# THE CREDIT RISK MANAGEMENT AND PERFORMANCE OF COMMERCIAL BANK.

## CASE STUDY: NILE BANK

BY

WANJIRU WILLIAM KAMAU

BBA/2248/31/DF

SUPERVISOR

DR. SUNDAY NICHOLAS

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**DECLARATION**

I am aware of the rules and plagiarism and therefore hereby declare that the report is authentic and has never been submitted to any institution of learning for an award to be assigned by the researcher. All secondary sources of literature have been declared in this compilation.

Researchers Names

Wanjiru William kamau

Signature

07/08/06

## Approval sheet

This is to certify that this research report entitled credit risk management and the performance of commercial bank submitted in partial fulfilment of a degree of bachelor of Business Administration of Kampala International University by William Kamau Wanjiru was under my supervision and guidance and now it is ready to be submitted to the school of Business and Management with my approval:

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

**Dr Nicholas sunday (supervisor)**

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

**Signature**

15/8/06.

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

**Date**

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## LIST OF ABBREVIATIONS

| | | |
|---|---|---|
| ISO | - | International Organisation for Standardization |
| UNDP | - | United Nation Development Programme |
| GBL | - | Greenland Bank Limited |
| IBL | - | International Credit Limited |
| CBL | - | Cooperative Bank Limited |

# ABSTRACT

Chapter one is introductory in nature. It focuses on some important aspects such as the study background, rationale of the study, objectives of the study, theory and brings out the significant of the study.

Chapter two endeavors to review the literature in line with the ideas of various researchers undertaken on the area of credit risk management and the credit policy.

Chapter three illustrates scientific ways employed in the selection of the respondents, methods of data collection, definition of the survey methods among others.

Chapter four is concerned with the findings and their interpretations. The interpretations are in line with the objectives and the research questions established to guide the study. It also brings about the relationship between credit risk management and the performance of commercial Nile Bank.

Chapter five attempts to discuss summaries, recommendation and conclusions from the study about credit risk management and performance of commercial bank

# CHAPTER ONE

## INTRODUCTION

Van Greuning (2003) defines Credit risk as the possibilities that a borrower of financial instrument or the issuer of a security may be unable to meet interest and principal payment when they fall due. The failure of a borrower to carryout their financial obligation to their lenders as p ledged by contract is called default.
Credit risk means that payment, may be delayed or ultimately not paid at all, which can turn cause cash flow problems and affects bank liquidity.

Despite innovation in financial services sector, credit risk is still the major single cause of bank failures. The reason is that more than 80% of banks balance sheet generally relates to this aspect of risk management.
There are three types of credit risk

- Personal or consumer risk
- Corporate or company risk
- Sovereign or country risk

Because of the potentially dire effects of credit risk, it is important to perform a comprehensive evaluation of banks capacity to assess administer, supervise, enforce and recover loans, advances, guarantees and other credit instrument. An overall credit risk management review will include an evaluation of credit risk management, policies and practices of a bank. This evaluation should also determine the adequacy of financial information received from a borrower or the issuer of financial instrument, which has been used by the bank as the basis for investing in such financial instrument or the extension of credit, and the period assessment of its inherently changing risk.

Giving credit is one of the major activities where commercial banks make profits by charging interest on the loan advanced, thus growing and expanding in terms of performance. However, without lending to customers commercial banks loose interest, thus low or no profit can help in running these banks' activities such as paying debts, salaries of workers and daily activities. Bank should know that giving credit, there is a possibility of default that is credit risk; Banks in Uganda have performed poorly where several banks were closed within 1999, these banks include; Greenland Bank Ltd (GBL), international credit Ltd (IIBL), and cooperative Bank Ltd (CBL) due to mismanagement of their loan portfolios and poor credit policy. Poor quality of management manifest in poor lending policies due to deficient internal control.Inadequate credit analysis, excessive risk concentration and fraud, hence poor performance of commercial banks in Uganda. In addition many banks in the past have been facing a problem of debt recovery which could have been attributed to the above problems.

**Related – Party lending**

Lending to connected parties is particularly dangerous form of credit risk exposure. Related parties typically include a bank's parent, major shareholders, subsidiaries, affiliate companies, directors, and executive officers. Their relationship includes the ability to exert control over or influence a bank's policies and decision-making, especially concerning credit decisions. A bank's ability to systematically identify and track extensions is made in rational basis and according to the bank's policies and procedures. An additional concern is whether credit is based on market terms or granted on terms that are more favorable with regard to amount, maturity, rate and collateral, than those provided to the general public.

Most regulators establish limits of aggregate lending to related parties cannot exceed a certain percentage of tier or total purifying capital. If such limit has not been established by prudential regulations, a bank should be expected to maintain one as a matter of board policy. A prudent banking practice would require all loans and related parties to be approved by the board.

