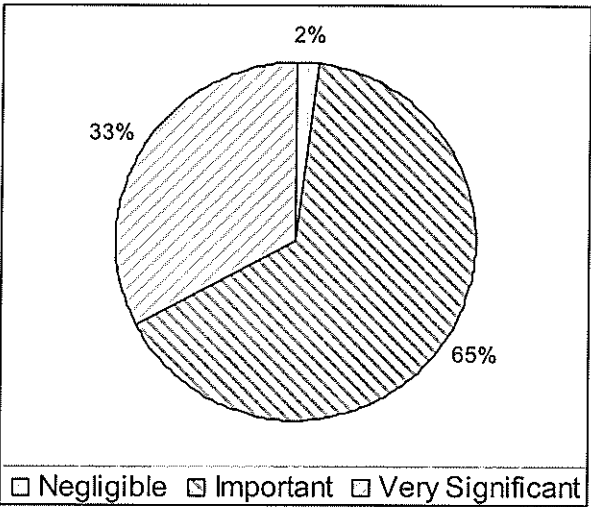
**Figure 8: Bar graph showing duration to loan acquisition as responded to by bank staff**



Source: Primary Data

The data in figure 8 above showed that the majority of staff respondents stated that the average loan processing time was 2-3 weeks as stated by 58.0% of respondents. A further 34% stated that it took generally 1 week to process loans while only 8% said it took 1-3 days.

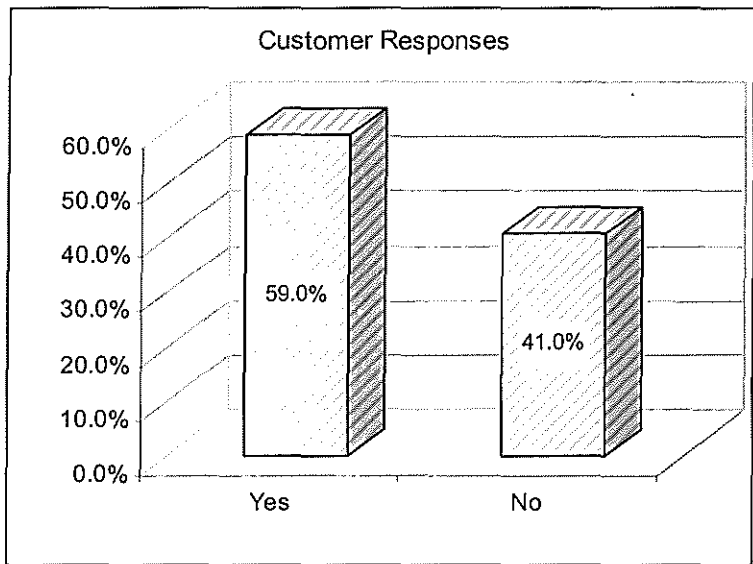
**Figure 9: Pie Chart showing importance of clients' liquidity risk when accessing a loan**



Source: Primary Data

The table above showed that the majority of respondents (72%) believed that the lending position of the bank negatively affected the borrowers. This was closely followed by 66% of respondents who felt that borrowers were discouraged from borrowing as a result of the lending position of the banks. A further 62% felt that the lower interest would encourage more loan acquisition but this was limited to those who had a low risk to the bank.

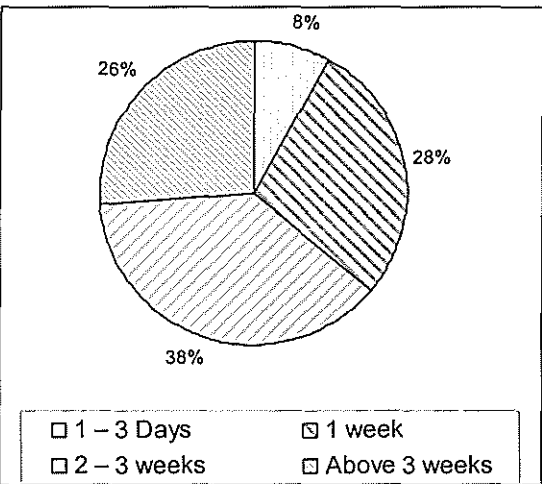
**Figure 10: Bar graph showing the number of respondents who have ever acquired a loan**



Source: Primary Data

The data in figure 10 above showed that the majority of respondents (59%) had ever acquired a loan from a bank. This was compared to 41% who had not.

