**CREDIT RISK MANAGEMENT AND PROFITABILITY OF COMMERCIAL BANKS IN UGANDA**

**A CASE STUDY OF BARCLAYS BANK, KITORO BRANCH, ENTEBBE**

**BY**

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# DECLARATION

I **BIIBI JULIUS** declare that this dissertation under the topic “the role of credit risk management on profitability of commercial banks in Uganda, focusing on a case study of Barclays Bank Uganda, Kitooro Branch Entebbe” is my original work and has never been presented for any university or institution of higher learning and where the works of others have been used due acknowledgement has been done.

Signature: ………………… Date: ……………………………

Biibi Julius

# APPROVAL

This dissertation titled credit risk management and profitability of commercial banks in Uganda; a case of Barclays Bank, Kitooro branch was under my supervision and has been submitted for examination with my approval.

Signature: ………………………

Mr. Owino Joshua (Supervisor)

Date:…………………………….

# DEDICATION

I dedicate this dissertation to my dear family and friends who have supported me throughout my academics.

# ACKNOWLEDGEMENTS

I would like to extend my sincere thanks to God Almighty that has kept and sustained me throughout my stay at the University. Heartfelt appreciation goes to my family and all my friends for the support, advice and encouragement.

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# TABLE OF CONTENTS

[**DECLARATION i**](#_Toc14432532)

[**APPROVAL ii**](#_Toc14432533)

[**DEDICATION iii**](#_Toc14432534)

[**ACKNOWLEDGEMENTS iv**](#_Toc14432535)

[TABLE OF CONTENTS v](#_Toc14432536)

[LIST OF FIGURES xii](#_Toc14432537)

[LIST OF TABLES xiii](#_Toc14432538)

[ABSTRACT xv](#_Toc14432539)

[**CHAPTER ONE 1**](#_Toc14432540)

[**INTRODUCTION 1**](#_Toc14432541)

[Background to the study 1](#_Toc14432542)

[Statement of the problem 7](#_Toc14432543)

[Purpose of the study 8](#_Toc14432544)

[Research objectives 8](#_Toc14432545)

[Research questions 8](#_Toc14432546)

[Scope of the study 9](#_Toc14432547)

[Content scope 9](#_Toc14432548)

[Geographical scope 9](#_Toc14432549)

[Time scope 9](#_Toc14432550)

[Hypotheses of the study 10](#_Toc14432551)

[Significance of the study 10](#_Toc14432552)

[Arrangement of the study 11](#_Toc14432553)

[**CHAPTER TWO 13**](#_Toc14432554)

[**STUDY LITERATURE 13**](#_Toc14432555)

[Introduction 13](#_Toc14432556)

[Literature survey 13](#_Toc14432557)

[Literature review 16](#_Toc14432558)

[Theoretical review 16](#_Toc14432559)

[Loan pricing theory 17](#_Toc14432560)

[Firm characteristics theories 17](#_Toc14432561)

[CAMELS 18](#_Toc14432562)

[Credit market theory 19](#_Toc14432563)

[Transactions costs theory 19](#_Toc14432564)

[The relationship between credit risk management and profitability 20](#_Toc14432565)

[Credit monitoring 24](#_Toc14432566)

[Debt collection 27](#_Toc14432567)

[Credit risk governance practices 29](#_Toc14432568)

[Conceptual framework 31](#_Toc14432569)

[**CHAPTER THREE 33**](#_Toc14432571)

[**METHODOLOGY 33**](#_Toc14432572)

[Introduction 33](#_Toc14432573)

[Research design 33](#_Toc14432574)

[Research approach 33](#_Toc14432575)

[Research strategy 34](#_Toc14432576)

[Research duration 34](#_Toc14432577)

[Research classification 34](#_Toc14432578)

[Study Population 35](#_Toc14432579)

[Sample size and selection method 35](#_Toc14432580)

[Background information of respondents 37](#_Toc14432582)

[Gender of respondents 37](#_Toc14432583)

[Age group of respondents 37](#_Toc14432585)

[Number of years served in Barclays Bank 38](#_Toc14432587)

[Level of education attained 39](#_Toc14432589)

[Sampling method 40](#_Toc14432591)

[Data collection sources 41](#_Toc14432592)

[Data collection procedure 41](#_Toc14432593)

[Data collection methods 41](#_Toc14432594)

[Interview 42](#_Toc14432595)

[Survey method 42](#_Toc14432596)

[Document review 42](#_Toc14432597)

[Data collection instruments 43](#_Toc14432598)

[Validity of the instruments 44](#_Toc14432599)

[Reliability of the instrument 44](#_Toc14432600)

[Data processing 45](#_Toc14432601)

[Data analysis 45](#_Toc14432602)

[Limitations of the study 45](#_Toc14432603)

[Ethical issues 45](#_Toc14432604)

[**CHAPTER FOUR 47**](#_Toc14432605)

[**CREDIT MONITORING AND RETURN ON ASSETS 47**](#_Toc14432606)

[Introduction 47](#_Toc14432607)

[Barclays bank ensures monitoring of all loaned credit 48](#_Toc14432608)

[Barclays offers loans on basis of institution’s policy 49](#_Toc14432610)

[Unit increase in credit monitoring increases on return on assets 50](#_Toc14432612)

[The bank has a clear system of tracking non-performing loans 51](#_Toc14432614)

[Credit advanced to clients is effectively monitored in terms of repayment 53](#_Toc14432616)

[Customers always make timely payments as per credit terms 54](#_Toc14432618)