Greuning et al (1999), credit risk is still a major single cause of bank failure. The reason is that more than 80% of bank balance sheet relate to this aspect of credit risk management. With the report by UNDP (1996) the major problem facing the commercial banking in Uganda is the poor recovery procedures. These bad debt thus involve not only erode the commercial banks ability to recycle their financial resources, but also threatens their profitability and survival.

## 1.0 Background

Nile Bank limited is a private bank, registered in Uganda, with shareholders from Uganda, Israel, and South Africa. Nile bank limited was established in 1988 to provide quality banking services to the public at a time when low cost banking was almost non-existent. By 1992 the bank had two branches and has since expanded to seven branches including branches in Mbarara, Entebbe, Jinja and most recently Mbale. In January 2003, the bank became the first Ugandan bank to receive I.S.O certification. The bank has a customer base in excess of 89,000 with continued provision of affordable, innovative and competitive banking services Nile bank limited offers the products and services inform of accounts which include, My source, Cash source (ATM), Future source and also inform of loan facilities which include Credit source, Flexi source, Wheel source, Entertainment source among other products and services.

## 1.1 Statement of the problem

The effective management of this risk is central to the performance of financial institution and creates efficient and competitive banking system. Financial institutions in Uganda are faced with poor banking performance due to the poor credit policy (UNDP Report 1996) commercial banks registered a high percentage of poor performance of loans. Commercial bank retaliated by putting in place credit policies in order to minimize default rate and bad debtors and maximize the bank benefits.

In case of businesses the problem manifests themselves because of the following reasons; Slump in sales, sudden increase in operating costs or even the cost of raw material, stiff competition in market place, labour problems or industrial regulations, all which may cause default risk. Anything that affects the borrower's position may contribute to credit risk.

The study therefore evaluates credit risk policies and how they relate to performance in order to come up with observations and recommendations.

**1.2 Objectives of the study**

1. The research examine the credit risk policies of Nile Bank
2. To evaluate the effective credit standard, credit terms and collection efforts.
3. To establish the relationship between credit management policy and performance of Nile bank.

**1.3 Significance of the study**

The study helps planners and policy maker's most especially commercial bank and ministry of finance in their effort to improve the monetary sector of the economy. The study findings will be of importance to stakeholders especially those of commercial banks and other lending institution on how to improve on credit risk or terms of credit policy. The study also intent to be used in making detailed assessment of implementation and progress of loans disbursement by Nile Bank towards maximizing their benefits. The study will also be used by academicians for future studies about the similar topics of study.

**1.4 Scope of the study**

The geographical scope

The study was carried out at Nile Bank, Kampala road at Nile Bank Chambers this was because the main branch of Nile bank or Head Office keeps all the returns and reports of other branches in the country. It covered period between 2002-2005.

**1.5 Research question**

The following research question was used in the study

1. What is credit risk?
2. How effective is credit risk management in place?
3. Is there any relationship between credit risk management and the performance of Nile Bank?

4. Is the performance brought about by the Nile Bank effectiveness of credit policy guidelines in commercial banks?
5. What could be the recommendations to improve credit management and performance in commercial banks?

### 1.6 Research hypothesis

1 banks seek the highest yield possible on their investments and loans but they must carefully consider how risk are willing to take to achieve that objective.

2 That each bank has strategies in play to attract clients and deposits

# CHAPTER TWO

# LITERATURE REVIEW

## 2.0 Introduction

This chapter provides a critical review of literature in the area of credit risk management. It was mainly drawn from the survey of text books on credit risk management.

## 2.1 Credit risk

Van Greuning (2003) credit risk is the possibility that a borrower of financial instruments or the issuer of the security may be unable to meet interest and principle payment when they fall due.

Geralald O. Hatler (1999) refers to credit risk as also a business risk; is the possibility that a borrower of a loan or the issues of security may be unable to meet interest and principal payment when they fall due. The failure of borrowers to carry out their financial obligation to their lenders as pledged by the contract is called default.

Ringtho (1998) credit policy is a framework guideline formulated by the organization to be followed in process of credit extension to borrowers. Firms and Banks set credit contract or credit policies to ensure control and minimizing the rate of default.

A borrower may be unable to perform up to expectation for a variety of reasons, many of which are not always predictive. In case of a business the reasons for default may include a slump in sales, a sudden increase in operating costs or even the cost of raw material, stiff competition in market place, labour problems or industry regulations all may cause default. Anything that affects the borrower position may contribute to credit risk.

