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Credit risk management and loan recovery in micro finance institutions in Ishaka Bushenyi municipality: a case study of Kyamuhunga Sacco

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ABSTRACT

This study assessed the effect of credit management policies on loan recovery in microfinance institutions in Uganda, with a case study of Kyamuhunga Sacco in Ishaka Bushenyi Municipality. The study targeted top management, cashiers, loan officers, clients, and accountants. A combination of simple random and purposive sampling techniques was used to identify the study's sample size. Data collection methods included questionnaires, observations, and interviews. The collected data was edited, coded, entered into a computer, and analyzed using Microsoft Excel. The results were presented in tables for clarity. Based on the study's findings, 100% of respondents confirmed that Kyamuhunga Sacco applies various credit management policies, including credit terms that address both the length of the credit period and the discount rate, the loan amounts recommended by credit officers, and collateral security requirements. The study further revealed that the rate of loan recovery in microfinance institutions in Uganda is influenced by profitability ratios, efficiency ratios, outstanding loans, and the real annual average growth rate of loans. In line with the third objective, the respondents indicated that there is a significant relationship between credit management policies and loan recovery. Effective credit management policies provide the institution with reasonable and adequate returns on loans, and borrowers are typically granted smaller loan amounts to reduce risk. The researcher concluded that Kyamuhunga Sacco applies a variety of credit management policies, with the majority of respondents agreeing that credit terms include both the duration of the credit period and applicable discount rates, alongside a uniform interest rate. The study recommends that Kyamuhunga Sacco should consider redesigning its credit policy to make credit management more effective, thereby reducing loan losses and write-offs.

INTRODUCTION

The development of microcredit, or microloans, as a tool to alleviate poverty in impoverished nations, originated in Bangladesh during the 1970s [1]. Professor Muhammad Yunus, the founder of Grameen Bank and recipient of the 2006 Nobel Peace Prize, is largely credited with pioneering this movement [2]. Yunus envisioned a system where individuals, regardless of their financial status, could access loans, seeing this as a fundamental human right. His vision led to the establishment of Grameen Bank, which focused on providing small loans, particularly to women, to promote self-employment. Over the past two decades, Grameen Bank has loaned more than 6.5 million dollars, empowering the poorest populations, especially women. This initiative has significantly contributed to the global growth of microcredit and financial inclusion. Yunus's life and work are captured in his book Banker to the Poor, which has been translated into numerous languages, reaching a global audience [2]. In 1973, the need for financial services in low-income communities was further highlighted with the founding of ShoreBank, a community development bank in Chicago. ShoreBank aimed to meet the financial needs of low-income neighbourhoods, particularly African-American communities [3]. The bank's success in revitalizing Chicago's poor neighbourhoods led to international recognition and set a benchmark for financial sector development. This success inspired Bill Clinton, then Governor of Arkansas, to establish the Community Development Financial Institutions Act in 1994 [4]. In the 1980s, Shore Bank collaborated with Yunus to help establish Grameen Bank in Bangladesh, with a grant from the Ford Foundation [5].

Credit management policies (CMP) are key tools that financial institutions use to regulate credit sales and ensure profitability [6]. These policies help balance the risks and benefits of offering credit, especially in today's competitive economy. A well-defined credit management policy establishes a framework for the entire credit process, outlining objectives, standards, and procedures that guide loan officers and managers in loan disbursement and recovery [7]. Credit management policies also provide a basis for evaluating and improving the performance of credit systems, especially in loan recovery [8]. Effective credit policies help mitigate risks by setting clear procedures for evaluating loan applicants and monitoring their creditworthiness [9] Loan recovery is vital for the financial health of lending institutions. It enables institutions to clear their balance sheets, improve collection efforts, and prepare accurate financial reports [10]. Efficient loan recovery minimizes default risks, reduces operational costs, and ensures the effective recycling of financial resources [11]. However, poor credit management practices, such as inadequate information systems and administrative shortcomings, often lead to bad debts and financial losses [12]. Many microfinance institutions, including Kyamuhunga Sacco, face challenges in loan recovery, with increasing levels of nonperforming loans. Kyamuhunga Sacco's 2021 annual report identifies these issues as a result of inadequate credit management tools, which have contributed to rising loan defaults. The study seeks to examine the effect of credit management policies on loan recovery at Kyamuhunga Sacco in Ishaka Bushenyi Municipality. By investigating the challenges Kyamuhunga Sacco faces in loan recovery, the research aims to provide insights into how credit management policies can be improved to enhance the institution's performance and ensure its long-term sustainability. The purpose of this study is to assess the impact of credit risk management policies on loan recovery in microfinance institutions in Uganda, with Kyamuhunga Sacco serving as a case study.