**Figure 11: Pie chart showing time to acquire loan by customers**



Source: Primary Data

**Table 2: Table showing customer perception about the bank's reasons for requiring liquidity information**

Factor		Frequency (f)	Percentage (%)
Do you think the bank was interested in your liquidity (ability to pay when required)?	Yes	42	84.0%
	No	8	16.0%
Do you think your liquidity is a very big determinant for the bank lending you money?	Yes	41	82.0%
	No	9	18.0%
Do you think the bank's estimation of your liquidity was fair?	Yes	18	36.0%
	No	32	64.0%
If No, why do you think so	Under valued my assets	18	36.0%
	Valued my asset base as risky	22	44.0%
	Required a stable job also	10	20.0%
If Yes, why do you think so	I have debtors	5	10.0%
	They also gave me advice on my business needs	7	14.0%
	They showed me a perspective I did not see	6	12.0%

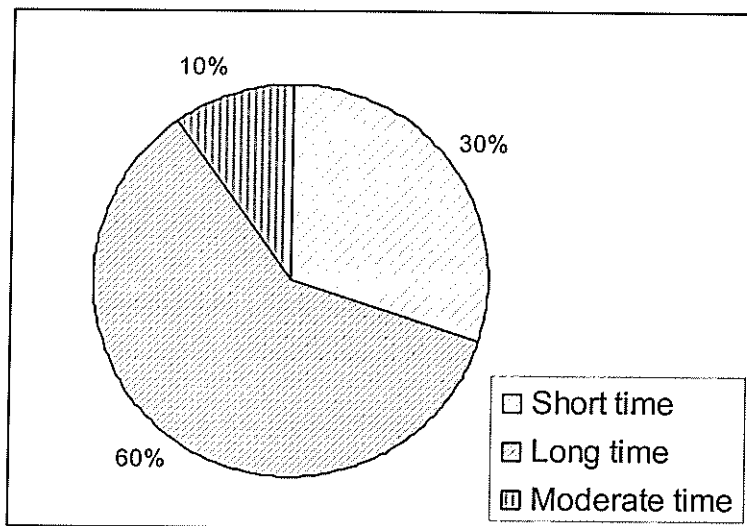
Source: Primary Data

The data in the table above showed that the majority of respondents felt that the bank was interested in their liquidity position as showed by 84%. Only 16% did not think the bank was interested in their liquidity position.

When the respondents were asked whether they thought their liquidity was a very big determinant, the majority stated that they believed it was. This was shown by 82% while only 18% did not think so.

The respondents were further queried what they thought the banks estimation of their liquidity was fair. The majority of respondents stated that the bank's estimation was unfair (64%) while only 36% felt it was fair.

**Figure 12: Pie Chart showing time it takes to deliver bank products to the customers**



Source: Primary Data

The data showed that the majority of respondents acquired their products from the bank after a long time (60%) while only 10% acquired their loans after a moderate waiting time.

The findings in figure 13 below showed that the customers believed that 60% of customers believed that assessing liquidity risk was important when accessing loans. However, 10% believed that liquidity risk was negligible when it came to loan acquisition. Only 30% of the customer respondents said that liquidity risk assessment was very significant when acquiring a loan.

**Table 3: Showing the role played by private sector credit risk in the banks' decision when lending finance**

Factors		Frequency (f)	Percentage (%)
Does the bank utilize loan asset management?	Yes	46	92%
	No	4	8%
What is the effect of the bank's loan asset management and credit risk assessment on lending to private sector?	Leads to time lag in disbursing loans	11	22%
	Leads to many requirements for loan application	26	52%
	Increases the need for actuaries	12	24%
	Discourages many loan applicants	32	64%
	Makes it almost impossible for acquisition of emergency capital loans	26	52%
	Generally discourages lending to private sector	18	36%

Source: Primary Data

The respondents were queried to establish what effects the banks loan asset management had on lending to private sectors and the results showed that the majority of respondents (64%) felt that it discouraged loan applicants.

IT was also found that other shortcomings of the loan asset management policies were that the many requirements as noted by 52% as well as the difficulty in processing emergency loans as showed by 52%.

## 4.5 Discussion

The bank staffs were interviewed to establish whether the bank uses a risk management policy. The results showed that the majority of the respondents 89% believed the bank used a risk management policy while only 11% did not think so. These findings were in agreement with Crockford (1986) who stated that to minimize and control this liquidity risks, bankers plan for liquidity through their assets portfolio. The data in figure 8 above showed that the majority of staff respondents stated that the average loan processing time was 2-3 weeks as stated by 58.0% of respondents. A further 34% stated that it took generally 1 week to process loans while only 8% said it took 1-3 days. Therefore, the credit risk and loan asset management tools used by the banks restrict the level and rate at which the bank provides loans.