## 2.2 Credit risk in loans

Halter (1999), extending unsecured loan involves a risk; losses on some loans are to be expected. Steps that banks can take to limit loan losses include obtaining sufficient information on loans and borrowers and establishing an internal system of loan review in addition to the loan reviews of regulatory agencies.

### 2.3 Credit standards

Ringtho (1998), banks have their unique way of establishing the credit worthiness through the set credit standard. Credit standard is defined as the criteria banks use in selecting its customers for credit. It is the process by which institution establishes the credit worthiness of customers. It involves the appraisal of the customers to identify possible risks in lending to customers as well as establishing the capacity to repay the loan. The viability of credit institutions depends critically on selecting applicants who have a high probability of repayment and rejecting those with high chances of non-repayment. Therefore, credit analysis is important to lending institutions and requires extensive information about the credit applicant to enable the analysis to be carried out properly. The bank can decide to extend credit to those customers with good records, whereas a stringent credit standard for credit applicant with high chances of default. In evaluating whether the customer is credit worthy or risk associated with the customer, bank use five standard "Cs" which are: - Characters, capacity, capital, collateral and condition.

Kapoor et al (1992) defined capacity as the probability that a customer will try to meet obligations as they fall due. It mainly involves assessment of the moral factors. Capacity is subjective judgment of the customer's ability to pay. It may be assessed using the customers past records supplemented by physical observations. It considers the ability to generate cash to meet obligations. Capital is assessed by looking at tangible net worth of the business. It can be done using ratio analysis. Collateral is presented by the assets offered by the customer as pledge for the security of the credit to be extended.
Western and Briggham (1979), condition refers to the impact of general economic trends on business developments in certain areas of the economy that may affect the customer's ability to meet the obligation. Commercial banks seek information about the company, the type of business they are in and the purpose of the loan.

## 2.4 Information lenders look in determining credit worthiness (Kapoor et al, 2001)

**THE FIVE C'S OF CREDIT**

**CREDIT HISTORY**
**1. Character: will you repay the loan? Yes No**
Do you have a good attitude toward Credit obligations?
Have you used credit before?
Have you ever filed for bankruptcy?
Do you live within your means?

**STABILITY**
How long have you lived at your present address?
Do you own your home?
How long have you been employed by your present employer?

**Income**
**2. Capacity: can you repay the loan?**
Your salary and occupation?
Place of occupation?
How reliable is your income? Reliable – not reliable
Any other sources of income?

**Expenses**
Number of dependents?
Do you pay any alimony or
Child support?
Current debts?

**Net worth**
**3. Capital: What are your assets and net worth?**
What are your assets?
What are your liabilities?
What is your net worth?

**LOAN SECURITY**
**4. Collateral: What if you don't repay the loan?**
What assets do you have to secure the loan?
(Car home, furniture?)
What sources do you have besides income? Saving stocks bonds insurance.)

**Job security**
**5. Conditions:** what general economic conditions can affect your repayment of the loan?
How secure is the firm you work for?

**2.5 Credit terms**

According to Pandey (1995) credit terms are the stipulations under which the firm sell on credit to its customers.

(i) Credit period

This is the length of time to which credit is extended to customers or schedule of repayment of principal plus interest.

(ii) Cash discount is a reduction in the amount to be paid to induce customers to repay credit obligation within a period of time which is less than a normal credit period.

In practice Credit terms include;

a) the rate of cash discount
b) The cash discount period
c) The net credit period

**2.6 Collection efforts and procedures**

Kabir Hussa (2002), these are procedures used to collect cash from debtors once credit has been extended. This should be done in organized manner that will accelerate cash receipts without damaging the relationship between the debtors and the creditor.

Kakuru (2000) Credit risk may arise due to inability of clients to pay back because of shortfalls and willful default where a client willingly refuses to pay back the loan obligation due to imprudent behavior.

**2.7 Management of credit transition processes**

Pandey (1995), procedures to collect dues from slow paying and, non paying customers include;

i.) Reminders

This should be a stop by stop process which involves sending credit notice to the debtor to remind of his account due. Send a polite letter , a strong letter and make personal contacts.

(ii) Ensuring your debtor. To take out insurance policy on your debtors since the assets are of the firm.

(iii)Factoring of debtors

Here you sell your debtors to a firm less a discount and inform your debtors to pay a factor firm (Pandey (1995).

### 2.8 Management of credit transaction process

Huntur (1996) this is the process involved in activities which first bring the bank and client into contact; it involves stages as below;

**2.8.1Origination;** this is a systematic discovery whereby the lending officers initiates the decision making process by gathering information from potential borrowers to decide whether the client request is compatible with the corn bank policy. The credit officer should know where the client comes from and should visit its potential customers for thoroughly credit assessment.

#### 2.8.2 Evaluation

This is concerned with viability of the credit propose by the client.