[Credit monitoring ensures credit default is low 55](#_Toc14432620)

[Effective debt collection reduces on effects of non-performing loans 56](#_Toc14432622)

[Barclays bank has effective screening process of debtors 58](#_Toc14432624)

[Bank has credit policies that improve prudential oversight of asset quality 59](#_Toc14432626)

[**CHAPTER FIVE 61**](#_Toc14432628)

[**DEBT COLLECTION AND LOAN RECOVERY 61**](#_Toc14432629)

[Introduction 61](#_Toc14432630)

[Barclays bank ensures effective debt collection 62](#_Toc14432631)

[Effective debt collection reduces on bad debts 63](#_Toc14432633)

[Barclays bank has experienced debt collection officers 64](#_Toc14432635)

[Credit officers ensure to perform credit appraisal on clients 65](#_Toc14432637)

[The credit appraisal methods are effective 67](#_Toc14432639)

[Amount of non-performing loans is reduced 68](#_Toc14432641)

[Debt collection is done in line with credit policy 69](#_Toc14432643)

[Debt collection takes in regard the credit worthiness of a client 70](#_Toc14432645)

[Debt collection reduces capital locked with debtors 71](#_Toc14432647)

[**CHAPTER SIX 73**](#_Toc14432649)

[**CREDIT RISK GOVERNANCE AND LIQUIDITY 73**](#_Toc14432650)

[Introduction 73](#_Toc14432651)

[Credit risk governance is implements under credit policy 74](#_Toc14432652)

[Credit risk governance processes enhances profitability 75](#_Toc14432654)

[Credit and field officers have relevant training on credit management 76](#_Toc14432656)

[Customers comply with stipulated credit period given 78](#_Toc14432658)

[Credit governance ensure charged interest rates fetch enough profits 79](#_Toc14432660)

[Credit risk governance ensures effective monitoring of debtors 80](#_Toc14432662)

[Failure to pay back loan affects bank’s profitability 81](#_Toc14432664)

[Customers provide sufficient collateral to cover offered loans 82](#_Toc14432666)

[Hypothesis testing 84](#_Toc14432668)

[Regression analysis 84](#_Toc14432669)

[**CHAPTER SEVEN 87**](#_Toc14432673)

[**TOWARDS HARMONISING CREDIT RISK MANAGEMENT AND PROFITABILITY 87**](#_Toc14432674)

[Introduction 87](#_Toc14432675)

[Credit monitoring and return on assets 87](#_Toc14432676)

[Debt collection and loan recovery 90](#_Toc14432677)

[Credit risk governance and improved liquidity 94](#_Toc14432678)

[**CHAPTER EIGHT 97**](#_Toc14432679)

[**SUMMARY, CONCLUSIONS AND RECOMMENDATIONS 97**](#_Toc14432680)

[Introduction 97](#_Toc14432681)

[Summary of the findings 97](#_Toc14432682)

[Credit monitoring and return on assets 97](#_Toc14432683)

[Debt collection and loan recovery 98](#_Toc14432684)

[Credit risk governance and liquidity 98](#_Toc14432685)

[Conclusion 99](#_Toc14432686)

[Recommendations 100](#_Toc14432687)

[Areas of further studies 101](#_Toc14432688)

[**REFERENCES 102**](#_Toc14432689)

[APPENDIX A: SELF ADMINISTRED QUESTIONAIRE 107](#_Toc14432690)

[APPENDIX B: INTERVIEW GUIDE 113](#_Toc14432691)

# LIST OF FIGURES

[Figure 2.1: Conceptual framework 31](#_Toc8134477)

# LIST OF TABLES

[Table 3.2: Gender 37](#_Toc14432584)

[Table 3.3: Age group 38](#_Toc14432586)

[Table 3.4: Number of years served in Barclays Bank 38](#_Toc14432588)

[Table 3.5: Level of education attained 39](#_Toc14432590)

[Table 4.1: Barclays ensures monitoring of all loaned credit 48](#_Toc14432609)

[Table 4.2: Barclays offers loans on basis of institution’s policy 49](#_Toc14432611)

[Table 4.3: Unit increase in credit monitoring increases on return on assets 51](#_Toc14432613)

[Table 4.4: The bank has a clear system of tracking non-performing loans 52](#_Toc14432615)

[Table 4.5: Credit advanced to clients is effectively monitored in terms of repayment 53](#_Toc14432617)

[Table 4.6: Customers always make timely payments as per credit terms 54](#_Toc14432619)

[Table 4.7: Credit monitoring insures credit default is low 55](#_Toc14432621)

[Table 4.8: Effective debt collection reduces on effects of non-performing loans 57](#_Toc14432623)

[Table 4.9: Barclays bank has effective screening process of debtors 58](#_Toc14432625)

[Table 4.10: Bank has credit policies that improve prudential oversight of asset quality 59](#_Toc14432627)

[Table 5.1: Barclays ensures effective debt collection 62](#_Toc14432632)

[Table 5.2: Effective debt collection reduces on bad debts 63](#_Toc14432634)

[Table 5.3: Barclays has experienced debt collection officers 64](#_Toc14432636)

[Table 5.4: Credit officers ensure to perform credit appraisal on clients 66](#_Toc14432638)

[Table 5.4: The credit appraisal methods are effective 67](#_Toc14432640)

[Table 5.6: Amount of non-performing loans is reduced 68](#_Toc14432642)

[Table 5.7: Debt collection is done in line with credit policy 69](#_Toc14432644)