METHODOLOGY

Research design

The study used a cross-sectional research design that utilized both qualitative and quantitative data analysis [13]. The design allowed accessing respondents from various sections of the population. Qualitative approach was used because it helps to view comprehensively and in detail the available data from the questionnaire.

Area of the study

The study was carried out in Kyamuhunga Sacco in Ishaka Bushenyi municipality Bushenyi district.

Study population

The population of the study consisted of the top management of the Kyamuhunga Sacco that is the manager, cashier, an accountant, loans officer, shareholder management, employees. Therefore, this constituted of 55 respondents as indicated by Krejcie and Morgan [14].

Study sample and sampling technique

The study consisted of 60 respondents representing the entire population of Kyamuhunga Sacco. This included 9 members of the top management that were the managers, one accountant, 3 cashiers, 4 loans officers and 44 clients. The researcher used purposive sampling to select the top management team that is manager, an accountant, cashiers and loans officers while simple random sampling technique was used to select clients. These methods were considered to be simple and easy to use cost effective and convenient to the researcher. The sample size was selected from the whole population which is as follows 1 cashier, 2 loans officers, 41 clients, 5 members of top management and 1 accountant totalling to 50 respondents.

Table 1: Population and Sample Size

Subject	Population	Sample
Top management	9	5
Cashiers	3	1
Loans officers	4	2
Clients	44	41
Accountant	1	1
Total	**61**	**50**

Data sources

There are two types of data that were used by the researcher during the study. These included both primary and secondary sources of data collection.

Primary data

It involved the researcher going into the field to get information related to the study from different respondents, primary data provided firsthand information that was needed by the researchers and terms will carefully be defined so as to avoid humanity possible misunderstandings.

Secondary Data

This type of data was obtained from already collected data from newspapers, reports, journals and magazines. This type of data was helpful in compiling large amounts of data. However, its liable to exaggeration by many scholars.

Data collection instruments/ methods

Data from the field was obtained by the use of interview guide questionnaire and observation.

Interview guide

Here the research set questionnaire from the interview guide. The researcher was adopted this method because it gave more elaboration on answers given and more information that was obtained from respondents. Oral interview was also conducted to collect more data to supplement data was obtained from the questionnaire and interview were mostly conducted to key respondent who were considered are more knowledgeable about the problem under study. This method was chosen because it procures high resource rate.

Questionnaire

The researcher set questions and answers of yes/no alternatives that was filled in by the respondents. The questions were designed in an open and close format short and straight forward method. Questionnaires were taken physically by the researcher to reduce costs and avoid non response. This method was preferred because it was more convenient to the respondent, cover a large area and population in a very short period of time. This meant the researcher increased the size of her population. The researcher made the sample larger, hence stand a chance of making and producing reliable results.

Observation

This relied on the researchers seeing, testing and smelling things and does not depend on getting information through someone else. The researcher to some point used observation method in collecting data. This was done through standing and watching how transactions were made between the staff and clients that are through banking and withdrawing of money by the clients of the institution. This method helped the researcher to get firsthand information.

Documentary

The information presented by the researcher was got from the internet, newspapers, magazines, from different scholars, books, and from the field.