The credit officer should consider the purpose of loan,, factors that may make repayment difficult by carrying out financial analysis an non-financial analysis and competence of the management (Mugisha (1995).

#### 2.8.3 Negotiations

This occurs when proposed by the client is basically viable but there are certain issues to be focused on like, lifespan of credit payment procedures, nature of collateral securities and general obligation of the client and the bank.

#### 2.8.4 Approval

Commercial banks will adopt either a committee or a sequential process. The committee receives alternative approval of the loan and consists of senior management breads of lending section.

Craing & Dan (2001) before recommending an application, loan officer need to have a high degree of confidence that the loan will be repaid.

### 2.8.5 Documentation

Here it involves legal drafting of a loan contract that spells out condition, restrictions, or covenant which ensures that the client will continue to meet his financial obligations. Loan contracts documentation therefore, provides a risk protection by enabling the bank to take legal actions when a borrower default (Ghatuk, 1999).

### 2.8.6Disbursement

This is the final stage, which involve the giving out funds or loans in accordance with agreed terms spelt out in the documentation.

Ogoola (2000) argues that inadequate credit policies and poor loan administration and monitoring procedures are like termites to a bank that cuts away surreptitiously at banks performance.

### 2.9 Performance measures

According to Alan (Pizzey 1987) defined performance as a barometer of Indices. That measures the return of profits in relation to cost further more good demonstrated by increasing profitability. Performance such as net profit to turnover and expenses incurred towards the extension of credit.

A performance measure involves assessing achievement against the objectives and overall performance during the year. Using the financial ratios as below;

$$\text{Account receivables} = \frac{\text{Sales}}{\text{Accounts receivables}}$$

$$\text{Profit margin} = \frac{\text{N... Earnings}}{\text{Sales}}$$

$$\text{Return on investment} = \frac{\text{Net earnings}}{\text{Net worth's}}$$

High interest rate increases default rate of return generated are not enough to pay interest charged Balunywa (1995).

## 2.10 Indicators of good performance

It may include;

- High returns or high profitability index annually
- Expansion of services to the public / opening up other branches
- Stable workforce ( low employer turnover)
- Increase on bank customers accounts
- High quality employees, in terms of their skills.
- Efficient and effective accounting systems for cost, budget and profit planning

## 2.11 Conclusion

Credit management policies in Uganda have not been well implemented and understood by the borrowers. This is because sources of credit information are also not fully established. Hence poor performance of commercial banks in Uganda. It is because of this reason research was conducted to carry further investigation on credit risk management and performance of commercial banks. It was be investigated in Nile bank as a case in point.

# CHAPTER THREE

# METHODOLOGY

## 3.1 Introduction

This chapter indicates how data was collected, processed and analyzed. It covers research design, sampling design, data collection method and instruments, data processing and analysis.

## 3.2 Research design.

The research employed analytical and descriptive research design based on records and reports publication, questionnaires and interview from selected department of Nile Bank.

## 3.3 Sample size

The target population was (25) twenty five respondents but twenty (20) of them responded.

### 3.3.1 Study population

The study population includes the managers, internal auditors, loan officers and the staff of Nile Bank.

## 3.4 Data type and Sources.

This included primary and secondary data. Primary data came from interviews, questionnaires, and observations while secondary data was obtained from library, accounts records, returns and reports from Nile bank chambers.

## 3.5 Data collection instruments / methods.

The study used the following data collection instrument.

### 3.5.1 Questionnaires.

Questionnaires were used to get information from different respondents by filling them. These included both structured and unstructured questions.

### 3.5.2 Interviews.

It was employed to get direct responses from respondents. The interview were flexible source of information particularly from high level management. It covered information not included in questionnaire.

### 3.5.3 Documentary review.

This were collected from the Nile bank chambers. The document aided in study due to that information which would not be got from interview and the questionnaire.

### 3.6 Data processing analysis.

This was done through editing, coding, tabulation data from the respondents on the questionnaire and interview guides. This assisted in detecting and eliminating errors and identification of vital information.

# CHAPTER FOUR

# PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS

## 4.0 Introduction

This chapter presents research findings and interpretation. These findings were mainly got from both primary and secondary sources concerning the evaluation of credit risk and performance of commercial bank, employed by the Nile bank.

## 4.1 General Findings

The research finding from the study was that Nile bank has a credit committee in place, with major roles to implement the credit policies, scrutinize credit application as police the extension of credit to their customers.

## 4.2 Demographic characteristics

The respondents were both male and female

**Table1 : sex of respondents**

| Gender | Frequency | Percentage |
|---|---|---|
| Male | 15 | 80 |
| Female | 5 | 20 |
| Total | 20 | 100 |

Source: Primary data

The majority of the respondents were male representing 80% and the rest 20% were female.