[Table 5.8: Debt collection takes in regard the credit worthiness of a client 71](#_Toc14432646)

[Table 5.9: Debt collection reduces capital locked with debtors 72](#_Toc14432648)

[Table 6.1: Credit risk governance is implemented under credit policy 74](#_Toc14432653)

[Table 6.2: Credit risk governance processes enhances profitability 75](#_Toc14432655)

[Table 6.3: Credit and field officers have relevant training on credit management 77](#_Toc14432657)

[Table 6.4: Customers comply with stipulated credit period given 78](#_Toc14432659)

[Table 6.5: Credit governance ensures charged interest rates fetch enough profits 79](#_Toc14432661)

[Table 6.6: Credit risk governance ensures effective monitoring of debtors 81](#_Toc14432663)

[Table 6.7: Failure to pay back loan affects bank’s profitability 82](#_Toc14432665)

[Table 6.8: Customers provide sufficient collateral to cover offered loans 83](#_Toc14432667)

[Table 6.9: Regression Analysis Model Summary 84](#_Toc14432670)

[Table 6.12: ANOVAa 85](#_Toc14432671)

[Table 6.11: Coefficientsa 86](#_Toc14432672)

# ABSTRACT

The study examined the role of credit risk management on profitability in Uganda basing on a case of Barclays Bank Uganda. It was guided by three objectives i) to examine how credit monitoring enhances return on assets in Barclays Bank Uganda, ii) to assess how debt collection have enhanced loan recovery in Barclays Bank Uganda and iii) to examine how credit risk governance have ensured improved liquidity in Barclays Bank Uganda.

The study adopted a cross sectional survey design divided in section of research approach, research strategy, research duration and the research classification. The study used a sample size of 57 respondents. It is also shown that the Adjusted R square is .243 which is an indication that 24.3% of the changes that do occur in profitability is due to changes in credit risk management. The test also revealed that Barclays bank’s credit management has a positive relationship with profitability and as such the null hypothesis was rejected. In conclusion, the study notes that Interest rates charged had a negative effect on the performance of the loans, the higher the interest rates the lower the loan performance and that the involvement of credit officers and customers in formulating credit terms affects Barclays bank loan performance. In recommendation, the study suggested that there is need for Barclays bank to enhance their credit risk monitoring techniques so as to improve profitability. In addition, the study recommends that credit risk identification should not be a one off thing as some risks could be hard to detect or overlooked by those tasked to identify them.

# CHAPTER ONE

# INTRODUCTION

# Background to the study

The study examines about the role of credit risk management on profitability of commercial banks in Uganda. It focused on a case study of Barclays Bank Uganda, Kitooro Branch, Entebbe

The study about credit risk management in financial institutions, particularly commercial banks has become more important not only because of the financial crisis that the world is experiencing currently, but also as a crucial concept which determines banks’ survival, growth and profitability. Banks today are the largest financial institutions around the world, with branches and subsidiaries throughout everyone’s life. However, commercial banks are facing risks when they are operating. Credit risk is one of the most significant risks that banks face, considering that granting credit is one of the main sources of income in commercial banks. Therefore, the management of the risk related to that credit affects the profitability of the banks. The aim of the research is to provide stakeholders with accurate information regarding the credit risk management of commercial banks with its impact on profitability.

According to Bikker et.al, (2005) credit risk management is defined as the process that a bank puts in place to control its financial exposures. The process of risk management comprises the fundamental steps of risk identification, risk analysis and assessment, risk audit monitoring, and risk treatment or control. Furthermore, it is stated that financial institutions are exposed to a variety of risks which include interest rate risk, foreign exchange risk, political risk, market risk, liquidity risk, operational risk and credit risk (Yusuf, 2003). In some instances, commercial banks and other financial institutions have approved decisions that are not vetted in that there have been cases of loan defaults and nonperforming loans, massive extension of credit and directed lending.

On the other hand, profitability shows how efficiently management can make profit by using all the resources available in the market (Aduda, 2011). Profitability is the relationship of income to some balance sheet measure which indicates the relative ability to earn income on assets. Irrespective of the fact that profitability is an important aspect of business, it may be faced with some weakness such window dressing of the financial transactions and the use of different accounting principles.

Kargi, (2011) explains that commercial banks are important to economic development through the financial services they provide. Their intermediation role can be said to be a catalyst for economic growth. The efficient and effective performance of the banking industry over time is an index of financial stability in any nation. Therefore, the extent to which a bank extends credit to the public for productive activities accelerates the pace of a nation’s economic growth and its long-term sustainability. Further, credit extension enhances the ability of investors to exploit desired profitable ventures and is an avenue through which banks create credit. However, this exposes banks to credit risk which in turn could eventually lead to a financial crisis.

Credit risk is the possibility that the actual return on an investment or loan extended will deviate from that, which was expected (Conford, 2000). Coyle (2000) defines credit risk as losses from the refusal or inability of credit customers to pay what is owed in full and on time. The main sources of credit risk include, limited institutional capacity, inappropriate credit policies, volatile interest rates, poor management, inappropriate laws, low capital and liquidity levels, directed lending, massive licensing of banks, poor loan underwriting, reckless lending, poor credit assessment., no non-executive directors, poor loan underwriting, poor lending practices, government interference and inadequate supervision by the central bank. To minimize these risks, it is necessary for the financial system to have; well-capitalized banks, service to a wide range of customers, sharing of information about borrowers, stabilization of interest rates, reduction in non-performing loans, increased bank deposits and increased credit extended to borrowers.