Validity and Reliability of Instrument

Validity of Instrument

Validity of instruments refers to the extent to which an instrument is truly measuring what is intended to measure. Adequate measures was taken to ensure that the questionnaire fulfill content validity. To ensure that the instrument collects data as per its intention, the researcher distributed copies to experts including the supervisor and colleagues with more experience to rate the valid items in the questionnaire.

Reliability of the Instrument

Reliability refers to the degree to which an instrument consistently measures what it is supposed to measure. Therefore, before the instrument was used, a pilot study was conducted in a location different from the actual area of study. The results from the pre-test then were substituted with the final findings using Pearson's Correlation Coefficient formula.

Data processing

Data was collected by use of questionnaire and interview guide were processed through three stages.

Editing

This was done by scrutinizing the data at an earlier stage to detect errors omission and inconsistencies before data is tabulated and each individual schedule was checked in detail to certain whether it had been answered in full and accurately. Editing of data was done by filling the missing information gaps which helped to correct any error for the purpose of uniformity consistency completeness and accuracy.

Coding

This involved assigning and categorizing that data (answers) in codes to eliminate looping of facts.

Data analysis

After gathering all the information using the relevant research instruments data was arranged and put into different categories for easy interpretation. It was tabulated and be analyzed using tables, graphics and charts. Percentages were calculated which was a basis for drawing meaningful conclusions. The researcher first classified the collected data before presenting it in its final form. Classification is the process of relating the separate item within the mass of collected data. This was established the kind of relationship between dependent and independent variables.

The formula was used as it is below;

$$X^2 = \sum_{i=1}^{r}\sum_{j=1}^{c}\left[\frac{\left(O_{ij} - E_{ij}\right)^2}{E_{ij}}\right]$$

$X^2 =$ chi square

$i =$ Variation from 1 to r
$j =$ Variation from 1 to c
$O_{ij} =$ Observation frequency
$E_{ij} =$ Expected frequency

Expected frequency (f_e) was obtained using the formula;

$$E_{ij} = \frac{RowTotal - columnTotal}{GrandTotal}$$

This level of significance was determined between the two studied variables or interest at the end of the calculation.

Limitations of the study

False information from the respondents was an expected limitation. However, the researcher tried to convince respondents that the information needed is for academic purpose. The researcher speculated that some respondents are likely to refuse to give data because of being stubborn and they thought that the researcher was trying to spy on activities. However, the researcher tried to give through explanation about the purpose of carrying out the study. Lack of information from respondents who might not give relevant information as needed. However, the researcher spent more time because of reluctance of respondents in filling the questionnaire thus made the data collection so slow and difficult. The researcher created good communication skills to alert the respondents. The researcher faced financial problem. The research process required a lot of funds to cater for various items and activities like transport, stationery. However, the researcher ensured that enough funds were mobilized early enough.

RESULTS

Gender composition of the respondents

Table 2: Showing gender composition of respondents

Gender	Frequency	Percentage (%)
Male	41	82
Female	09	18
Total	**50**	**100**

As illustrated in table 1, the study found out that the majority of the respondents were male as compared to the female. The number of males who participated in the study was represented 41(82%) as compared to less number 09(18%) of the female respondents.

Age composition of respondents

Table 3: Age composition of the respondents

Age range	Frequency	Percentage (%)
Below 30	02	04
30 -40	15	30
40 – 50	23	46
51 & above	10	20
Total	**50**	**100**

The table above 2 shows that most of the respondents were between the ages of 40-50 accounting for 23(46%). This implied that were likely to understand better the impact of audit and fraud prevention. The other category of the respondents were in the age range of 30-40 as reported by 15(30%) of the study respondents and these respondents' views were very important for the study as most of them were participating in the determining the impact of auditing and fraud prevention in Bushenyi district. More, 10(20%) of the study respondents were in the category age of 51 & above while 02(04%) of the respondent were below 30 years as these were of the least in number.