The question about the main banking services offered by the Nile Bank was as follows;

**Table2: Main banking services**

| Service | Frequency | Percentage |
|---|---|---|
| Lending | 6 | 30 |
| Deposit | 8 | 40 |
| Forex services | 4 | 20 |
| Advisory | 2 | 10 |
| Total | 20 | 100 |

Source: Primary data

From the findings 40% showed that deposit is the main function banking services offered by Nile bank, followed by lending with 30% then forex services with 20% and then advisory services with 10%.

For the question about which sector of most clients follows: the respondents were as follows;

**Table 3: Sector of the economy where customers comes from**

| Sector | Frequency | Percentage |
|---|---|---|
| Agriculture | 3 | 15 |
| Business | 14 | 70 |
| Fishing | 1 | 5 |
| Others | 2 | 10 |
| Total | 20 | 100 |

Source: Primary data

From the findings it showed that most clients comes from business sector of the economy representing 70% of the respondents, followed by the Agriculture sector with 15% and then followed by other sectors of economy representing 10% and lastly 5% from the fishing industries.

**Table 4: Effectiveness of risk management**

| Options | Frequency | Percentage |
|---|---|---|
| Strongly agree | 3 | 15 |
| Agree | 8 | 40 |
| Uncertain | 6 | 30 |
| Disagree | 2 | 10 |
| Strongly disagree | 1 | 5 |
| Total | 20 | 100 |

Source: Primary data

The table above show that 40% of respondent agreed that risk is effectively managed, 30% were uncertain, 15% strongly agreed, 10% disagreed, while, 5% strongly disagreed. This shows that to some extent the risk was well managed. Here it requires only that new loan officers be introduced to the system of loan rating, through training and apprenticeship to achieve a standardization of rating through the bank.

**Table 5: Credit standards for Nile Bank**

| Standard | Frequency | Percentage |
|---|---|---|
| Capacity | 6 | 30 |
| Collateral | 10 | 50 |
| Condition character | 1 | 5 |
| Capital | 3 | 15 |
| Total | 20 | 100 |

Source: Primary data

From the findings 50% represent the way the management consider collateral as a way to minimize risk of default of its client. In addition to this 30% of respondents considers this capacity to repay the loan. While 15% among the management considered capital of the client as base to grant to customer. Condition and character also help to sort the willingness of the clients' application to meet their obligation as and when they fall due this is represented by 5%.

### 4.3. Collection procedures

On the efforts designed to collect the funds from the clients in an optimal manner.

**Table 6: Collection Designed**

| Options | Frequency | Percentage |
|---|---|---|
| Systematic reminders | 6 | 30 |
| Insurance | 4 | 20 |
| Litigation | 8 | 40 |
| Others | 2 | 10 |
| Total | 20 | 100 |

Source: Primary data

The study showed that litigation is the most option used by the bank representing 40% of the respondents, while 30% showed that systematic reminders are also used. But 20% of the respondent indicated that insurance policy are as well employed against bad debts as well as other methods used against the defaulters which represent 10%. However the use of litigation should not be widely provoked to collect the loan if the bank desires a continuity of relationship with the clients. Bank undertakes its own collection with supporting information showed it takes its own collection but on default it confronts agents to collect its default loans as shown below.

**Table 7: Collection of loans**

| Options | Frequency | Percentage |
|---|---|---|
| Agent | 8 | 40 |
| Own collection | 12 | 60 |

| | | |
|---|---|---|
| Total | 20 | 100 |

Source: Primary data

The study showed that bank undertake its own collection of loans already disbursed, where 60% of respondents accepted the bank it undertake own collection, while 40% of the respondents that accepted that the bank employs an agent to recover the loan this include the loan which are already declared bad loans.

**4.4 Effectiveness of credit terms**

Basing on the prime lending interest rate, charged by the Nile bank of 20% per annum, the researcher concluded that it was high. However, this was supposed to recover high costs of operation. For the rate to be below then high levels of efficiency and cost cutting techniques are needed so as to reduce on high cost of operation which would also lead to favorable interest rate charges by clients which in turn reduces on loan default. Finding further showed that loan period does not exceed six months for working capital loan. For commercial purposes its recommendable to give loans up to 3 months. For current customers, the loan period can be extended to 12 months.