Kithinji (2010) notes that every financial institution bears a degree of risk when the institution lends to business and consumers and hence experiences some loan losses when certain borrowers fail to repay their loans as agreed. Principally, the credit risk of a bank is the possibility of loss arising from non-repayment of interest and the principle, or both, or non-realization of securities on the loans (Kithinji, 2010). Credit extended to borrowers may be at the risk of default such that whereas banks extend credit on the understanding that borrowers will repay their loans, some borrowers usually default and as a result, banks income decrease due to the need to provision for the loans. Where commercial banks do not have an indication of what proportion of their borrowers will default, earnings will vary thus exposing the banks to an additional risk of variability of their profits.

In addition, Hull (2007) states that the adequate management of credit risk in financial institutions is critical for the survival and growth of financial institutions. In the case of rural banks, the issue of credit risk is of greater concern because of the higher levels of perceived risk resulting from some of the characteristics of clients and business conditions that they find themselves in. Credit risk management is a structured approach to managing uncertainties through risk assessment, development of strategies to manage it and mitigation of risk using managerial resources. The strategies include transferring to another party, avoiding the risk, reducing the negative effects of the risk, and accepting some or all of the consequences of a particular risk.

Padmanabham (2008) suggest that credit risk management is a predictor of bank`s performance. For instance non-performing loans, an indicator of credit risk can reduce the value of a bank and destabilizes the credit system. As and Agu (1998) put it loan default reduces the resources base of a bank for further lending, weakens staff moral and affects the borrower’s confidence. The cost of managing overdue loans tends to be very high and this can reduce banks profitability levels. In some cases the cost on unpaid loans are shifted to other customers or borrowers in the form of high interest margin charged on loans.

The management of credit risk of credit portfolios is therefore one the most important tasks for the financial liquidity and stability of banking sector in connection with increased sensitivity of banks to the credit risks and changes in the development of prices of financial instruments (Kego, 2013). The most significant impact on performance of the enterprise has just financial risk. The unsystematic risks have a higher impact on performance of the enterprise as systematic risks.

The determination of each individual loan, or borrower, risk assessment techniques plays a primary role in the management and minimization of the credit risk. It is only after determining the risk represented by each individual borrower and by each individual credit service that one can begin to manage the loan portfolio as a whole. The credit risk assessment of the borrower consists in the study and evaluation of the qualitative and quantitative indicators of the economic situation of the borrower (Korobova, 2010).

According to Adengo (2015), Barclays Bank of Uganda Limited, commonly known as Barclays Bank Uganda Limited, is a [commercial bank](https://en.wikipedia.org/wiki/Commercial_bank) in [Uganda](https://en.wikipedia.org/wiki/Uganda). It is licensed by the [Bank of Uganda](https://en.wikipedia.org/wiki/Bank_of_Uganda), the [central bank](https://en.wikipedia.org/wiki/Central_bank) and national banking regulator. The bank opened in 1927, with two branches in the capital city, [Kampala](https://en.wikipedia.org/wiki/Kampala), and one in [Jinja](https://en.wikipedia.org/wiki/Jinja%2C_Uganda), the country's second-largest commercial centre. In 1969, the bank acquired the Ugandan business of the [Commercial Bank of Africa](https://en.wikipedia.org/wiki/Commercial_Bank_of_Africa_Group). In February 2007, the bank completed its acquisition of [Nile Bank Uganda Limited](https://en.wikipedia.org/wiki/Nile_Bank_Limited), strengthening its presence in the country. The bank is primarily involved in meeting the banking needs of individuals, [small and medium-sized businesses](https://en.wikipedia.org/wiki/Small_and_medium-sized_businesses) (SMEs), and large corporations. Before 2006, the bank focused on meeting the banking needs of only large corporations and high-net-worth individuals. That focus was loosened to include SMEs and regular customers. As of December 2017, the bank's total assets were valued at UGX: 2.477 trillion (approximately US$668 million), with shareholders’ equity of UGX: 448.2 billion (approximately US$121 million). At that time, Barclays Uganda was the fifth-largest commercial bank, by assets.

According to BoU (2011), banking institution in Uganda has the largest assets in the loan portfolio and the major source of revenue. This means, credit risk remain the largest source of risk in Uganda’s banking institutions, hence, commercial banks are most likely to make a loss. When the commercial banks have higher credit risk, the greater credit premiums to be charged by the banks. So, it leads to an improvement in the net interest margin (Hanweck and Ryu, 2004). Even so, trading activities of banks are increasing; it means that the bank is exposed to market risk, the risk of loss from adverse movements in financial market rates and prices.

According to Financial report of Barclays Bank (2001) Barclays Bank has the following the policy implementation objectives of credit risk management;

1. To ensure effective credit monitoring for loaned funds
2. To improve on debt collection to reduce on non-performing loans
3. To implement governance practices of credit risk
4. To ensure emphasise credit appraisal on clients
5. To improve on credit vetting

The study therefore based on three objectives from the list above to examine whether Barclays Bank, Kitooro Branch is achieving the set objectives

# Statement of the problem

The financial sector operates in a dynamic competitive environment and as such institutions continually reinvent themselves for survival. Therefore, the success of any commercial bank is to a large extent dependent on the effectiveness of their credit risk management systems because these institutions generate most of their income from interest earned on loans extended to various persons and organisations.

Lule (2015) observed that due to competition from other financial institutions and mobile service providers, banks in Uganda have loosened their rules and the regulations which have made it possible for loan approval in haste without proper assessment of the borrower.