Marital status of the respondents

Table 4: Showing marital status of the respondents

Marital status	Frequency	Percentage (%)
Married	29	58
Single	19	38
Separated/divorced	00	00
Widowed	02	04
Total	**50**	**100**

As seen in the table 3 above, majority of the study respondents constituting 29(58%) were married and these were followed by respondents who were single as reported by 19(38%) of the respondents finally 02(04%) were widowed as none of the study respondents reported to fall under the category of Separated/divorced.

Level of education of respondents

Table 5: Showing level of education of the respondents

Level of education	Frequency	Percentage (%)
Certificate	05	10
Diploma	26	52
Degree	11	22
Masters	08	16
Total	**50**	**100**

The table 4 above shows that most of the respondents had diploma as their level of education with 26(52%), followed by 11(22%) of the study respondents who had degree, then 8(16%) of the respondents had masters, finally 05(10%) of the respondents who cited that had certificate.

The credit management policies applied by Kyamuhunga Sacco Ishaka Bushenyi municipality

The study objective one was set to find out the credit management policies applied by Kyamuhunga Sacco Ishaka Bushenyi municipality. According to the study findings, all (100%) of the respondents were able to understand the credit management policies were applied d as none of the study respondents was able to reveal of not understanding the same study variable.

Table 6: Credit management policies applied by Kyamuhunga Sacco Ishaka Bushenyi municipality

Credit management policies applied	Yes	No	Frequency	Percentage (%)
Credit terms involve both the length of credit period and discount rate given	40(80%)	10(20%)	50	100
The loan amount recommended by credit and repayment	23(46%)	27(54%)	50	100
Offering uniform interest rate for the credit offer	17(34%)	33(66%)	50	100
Collateral security for covering rations	21(42%)	29(58%)	50	100
Borrowers remain excluded from formal bank loan	50(100%)	00(00%)	50	100

As illustrated in table 5, the researcher sought to know the Credit management policies applied due to credit terms involve both the length of credit period and discount rate given. This was answered by the respondents views, as indicated in the table 4.6 above as 40(80%) were in agreement as compared to the least of number of the study respondents cited by 10(20%) who were in a disagreement. Results from respondents' views also indicated 27(54%) of the respondents disagreed with the statement and 23(46%) responses of agreement of which male respondents indicated as the majority.

The rate of loan recovery in micro finance institutions

Table 7: Showing the rate of loan recovery in micro finance institutions

Rate of loan recovery in micro finance institutions	Number of Respondents	**Percentage%**
Profitability ratio	4	8
Efficiency ratios	2	4
Total balance of outstanding loans average outstanding	3	6
Real annual average growth rate of loans	6	12
Productivity and efficiency ratios	2	4
Provision of conducive loans for productive consumption and emergency	3	6
Aid from the government	30	60
Total	**50**	**100**

According to table 6 above, the rate of loan recovery and this accounted for 4(8%) of the number of respondents. Respondents are in agreement that profitability ratio measures on micro finance institutions net income in relation to the structure of its balance sheet. Respondents further agreed that this helps investors and managers determine whether they are earning an adequate return on funds invested in the microfinance institutions. Other respondents who were interviewed by the researcher noted efficiency ratios also shows rate of loan recovery in micro finance institutions and this accounted for 2 (4%) of the total respondents.

Basing on the study findings, it was also revealed that total balance of outstanding loans average outstanding determines the rate of loan recovery and this was accounted by 3(6%) of the total respondents. Respondents agreed that efficiency ratios measure the cost of providing loans to generate revenue; these are referred to as operating costs and should include neither financing costs nor loan loss provisions. 6(12%) of the total respondents reported that real annual average growth rate of loans also show the rate of loan recovery in Saccos. Respondent agreed that the outreach indicators include; number of active borrowers, total balance of outstanding loans average outstanding, real annual average growth rate of loans outstanding during the past years loan size, average minimum and maximum, average disbursed loan size, average outstanding raters, average loan term, nominal interest rates, effective annual interest rates, value of loans per staff member and number of loans per staff member