This is further agreed with by the findings since the majority of respondents (72%) believed that the lending position of the bank negatively affected the borrowers. The data in the table above showed that the majority of respondents felt that the bank was interested in their liquidity position as showed by 84%. Only 16% did not think the bank was interested in their liquidity position. The findings therefore show that the liquidity risk and liquidity risk management had a negative impact on the delivery of lending services to private sector.

The respondents were further queried what they thought the banks estimation of their liquidity was fair. The majority of respondents stated that the bank's estimation was unfair (64%) while only 36% felt it was fair. The data showed that the majority of respondents acquired their products from the bank after a long time (60%) while only 10% acquired their loans after a moderate waiting time. The respondents were queried to establish whether the banks used loan asset management and it was found that all personnel knew that the bank used loan asset management. The respondents were queried to establish what effects the banks loan asset management had on lending to private sectors and the results showed that the majority of respondents (64%) felt that it discouraged loan applicants. IT was also found that other shortcomings of the loan asset management policies were that the many requirements as noted by 52% as well as the difficulty in processing emergency loans as showed by 52%.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Summary**

The study aimed to establish the risks that commercial banks face when lending to private sectors and ways of controlling them. The study objectives were; to ascertain the impact of liquidity risks and liquidity risk management has had on commercial banks lending to private sector, to establish the impact of credit risk and loan asset management (credit risk management) on commercial banks lending to private sector, to establish the effect that the following external/environmental risk factors have had on commercial bank lending to private sector including; treasury bills rate risks, inflation and exchange rates.

The study was centered on Barclays Bank, Kampala road branch in Kampala seeking responses from management, staff and customers. A representative sample was obtained by using a population of (50) fifty respondents.

The study utilized questionnaire, interviews, observation and secondary data collection as the major data collection techniques. The data was then edited, coded, arranged and analyzed using percentages, ratios, measures of variability correlations for relationships using conceptual frame work.

#### **5.2 Conclusions**

The rapid expansion of private entrepreneurship and the inequitable bank loan policies lead to the question of how the private sector can be financed. The goal of this study was to investigate the risks faced by the banks in lending to the private sector.

Findings showed that the loans provided to the private sector had very many restrictive policies to lending which tended to show that the banks have biases against the private sector. The supply-side view argued that firm size mattered. Larger firms, according to this explanation, have advantages in obtaining bank loans

because of their more transparent structures and because they can provide adequate collateral.

The key insight from the resource dependence perspective is that entrepreneurs are actually very active to play strategies to acquire legitimacy from and reduce dependence on the environment.

Researchers predict that a growing robust private sector will result in the development of a strong middle class similar to that in the Western development countries, thus making Uganda a more democratic state and a more responsible member in the World community (Dickson, 2003).

### **5.3 Recommendations**

Commercial banks should endeavor to promote a savings culture by providing low interest rates to persistently good savings customers. This will reduce the risks associated with providing credit to individuals and further ensure a more robust and flexible loan arrangement process.

Commercial banks should diversify their profit centers such as enlist into government treasury bills and corporate treasury bills so as to minimize losses from cost of loan processing. Government should institute a policy to shield commercial banks from the harsh effects of inflation so as to encourage the commercial banks to provide low interest rates to individual borrowers. This will also be good for the economy as loans fuel economies.



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## APPENDICES

### APPENDIX 1: QUESTIONNAIRE

Dear Sir/ Madam,

I humbly ask you to participate in this research on Risks Faced By Commercial Banks When Lending To Private Sectors. Your responses will be treated with utmost confidentiality.

**Instructions:** **TICK** the appropriate answer and **FILL-IN** the blanks where necessary.

1. Sex:

- ☐ Male
- ☐ Female

2. Age:

- ☐ Below 25
- ☐ 25-35
- ☐ 36-45
- ☐ Above 46

3. Job position

- ☐ Administration
- ☐ Finance
- ☐ Marketing & Sales
- ☐ Other Staff (Please specify).....

4. Academic qualification attained

- ☐ a) Certificate
- ☐ b) Diploma level
- ☐ c) University Degree
- ☐ d) Others.....