According to BoU (2015) monthly economic review report, the value of gross non-performing loans (NPLs) at Barclays Bank increased by 32.7% from shillings 81.4 billion in November 2016 to shillings 108.0 billion in November 2017. Correspondingly, the ratio of gross loans increased from 5.1% in November 2016 to 5.5% in November 2017. The report further indicate the quality of the bank’s loan book measured by the ratio of the net non-performing loans to gross loans deteriorated from 2.3% in November 2016 to 2.7% in November 2017. This could be attributed to loop holes in credit risk management.

It is based upon this evidence that the study intends to establish the role of credit risk management on profitability of Barclays Bank, KITORO.

# Purpose of the study

The purpose of the study was to examine the role of credit risk management on profitability of commercial banks in Uganda. It based on a case study of Barclays Bank Uganda, Kitooro Branch, Entebbe.

# Research objectives

The study was guided by the following research objectives:

1. To examine how credit monitoring enhances return on assets in Barclays Bank Uganda.
2. To assess how debt collection have enhanced loan recovery in Barclays Bank Uganda.
3. To examine how credit risk governance have ensured improved liquidity in Barclays Bank Uganda.

# Research questions

The study was guided by the following research questions:

1. How has credit monitoring enhanced return on assets in Barclays Bank Uganda?
2. How has debt collection enhanced loan recovery in Barclays Bank Uganda?
3. How has credit risk governance ensured improved liquidity in Barclays Bank Uganda?

# Scope of the study

# Content scope

The study focused on credit risk management as the independent variable and profitability as the dependent variable. Credit risk management was e discussed in terms of its elements of credit monitoring, debt collection practices and credit risk governance practices while the dependent variable was discussed in terms of return on assets, loan recovery and improved liquidity.

# Geographical scope

The study was carried out in Barclays Bank Uganda, Kitooro Branch in Entebbe, it is located near Pearl supermarket.

# Time scope

The study mainly explored data from three operational years of Barclays Bank, Uganda from 2015-2018. The researcher believed this was enough scope to gather the most relevant and reliable information about the study, this is also the time when the commercial bank faced problems in credit risk management.

# Hypotheses of the study

H0: There is no significant relationship between credit risk management and profitability in Barclays Bank Uganda.

H1: There is a significant relationship between credit risk management and profitability in Barclays Bank Uganda.

# Significance of the study

The study findings may benefit various stakeholders in the following ways:

**To management of Barclays Bank Uganda:** This study is expected to provide information to management about the role and impact of credit risk management in the success of the bank. This may enable the commercial bank’s management to not only understand the aspect but also appreciate the importance of implementing proper credit risk management in attainment of the institution’s objectives and be able to succeed. It may inform policies towards setting up of proper risk control systems, and show how these can be used as a powerful management tool to improve the way the bank and its stakeholders can achieve greater profitability.

**To other commercial banks:** This study intends to provide relevant information to commercial banks in Uganda in understanding how credit risk management can be effectively implemented in ensuring improved profitability and achievement of overall institutional objectives.

**To future academicians:** This study intends to contribute to the body of knowledge, the findings of which can be used as a reference material by future researchers and also a basis for further research.

# Arrangement of the study

The study is arranged into eight chapters and presented below

**Chapter one**

This chapter presents the introduction of the study, background of the study, purpose of the study, objectives of the study, research questions, the significance of the study, and the arrangement of the study

**Chapter two**

This chapter presents the study literature and it is made up of the literature review and conceptual framework.

**Chapter three**

This chapter contains the research methodology that was used to accomplish the research undertaking outlined above. It presented research design and data collection tools and techniques.

**Chapter four**

This chapter focuses on examining how credit monitoring enhances return on assets in Barclays Bank Uganda.

**Chapter five**

This chapter presents how debt collection has enhanced loan recovery in Barclays Bank Uganda

**Chapter six**

This chapter presents findings on examining how credit risk governance has ensured improved liquidity in Barclays Bank Uganda.

**Chapter seven**

This chapter harmonises credit risk management and profitability in Barclays Bank.

**Chapter eight**

This chapter presents the summary of findings, conclusions and recommendations.

# CHAPTER TWO

# STUDY LITERATURE

# Introduction

This chapter is presented in three key sections. Section one deals with the literature survey which is concerned with local studies that have been conducted in the same area. Section two deals with literature review and models in line with the study objectives and Section three presents the conceptual framework.

# Literature survey

This section presents the various studies carried out in Uganda in the field of this study with the view to identify gaps of the existing studies which this study will attempt to close. There is no single study done on credit risk management and profitability in Barclays Bank.

Owusu (2012) carried out a study about credit risk management and profitability of selected rural banks in Uganda. His study used financial statements from 10 selected commercial banks for a period of 5 years. The study revealed that there is a significant positive relationship between non-performing loans and rural banks’ profitability revealing that, there are higher loan losses but banks still earn profit. This indicates that, rural banks do not have sound and effective credit risk management practices. In Furthermore, the study theoretically revealed that non-performing loans reduce the profit levels of rural banks but in situation where non-performing loans are increasing proportionately to profitability, then it means that rural banks do not have effective institutional measures to deal with credit risk management. What the banks do is that they shift the cost on loan default to other customers in the form of higher interest rate on loans. The study also indicated that higher interest margin charged on loan by rural banks due to weak credit risk management practices prevent microenterprises from accessing loans. Such a situation prevents business expansion and rural industrialization which are essential for poverty reduction. However, despite the study findings, his study failed to mention how credit monitoring enhances return on assets on banks profitability. It is the aim of this current study therefore to fill the identified gap by providing relevant literature.