2(4%) of the total respondents reported that productivity and efficiency ratios shows the rate of loan recovery. While 3(6%) of the total respondents interviewed revealed that provision of conducive loans for productive consumption and emergency acts as means to show the rate of loan recovery. Respondents agree that outreach indicators include; number of active borrowers, total balance of outstanding loans average outstanding, real annual average growth rate of loans outstanding during the past years loan size, average minimum and maximum, average disbursed loan size, average outstanding raters, average loan term, nominal interest rates, effective annual interest rates, value of loans per staff member and number of loans per staff member.

Relationship between customers credit management policy and loan recovery

Table 8: Showing the relationship between credit management policy and loan recovery

Relationship between credit management policy and loan recovery	Frequency	Percentage (%)
Good credit management provide the institution with a reasonable and adequate return on loans	10	28
Credit standards are criteria for selecting customers for credit	10	24
Borrowers are given small amount of money it will not be sufficient for business operations	07	14
Institution may have tight credit standards that it may extend loan to the most reliance and financially strong customers	05	16
Credit manager should check on the amount the customer is demanding	07	14
Collection efforts determine the actual collection period of the loan	02	04
Credit standards are methods for selecting its customers for loan	4	08
Organization extends credit to only the strongest customers	2	04
Credit managers and loan officers should check on the amount demanded by the customers whether it is too much or little	3	6
Total	**50**	**100**

The findings in table 7 shows that of the respondents covered by the study majority good credit management provide the institution with a reasonable and adequate return on loans as one of relationship between credit management policy and loan recover accounting to 10 (28%) of the study respondents. 12(24%) of the number of respondents mentioned Credit standards are criteria for selecting customers for credit. Furthermore, 07(14%) of the respondents revealed that borrowers are given small amount of money and not sufficient for business operations. The credit manager should check on the amount the customer is demanding for, whether it is too much or little.

The study findings also showed 07(14%) of the study respondents each who agreed that Fraud policies should be reviewed.

The study findings also showed 7(14%) of the number of respondents revealed that Credit manager should check on the amount the customer is demanding. Other 05 (16%) of the number of respondents revealed that Institution may have tight credit standards that it may extend loan to the most reliance and financially strong customers. Other respondents mentioned that credit manager should check on the amount the customer is demanding. The finding further revealed that 2(04%) of the total respondents mentioned collection efforts determine the actual collection period of the loan. Respondents were in agreement Pandy (1992) Who revealed that collection efforts determine the actual collection period of the loan. He further reported that MFIs get only normal interest rate to customers but incurs like penalties on default, transports, time and meetings. Respondents further agreed that mandatory savings that may eventually fail the customer to pay at the end of the period given for the loan. Lastly, 2(4%) of the respondents revealed that Credit managers and loan officers should check on the amount demanded by the customers whether it is too much or little is related to relationship between credit management policy and loan recovery. Respondents agreed that credit managers and loan officers should check on the amount demanded by the customers whether it is too much or little. The chartered institute of bankers, lending text advises lending organizations on the amount to be given to the borrower.