#### SECTION A:

#### WHAT IMPACT DOES LIQUIDITY RISKS AND LIQUIDITY MANAGEMENT HAVE ON COMMERCIAL BANKS LENDING TO PRIVATE SECTORS

1. Does the bank have a system of liquidity risk management policy?

- ☐ Yes
- ☐ No

2. What system/policy do you have in place?

.....

.....

.....

3. Do you think the process increases the time to deliver to customers the loan products?

- ☐ Yes  
☐ No

4. How long does it take to process a loan?

- ☐ 1 – 3 Days  
☐ 1 week  
☐ 2 – 3 weeks  
☐ Other (Please specify).....

5. How important is a clients liquidity risk when accessing a loan?

- ☐ Negligeable  
☐ Important  
☐ Very Significant

6. How does it affect the lending position of the bank to the private sector?

.....  
.....  
.....  
.....

7. In your opinion, which of the following statements below do you agree with the most?

- ☐ Liquidity risks and liquidity management *negatively* affect private sector borrowing  
☐ Liquidity risks and liquidity management *positively* affect private sector borrowing  
☐ Liquidity risks and liquidity management *have no* effect private sector borrowing

#### SECTION B:

#### WHAT IMPACT DOES CREIT RISKS AND LOAN ASSET MANAGEMENT HAVE ON COMMERCIAL BANKS LENDING TO PRIVATE SECTORS?

1. How does the bank measure credit risk of potential borrowers from the private sector?

.....  
.....  
.....

2. In your opinion what role does private sector credit risk play in the banks decision when lending finance.

3. Does the bank utilize loan asset management?

- ☐ Yes  
☐ No

4. What is the effect of the bank's loan asset management and credit risk assessment on lending to private section?

.....  
.....  
.....

5. Overall, what is your opinion on the banks credit risk and loan loans asset management policy?

.....  
.....  
.....

**SECTION C:**  
**WHAT EFFECTS DO EXTERNAL/ENVIRONMENTAL RISK FACTORS HAVE ON**  
**COMMERCIAL BANKS LENDING TO PRIVATE SECTORS?**

1. Does the bank use the following environmental factors to base lending criteria to the private sector?

- ☐ Exchange Rates
- ☐ Treasury Bills Interest Rates
- ☐ Inflation

2. Which of the above, do you think is a very big determinant in assessing lending to potential private sector?

3. If you have any other information to add, note it below.

.....  
.....  
.....  
.....  
.....  
.....

**THANK YOU**  
**FOR YOUR PARTICIPATION**

### **APPENDIX 3: BUDGET OF THE STUDY**

<b>S/N</b>	<b>ITEMS/PARTICULARS</b>	<b>COST (Tshs)</b>
<b>1.</b>	Library research and traveling expenses	100,000
<b>2.</b>	Typing and photocopy	70,000
<b>3.</b>	Accommodation	50,000
<b>4.</b>	Telephone	20,000
<b>5.</b>	E-mail	10,000
<b>6.</b>	Miscellaneous	50,000
	<b>TOTAL</b>	<b>300,000</b>

## APPENDIX 4: WORKPLAN

S/N	Core Activity	Time in Months			
		2	2	3	1
1.	Proposal writing				
2.	Main field Data collection				
3.	Data analysis, processing and report writing				
4.	Final draft preparation and submission of the report				

# CURRICULUM VITAE

## PERSONAL INFORMATION

Name: Anna michael  
Date of birth: 28 march 1981  
Nationality: Tanzanian  
Sex: female  
Marital Status: Single  
Address: P.O. Box 6802, DAR ES SALAAM  
Phone: +255 786 767 604  
Email: mmasianna@yahoo.com

## CAREER OBJECTIVE

To advance my Marketing Management knowledge and skills in the banking sector

## WORK HISTORY

- Year: June 2004- August. 2004  
Organization: TANZANIA RAILWAYS CORPORATION(TRC)  
Position/ Department: supplies and procurement
- Year: June2008- August2008  
Organization: OVERSEES COMPANY LIMITED  
Position/ Department: Sales person (internship)

## KEY ROLES/ DUTIES AT OVERSEES COMPANY LIMITED

- Generating Sales Leads and getting orders
- Qualifying Sales Leads
- Arranging the Sales Call
- product presentation and stimulation of the prospect's interest
- Handling Buyer Resistance
- Closing the Sale
- Account Maintenance

## COMMUNICATION SKILLS AND COMPETENCE

LANGUAGES	ORAL	WRITTEN	READING
• ENGLISH	EXCELLENT	EXCELLENT	EXCELLENT
• KISWAHILI	EXCELLENT	EXCELLENT	EXCELLENT