Another study was conducted by Atidi (2012), about the effects of credit risk management practices on profitability of listed commercial banks at Kampala Securities Exchange in Uganda. His study was guided by three research objectives namely i) to examine how credit appraisal has ensured improved loan recovery, ii) to assess how credit vetting has enhanced improved liquidity, iii) to examine how implementation of collection policy has ensured increased profitability. The study revealed that the adequate management of credit risk in financial institutions is critical for the survival and growth of financial institutions. In the case of banks at Kampala Securities Exchange in Uganda, the issue of credit risk is of greater concern because of the higher levels of perceived risk resulting from some of the characteristics of clients and business conditions that they find themselves in. Credit risk management is a structured approach to managing uncertainties through risk assessment, development of strategies to manage it and mitigation of risk using managerial resources. The strategies include transferring to another party, avoiding the risk, reducing the negative effects of the risk, and accepting some or all of the consequences of a particular risk. His study also indicated that one of the basic formation of every organization, most importantly a banker is to understand the portfolio of risk it faced currently and the risk it plans to take in future. It was also opined that risks facing all financial institutions can be segmented into three separate types from a management perspective. However, his study did not mention the relationship between debt collection practices and loan recovery in financial institutions and this current study intends to fill this gap by providing relevant literature.

Furthermore, Fabiola (2016) carried out a study about credit risk management and financial profitability of banks in Uganda, focusing on a case study of Exim Bank and findings showed that every financial institution bears a degree of risk when the institution lends to business and consumers and hence experiences some loan losses when certain borrowers fail to repay their loans as agreed. Principally, the credit risk of a bank is the possibility of loss arising from non-repayment of interest and the principle, or both, or non-realization of securities on the loans. In addition, results indicated the coverage ratio, capital adequacy ratio, and bank size have a positive impact on bank performance. On the other hand, leverage ratio, non-performing loan ratio and female board member are found to have a negative impact on bank performance. However, liquidity ratio, asset quality, and cash reserve ratio turned out to be not significant variables in determining bank’s performance. The study recommended an effective credit risk management for commercial banks of Uganda based that maintains an optimum level of capital adequacy ratio, controls and monitors non-performing loan, enhances coverage ratio, balances leverage ratio, motivates female board members, and increases bank size to enhance financial performance. However, his study did not discuss whether credit risk governance practices in a financial institution can improve liquidity; it is the aim of this current study therefore to fill the identified gap.

# Literature review

# Theoretical review

Previous literature has shown that there exists information asymmetry in assessing commercial banks lending applications (Binks et al 1997). Information asymmetry describes the condition in which relevant information is not known to all parties involved in an undertaking (Ekumah et al 2003).

Studies on transaction costs have shown that transaction costs occur “when a good or a service is transferred across a technologically separable interface”. Therefore transaction costs arise every time a product or service is being transferred from one stage to another, where new sets of technological capabilities are needed to make the product or service. Therefore, it may very well be more economical to maintain the activity in-house, so that the company will not use resources on example contacts with suppliers, meetings and supervision. Managers must therefore weigh the internal transaction costs against the external transaction costs, before the company decides whether or not to keep some activity in-house.

# Loan pricing theory

Banks cannot always set high interest rates. Banks should consider the problems of adverse selection and moral hazard since it is very difficult to forecast the borrower type at the start of the banking relationship. If banks set interest rates too high, they may induce adverse selection problems because high-risk borrowers are willing to accept these high rates. Once these borrowers receive the loans, they may develop moral hazard behavior or so called borrower moral hazard since they are likely to take on highly risky projects or investments (Chodecai, 2004). From the reasoning of Stiglitz and Weiss, specify that in some cases we may not find that the interest rate set by banks is commensurate with the risk of the borrowers.

# Firm characteristics theories

Ziane (2008) asserts that theories predict that the number of borrowing relationships will be decreasing for small, high-quality, informational opaque and constraint firms, all other things been equal. Hamisu (2011), states that the most obvious characteristics of failed banks is not poor operating efficiency, however, but an increased volume of non-performing loans. Non-performing loans in failed banks have typically been associated with regional macroeconomic problems. Superior mangers not only run their banks in a most efficient fashion, and thus generate large profits relative to their peers, but also impose better loan underwriting and monitoring standards than their peers which result in better credit quality.

# CAMELS

According to Hirtle et.al (1999) the acronym “CAMEL” refers to the five components of a bank’s condition that are assessed: Capital adequacy, Asset quality, Management, Earnings, and Liquidity. A sixth component, a bank’s Sensitivity to market risk was added in 1997; hence the acronym was changed to CAMELS. Ratings are assigned for each component in addition to the overall rating of a bank’s financial condition. The ratings are assigned on a scale from 1 to 5. Banks with ratings of 1 or 2 are considered to present few, if any, supervisory concerns, while banks with ratings of 3, 4, or 5 present moderate to extreme degrees of supervisory concern.

Gilbert (1998) explains that during an on-site bank exam, supervisors gather private information, such as details on problem loans, with which to evaluate a bank’s financial condition and to monitor its compliance with laws and regulatory policies. A key product of such an exam is a supervisory rating of the bank’s overall condition, commonly referred to as a CAMELS rating. This rating system is used by the three federal banking supervisors (the Federal Reserve, the FDIC, and the OCC) and other financial supervisory agencies to provide a convenient summary of bank conditions at the time of an exam.