**Table 8: Factor of high credit risk in Nile Bank**

The table shows the major factor respondent for high credit risk in Nile bank

| **Factors** | **Frequency** | **Percentage** |
|---|---|---|
| Over reliance | 4 | 20 |
| Weak legal framework | 10 | 50 |
| Unrealizable valuation | 3 | 15 |
| Lack of loan classification | 2 | 10 |
| Others | 1 | 5 |
| Total | 20 | 100 |

Source: Primary data

From the above findings it is clear that respondents thought that weak legal frame work is the leading factor when it comes to credit risk. A lending policy should contain an outline of the scope and allocation of banks credit facilities and manner in which a credit portfolio is managed and that is how loans are originated, appraised, supervised, and collected. A good lending policy is not very restrictive, but allows for the presentation of loans to the board that offers consideration but which do not fall within the parameters of written guidelines. Over reliance on collateral is another reason that respondent thought it contributes to high credit risk with 20% respondents which showed that loan assessment is poor. Unrealizable valuation with 15% also is thought that contributed to high credit risk. A lending policy should specify types of loans and other credit instrument that bank intend to offer to clients and should provide guidelines for specific loans. Decision about types of credit instrument should be based on the expertise of lending officers, the deposit structure of a bank and anticipated credit demand. The type of credit that have contributed in an abnormal loss should be controlled by senior management or avoid completely. However 5% of respondent suggested other as poor financial climate in Uganda and lack of financial discipline among customers, which he solved by character and financial analyst as standards for credit assessment

**Table 9: Major expenses of Nile Bank**

| **Expense** | **Frequency** | **Percentage %** |
|---|---|---|
| Administrative | 10 | 55 |
| Interests | 3 | 15 |
| Bad and doubtful debt | 3 | 15 |
| Depreciation | 1 | 5 |
| Others | 2 | 10 |
| Total | 20 | 100 |

Source: Primary data

The study showed that administrative costs are the major expenses of the Nile bank interest expenses and bad and doubtful debt expenses are jointly represented by 15% of the respondents. While deprecation was represented by 5%, other expenses like training and recruitment, loan recovery cost amounted to 5% of the respondents.

## 4.5 The profitability Analysis

These were used to analyze the effectiveness of credit risk management as level of engagement into the engagement of revenue activities of Nile Bank to call off the bad debts and profitability of bank in general terms.

**Table 10: Performance of Nile Bank in the last 3 years**

| Performance | Frequency | Percentage |
|---|---|---|
| Only profit | 8 | 40 |
| Only losses | 0 | - |
| Profit and losses | 12 | 60 |
| Total | 20 | 100 |

Source: Primary data

From the data above 60% of respondents showed that bank has been making losses and profit while 40% of the respondents showed that the bank has made profits in the last three years. The performance has been moderate as majority of respondents did not want to indicate that the bank has been making only profits.

**Table 11: Profitability Trend**

| Trend | Frequency | Percentage |
|---|---|---|
| Improving | 10 | 50 |
| Declining | 1 | 5 |
| Constant | 6 | 30 |
| Others | 3 | 15 |
| Total | 20 | 100 |

Source: Primary data

From the above findings, 50% of respondents showed that the trend of profitability in the last 3 years there has been improvement; however, 30% of the respondent showed that the bank has been having a constant growth of the profit. 5% of respondent believe that the growth was declining and 15% of respondents shows it had slighter growth.

### 4.6 Factors hindering Nile Bank from profit maximization and effective performance

#### 4.6.1 Credit information

This indicates that loans have been extended without proper appraisal of borrowers credit worthiness. Respondent strongly agreed that appraisal takes sometime if the required information is not readily available like audited accounts. This may necessitate the use of auditors to audit the accounts on which the bank can base its assessment of the credit worthiness of borrowers. This can lead to delay in extension of the credit to the borrower.

#### 4.6.2 Self dealing

The research also revealed that an over extension of credit to shareholders or to their interest, while compromising sound principles under pressure from related parties.

#### 4.6.3 Anxiety over income

The situation whereby concern over earning outweighs the soundness of lending decisions, under scored by the hope that risk will not materialize or lead to loans with unsatisfactory repayment terms. The study revealed that this is frequent problem since a loan portfolio is usually a bank's key revenue producing assets.

#### 4.6.4Poor credit monitoring

The respondent whether the monitor the fund or loan they disburse. Whereby ineffective supervision invariably result in lack of knowledge about the borrowers affairs over the lifetime of the loan. Consequently, initially sound loans may develop problems and losses because of lack of effective monitoring.

### 4.7 Relationship between credit risk management and performance of commercial bank

Credit risk management lies at the heart of survival of many majority of banks. The credit risk management function is primarily focused on the loan portfolio, although the principle relating to determination of credit worthiness, apply equally to the assessment of counter parties who issues financial instruments. The study reveals that a poor credit risk management system lead to bank losses in terms of bad debts. This in turn result into the bank's ability to survive the stiff competition and may eventually undergo liquidation

## CHAPTER FIVE

## SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

### 5.0 Introduction

This chapter covers a summary of findings, conclusion and recommendations in line with the study objectives and research questions with specific reference to Nile bank.