DISCUSSION

Basing on objective one; the study showed that the credit management policies applied by Kyamuhunga Sacco include; credit terms involve both the length of credit period and discount rate given, the loan amount recommended by credit and repayment, offering uniform interest rate for the credit offer, collateral security for covering rations, borrowers remain excluded from formal bank loan. These study findings can be compared with the Abuka et al., [15] including the amount to evidence the credit the terms of the credit refer to the decisions relating to loan size, security on loan, loan minimizing balance and cost of credit. The loan amount recommended by credit and repayment in women's scale enterprises must be not be too little to satisfy the projects needs to borrowers. **Basing on objective two,** the study findings indicated that rate of loan recovery in micro finance institutions. These include profitability ratio, efficiency ratios, total balance of outstanding loans, average outstanding, real annual average growth rate of loans, aid from the government, provision of conducive loans for productive consumption and emergency, productivity and efficiency ratios. This was in agreement with respondents who explained that profitability ratio measures on micro finance institutions net income in relation to the structure of its balance sheet. Respondents further agreed that this helps investors and managers determine whether they are earning an adequate return on funds invested in the microfinance institutions. Productivity and efficiency ratios provide the information about the rate at which micro finance institutions generate revenue to cover their expenses. Productivity ratio focuses on the productivity officers because they are primary generators of revenue [16] **Basing on objective three;** The study findings indicated that there is a relationship between credit management policy and loan recovery as none of the study respondents was able to disagree with the same statement. The study on further findings established the Relationship between credit management policy and loan recovery as good credit management provide the institution with a reasonable and adequate return on loans, credit standards are criteria for selecting customers for credit, borrowers are given small amount of money it will not be sufficient for business operations, credit managers and loan officers should check on the amount demanded by the customers whether it is too much or little, credit manager should check on the amount the customer is demanding, collection efforts determine the actual collection period of the loan, credit standards are methods for selecting its customers for loan, organization extends credit to only the strongest customers, institution may have tight credit standards that it may extend loan to the most reliance and financially strong customers. The findings were in agreement with agreement with [17] who revealed that Good credit management provide the institution with a reasonable and adequate return on loans and capital employed primarily through improvement in operations efficiency this generates adequate internal resources to finance the institution's growth.

CONCLUSION

The findings concluded that credit management policies were applied by Kyamuhunga Sacco include; credit terms involve both the length of credit period and discount rate given, the loan amount recommended by credit and repayment, offering uniform interest rate for the credit offer, collateral security for covering rations, borrowers remain excluded from formal bank loan. In addition, it is concluded by showing the rate of loan recovery in micro finance institutions. These include profitability ratio, efficiency ratios, total balance of outstanding loans average outstanding, real annual average growth rate of loans, aid from the government, provision of conducive loans for productive consumption and emergency, productivity and efficiency ratios. Lastly, the study concludes revealing the relationship between credit management policy and loan recovery as good credit management provide the institution with a reasonable and adequate return on loans, credit standards are criteria for selecting customers for credit, borrowers are given small amount of money it will not be sufficient for business operations, credit managers and loan officers should check on the amount demanded by the customers whether it is too much or little, credit manager should check on the amount the customer is demanding, collection efforts determine the actual collection period of the loan, credit standards are methods for selecting its customers for loan, organization extends credit to only the strongest customers, institution may have tight credit standards that it may extend loan to the most reliance and financially strong customers.

Recommendations

In line with the above study findings and conclusions, the following recommendations are made as under;

Taking into consideration the study findings, the following recommendations were established to improve on the level of loan recovery in Kyamuhunga Sacco Ishaka Bushenyi municipality:

It's recommended that Lyamujungu Sacco should redesign its credit policy so as to make credit management more effective to reduce on loan losses and write offs.

In order to enhance loan recovery and reduce loan default, Kyamuhunga Sacco municipality should devise means of motivation and facilitation of the staff because the respondents cited uncommitted management, unsequenced and unqualified staff as problems that can be linked with ineffective credit management and this consequently affects the level of loan recovery.

To address the problem of loan default due to inadequate documentation of customers the bank should ensure constant training of the staff and ensuring that the lending procedures are properly documented and understood by every credit officer.

The researcher also recommends that Kyamuhunga Sacco should give incentives to their customers like cash discounts to customers who pay back the loan in time, this will encourage customers to pay back loans promptly and reduce loan default and bad debts.

The institution should also consider regular monitoring and supervision and analysis of financial statements of the clients. Follow ups should be made at least once a month to identify problem loans in time and offer necessary advise to borrowers on how best to change deteriorating loans into good and repayable loans.

To make clients appreciate the credit policies and recovery procedures. Kyamuhunga Sacco has to educate the clients and also listen to their grievances. Education background was found out to have an impact on the client's understanding of policies and recovery procedures.

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