Another approach to examining the value of private supervisory information is to examine its impact on the market prices of bank securities. Market prices are generally assumed to incorporate all available public information. Thus, if private supervisory information were found to affect market prices, it must also be of value to the public monitoring of banks (Cole, et.al 1998).

Such private information could be especially useful to financial market participants, given the informational asymmetries in the commercial banking industry. Since banks fund projects not readily financed in public capital markets, outside monitors should find it difficult to completely assess banks’ financial conditions. In fact, Morgan (1998) finds that rating agencies disagree more about banks than about other types of firms. As a result, supervisors with direct access to private bank information could generate additional information useful to the financial markets, at least by certifying that a bank’s financial condition is accurately reported.

# Credit market theory

A model of the neoclassical credit market postulates that the terms of credits clear the market. If collateral and other restrictions (covenants) remain constant, the interest rate is the only price mechanism. With an increasing demand for credit and a given customer supply, the interest rate rises, and vice versa. It is thus believed that the higher the failure risks of the borrower, the higher the interest premium (Ewert, 2000).

# Transactions costs theory

First developed by Schwartz (1974), this theory conjectures that suppliers may have an advantage over traditional lenders in checking the real financial situation or the credit worthiness of their clients. Suppliers also have a better ability to monitor and force repayment of the credit. All these superiorities may give suppliers a cost advantage when compared with micro finance institutions. Three sources of cost advantage were classified by Petersen and Rajan (1997) as follows: information acquisition, controlling the buyer and salvaging value from existing assets. The first source of cost advantage can be explained by the fact that sellers can get information about buyers faster and at lower cost because it is obtained in the normal course of business. That is, the frequency and the amount of the buyer’s orders give suppliers an idea of the client’s situation; the buyer’s rejection of discounts for early payment may serve to alert the supplier of a weakening in the credit-worthiness of the buyer, and sellers usually visit customers more often than micro finance institutions do.

# The relationship between credit risk management and profitability

Banks raise finances through collecting deposits from businesses and other institutions, households, and the government on the one hand and provide loans to households, businesses and other institutions, and the government through several different types of arrangements. Therefore, the crucial assets of banks are loans and bonds whilst major liabilities are customer deposits. In accordance with Saunders et.al (2005), balance sheet of a bank has loans representing the bulk amount of a bank’s assets; nevertheless, these loans come with risk. Where the bank makes bad loans to customers, the bank will be in serious problems if those loans are not repaid. Credit management is therefore concerned with rewards and risks that have to be objective through cautious and careful risk management, failure of which may possibly bring about legal action, economic loss or harm the banks’ name.

According to BOU report (2005), the assessment of the risk factors attending the granting of a particular loan and their comprehensive and systematic analysis in Uganda enables the bank to take several factors into account in credit risk management and to prevent their recurrent and adverse impact on the results of the bank’s future activities. This is in support of (Rodina et al., 2013) argument who mentioned that the methods used to quantify credit risk are accompanied by a special transparency requirement, including a quantitative assessment of the methods’ accuracy and a statistical method property known as robustness. This therefore means that the transparency of the credit risk methodology presents an opportunity to view a given phenomenon not only as a whole but also in detail.

According to Margaritis, (2010), it is observed that in order to mitigate risk and to avoid financial and economic difficulties, risk management is very important and is essential for long-term success of banks. The effective management of credit risk not only enhances profitability and viability of banks but contributes to the systemic stability and efficient allocation of capital in the economy. This is very important to banks as it is an integral part of the banks’ loan process.

Baesens (2009) states that, the financial system of a nation holds critical importance on banks’ credit risk and its management. A strong credit risk management will avoid significant drawbacks and increase banks financial performance. Good financial performance rewards shareholders for their investments. This will then encourage additional investment and bring economic growth. In contrast, poor banking performance can lead to banking failure and crisis which may have a negative consequence on economic growth.

Fatemi et.al (2006) asserts that bank credit is the borrowing facility made available to an individual by the bank in the form of a credit or a loan. The fundamental expectation of the financial system is that when funds are loaned out, there should be reasonable anticipation of refund of the loans, plus interest. Credit risk comes up from uncertainty in a given counterparty to meet up with the obligation of honoring the terms and conditions of the credit arrangement. It is the risk of loss originated by a debtor’s failure to pay a loan or line of credit. In essence, credit risk arises from uncertainty in counterparty’s ability or willingness to meet its contractual obligations. Another scholar, Rene (2000) also included a decline in the credit standing of counterparty as part of credit risk.

In the same vein, Naomi (2011) argued that credit risk represents the potential variation in the net income from non-payment or delayed payment of credit facility granted to customers. The Global Risk Management Group 1999 in its report conceded that credit risk is the possibility that bank borrower will fail to meet obligation in accordance with the agreed terms. It added that, the effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization. Lending involves the creation and management of risk assets, and it is an important task of bank management.

Modern risk management is the management procedure devised to eliminate or minimize the adverse effects of possible financial loss by identifying all the potential sources of loss, measuring the financial consequences of a loss occurring, and using controls to minimize actual losses or their financial consequences (Irukwu, 2008). Accordingly, the most important topic in the business world today is the management and control of risk. Every day, we learn about big-, small-, and medium-sized companies that have collapsed or gone into liquidation, because their management ignored the risks to which the organization was exposed due to the absence of an efficient risk management system.

The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization. A major function of commercial banks is to deal in the credit market; they perform this function by mobilizing funds from surplus economic units and channeling the same to deficit units for productive activities. This implies that, commercial banks grant loans to customers from the public’s funds with the overall object of increasing profitability resulting from earnings. Now, because profitability is a function of earnings resulting from viable loans and advances, it follows that banks ought to effectively manage its credit risks in order to protect and enhance profitability.