### 5.1 Summary of major findings

The study was meant to establish the evaluation of credit risk management in relation to the performance of commercial bank in Uganda with the reference to the Nile Bank. Although credit risk management have been designed and put in action, some of the means are effective while others are ineffective because they do not ensure accurate and proper assessment and awarding of loans and recovery.

The study reveals that the following controls are effective, revision of credit risk policies annually, use of collateral as minimum criteria for the extension of credit to customers.

The respondent agree that default rates were low which leads to low levels of loans declared bad loans at the closure of each accounting year, despite the credit risk policies in place.

The study also revealed that credit risk management in commercial banks is fairly effective considering the result got from Nile bank therefore it should assist commercial banks to develop and implement new comprehensive credit risk policies.

### 5.2 Recommendations

The study came up with various recommendations and all stake holders of Nile Bank that for it to achieve its objectives and effective performance the following have to be done.
Customer credit evaluation. Bank should put in place procedures for granting credit, should set standards on which to appraise the potential clients who will be capable of

meeting their debt obligations when they fall due. Also keep a register in order to identify its potential customers with information about their sales turnover and any relevant data. The setting of credit terms should be so that the bank is competitive thus the terms should be set as near as possible to industrial average. So it should be convenient.

There should be need for diversification of its assets in order to spread the risk for various assets and the economic sectors to avoid failures in difficulties met in these sectors.

When adopting collateral security, the bank should ascertain the true value of this collateral, the legal and physical existence to check whether the said value is in order to be fully covered in case of default by their clients. The study tried to put forward these recommendations to encourage evolution of the systems of credit risk management that will achieve the management objectives of the bank.

**5.3 Conclusion**

The conclusion review of the study in chapter four showed that Nile bank has credit risk management in place. The clients are properly screened before extending credit, there is a limit on the amount given, reminder letters are sent, limit on period offered and legal procedures are instituted on defaulters.

**5.4 Areas for further research**

However, more studies should be carried out to understand other element which will affect bank performance. The study would be able to come up with better findings on performance of banks in Uganda and suggest ways that would reduce on closure of commercial bank. Other than credit risk management. The study has not looked at other crucial areas such as poor management high competition, technology, quality of staff which could also play a big role in hindering bank performance once they are not put into consideration.

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## APPENDICES

## APPENDIX 1

**KAMPALA INTERNATIONAL UNIVERSITY**

**CLIENT QUESTIONNAIRES**

Dear Respondents,

I am a student of Kampala International University conducting a study on credit risk management and performance of commercial banks. A case study of Nile bank, as part of the requirement for the award of degree of bachelor of Business administration of Kampala International University.

Your response will be treated confidentially and all information provided will be published only in a statistical operation your assistance will be highly appreciated.

**PART 1 GENERAL INFORMATION.**

NAME: ………………………………………………………………..

Sex

Male ☐ Female ☐

Age of respondents

(a) 20 – 30 years ☐ (c) 40 – 50 years ☐

(b) 30 – 40 years ☐ (d) Over 50 years ☐

Education level

(a) None ☐ (c) Secondary ☐

(b) primary ☐ (d) Tertiary ☐

Do you have an established loan with the Nile Bank?

(a) Yes ☐ (b) No ☐

Did you get any loan with Nile Bank?

(a) Yes ☐ (b) No ☐

If your answer is yes, what kind of loan?

Overdraft ☐

Long term loan ☐

Consumer loan ☐

Car loan ☐

Working capital loan ☐

If any other specify …………………………………………………………………………..

From with sector are you?

Agriculture ☐ Fishing ☐

Business ☐ Services ☐

**PART 2: CREDIT EVALUATION**

My character and integrity is considered when evaluating Me. for a given loan.

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

My capital initially contributed in my business is called for when I am getting a loan.

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

My capacity to repay the loan is considered by the bank when am getting the loan

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

My character and integrity is considered when evaluating me for a given loan

| Strongly agree | Agree | Strongly disagree | Uncertain |
|---|---|---|---|
| | | | |

The way I am evaluated encourages me to strive and repaying the loan

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

**PART 3: MAXIMUM AMOUNT OF LOAN**

Nile Bank has a maximum amount to which it can lend to specific groups of customers

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

Is there a maximum amount the bank can lend to you?

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

Are you satisfied with the size of the loan you get from Nile bank?

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

Are you satisfied with the pay back period?

(a) Yes ☐ (b) No ☐

**PART 4: INTEREST RATES CHARGED ON LOANS**

Nile bank charges high interest rates on loans given to clients

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

Are Nile bank interest rates charged by Nile bank uniform with other banks?

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

High interest rates affect the repayment of the loan

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

If interest rates on loan's are low, one can pay and take new loans.

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

**PART 5: PROCEDURES FOR COLLECTION DEFAULT LOANS**

Nile bank has procedures for collecting loans

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

Nile bank only collect principal amount on the loan

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

Nile bank collects both interest and principal on the loan

| Strongly agree | Agree | Strongly disagree | Disagree | Uncertain |
|---|---|---|---|---|
| | | | | |

Nile Bank credit risk management affects the loan repayment pattern

Yes ☐ No ☐

What should be done by the management of Nile bank about its credit in order to ensure effective payment of the loan?

**Thank you very much for your corporation.**

## Appendix II

**Questionnaire for management and staff**

Dear respondents

I am a student of Kampala International University conducting a research on "credit risk management and performance of commercial bank". A case study of Nile Bank as part of the requirement for this award of the degree of bachelor of business administration of Kampala International University.

Your response will be treated confidentially and all information will be published only in statistical operation.

Your assistance will be highly appreciated.

Department ...............................................

Position in the bank.....................................

Sex: Male ☐ Female ☐

Age of respondent: 20 – 30 ☐ 30 – 40 ☐ 40 – 50 ☐ Over 50 ☐

Number of years in the bank

Under 4 years ☐

4 years – 8 years ☐

Tick where appropriate

1) Is lending the main banking services offered by Nile Bank

   (i) Yes ☐ (ii) No ☐

2) If no, what are other services offered by Nile Bank?

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

3) Are commercial loans the most popular category of loans in Nile Bank?

   Yes ☐ No ☐

4) If no what are the other loans offered by the bank?

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

5) Do you use collateral as the main credit standard of Nile Bank

(i) Yes ☐ (ii) No ☐

List other standards used by the Nile Bank?

………………………………………………………………………………………………

6) How is the characteristic of clients looked at in order to give a clear picture of the loan applicant?

(i) Professional ☐

ii) Age and gender ☐

(iii) Society standing ☐

☐

Any other, specify………………………………………………………………………..

7) How do you determine the ability of applicant to pay back the loan?

Through financial statements ☐

Through references e.g. Bankers ☐

Any other, specify………………………………………………………………………

8) Is land the main security used by Nile Bank to secure the loan?

Yes ☐ No ☐

9) What efforts are designed to recover funds from clients in an optimal manner?

(i) Systematic reminders ☐

(ii) Insurance policy ☐

(iii) Litigation ☐

Any other, specify…………………………………………………………………………

10) How does Nile Bank collect its bad debts?

(i) Undertakes its own collection ☐

(ii) Appoint a collection agent ☐

Any other, specify………………………………………………………………………

11) What is the biggest composition of the loans in Nile Bank?

(i) Public enterprises ☐

(ii) Private business firms ☐

(iii) Politician ☐

(iv) Ordinary citizens ☐

Any other, specify……………………………………………………………………

12) What is the rate of loan default of Nile Bank by customers?

(i) Very high ☐ (ii) low ☐

(iii) High ☐ (iv) very low ☐

13) Does Nile bank manage to recover all bad loans?

Yes ☐ No ☐

14) Which of the following factors mainly accounts for high credit risk in the bank

Negligent loan assessment due to over reliance on collateral ☐

A weak legal frame which does not facilitate loan recovery ☐

Loan of appropriate loan classification and provision standard ☐

Unreliable valuation report by some professional firms ☐

15) What are the main sources of revenue of Nile bank?

Interest income ☐

Dividend income ☐

Fees and commission income ☐

Foreign exchange gains ☐

16) How has Nile Bank been performing for he lost 4 years?

Only profit ☐

Only losses ☐

Profit with losses ☐

17) What are the main operating expenses of Nile Bank?

Administration costs ☐

Bad and doubtful debt expenses ☐

Interest expenses ☐

Depreciation ☐

Any other, specify ......................................

18) Is there a relationship between credit risk management and performance of Nile bank? ...........................................................................................

19) What describes the profitability of Nile bank over 4 years?

Gradually improving ☐

Gradual reducing ☐

No pattern ☐

Any other, specify ....................................................

20) What trends do you think bad debt have been taking in the last 4 years in Nile bank?

Gradually Improving ☐

Gradually reducing ☐

No pattern ☐

Any other, specify……………………………………………………………

21) What areas of credit risk management in Nile bank do you believe need improvement?

(i) ……………………………………………………………………

(ii) ……………………………………………………………………

(iii) ……………………………………………………………………

(iv) ……………………………………………………………………

22) What are the limitations of profit maximization and effective repayment in commercial banks?…………………………………………………………………………………

…………………………………………………………………………………………………

**Thank you for cooperation**