Yusoff et.al (2009), notes that the largest sources of credit risk for financial institutions throughout the activities of the bank are loans. In a nutshell, financial institutions are increasingly facing credit risk in various financial instrument loans, including acceptance, trade financing, foreign exchange transactions and. In order to compensate the risk that occurred in their business cycle, the banks should aware in identifying of measurement, monitored and controlled credit risk as well as inadequate capital against risk. Bikker and Bos (2005) found that commercial banks are most likely to make a loss due to credit risk. Generally, the greater the credit risk, the higher the credit premiums to be charged by banks and its lead to improve net interest margin.

# Credit monitoring

Shroff (2014) asserts that alternative financial information sources and monitoring mechanisms are also prevalent, but the extent to which these alternatives serve as substitutes for financial reporting is unclear. For example, tax returns are an important source of financial information which firms are required to produce annually for the IRS. However, prior research has been unable to directly examine how or when tax returns mediate the usefulness of financial statements. Whereas tax returns are natural substitutes for financial statements because of overlapping information, recent findings suggest tax reports can complement financial statements because of the implicit monitoring role of the IRS.

Berger (2006) points out that interim financial statements and collateral are positively correlated; the inference that banks use interim financial statements to monitor collateral could be incorrect because the positive relation could be driven by an omitted variable. In particular, borrowers with some unobservable characteristic could be more likely to both provide frequent financial reports and offer collateral. To mitigate this omitted variable concern.

In addition, Botosan et.al (2011) explains that the availability of substitute information from tax returns is related to a bank’s requests for financial statements. A common refrain among standard setters and academics is that financial statements are less beneficial for monitoring privately held firms because banks have access to alternative data sources, such as tax returns which report income statement and balance sheet related items

Hanlon (2014) asserts that when a bank requests a tax return, the propensity for the bank to request a financial statement is 9% lower. Cross-sectional tests reveal this negative relation is more (less) prevalent when firms have significant intangible assets (assets in place) suggesting that financial reports are particularly useful or less costly to produce vis-à-vis tax returns when a firm has physical assets. the propensity for a bank to request both financial statements and tax returns is increasing when information asymmetry between the bank and borrower is most salient: when the bank-borrower relationship is shorter, when the amount of non-financial information the bank collects is higher, or when the borrower has a middle-tier credit risk. Thus, while tax returns are generally substitute sources of financial information, they play an important complementary role to financial statements in monitoring borrowers when information problems are particularly severe.

There is certainly nothing more important to DMBs than the credit they grant to their teeming customers for it constitutes the largest single income-generating asset in their portfolios. This explains why banks spend enormous resources in estimating, monitoring and managing credit quality. Thus, when banks grant loans, they expect the customers to repay the principal and interesting accordance with agreed repayment terms. However, when credits go bad, it can be fatal to the banks; which often lead to bank distress and failure.

Ryan (2016) notes that in the Nigerian context, similar incidences of banking crises occurred in the 1990s and 2000s. Prominent among them are the incidences of the former Intercontinental Bank Nigeria Plc and Oceanic Bank International Plc. They crumbled on the back of irrecoverable credit questions. Executive management was reckless with investors’ funds, neglected due processes, took biased decisions and gave out huge loans without collateral. The increasing level of non-performing loan rates in banks, poor loan processing, capital adequacy ratio, loan loss provision, undue interference in the loan granting process, inadequate or absence of loan collaterals among others are associated with poor and ineffective credit risk management which ultimately pose negative impact on their performance.

Similarly, non-performing loan poses a great threat to the success of a bank and also reduces their profit channels. Loan loss provision is also another credit risk management technique which reduces funds that should be channeled to viable investment which ultimately affects their performance and survival. Moreover, inefficient credit management poses a great danger to the liquidity position of a bank, as it affects the amount of cash balances, bank balances and treasury bills representing short-term cash management which ensures the day-to-day running of the bank (Weber, 2012).

# Debt collection

The debt collection industry has changed significantly over the past ten years. The impact of technology on debt collection practices; industry consolidation, regulatory developments and increased government usage of debt collection services have moved the debt collection environment towards professionalism and specialisation in service delivery.

An effective debt collection strategy starts with a clearly thought out credit policy and credit management tools to enforce this policy. Success comes from the overall performance of the whole credit value chain. The collection function within financial organizations can make the difference between a good performance for the business and an excellent performance. By making use of opportunities to make the collection processes strategically effective, operationally efficient and customer orientated, an organization can expect the collection function to add significant value to the business (Benveniste, 2002).

The debt collection process can be defined as a legitimate and necessary business activity where creditors and collectors are able to take reasonable steps to secure payment from consumers who are legally bound to pay or to repay money they owe (Kitua,2002).Once a loan or credit agreement has been granted and paid out to a consumer, the next phase of the credit provider's tasks will start. The credit agreement has to be actively managed over its life cycle as payment dates on which the consumer should pay fall due. As a result of various reasons, the payment of agreements does not always occur as anticipated, and some of the payments may become overdue (Benveniste, 2002).

However, recently many borrowers have defaulted by failing to meet the contractual obligations set out in the loan agreements many of which include clauses allowing the microfinance institutions to adjust interest rates with or without notice to the borrower. Risk management is a practice by which a firm optimizes the manner in which it takes financial risk. It includes monitoring of risk taking activities, upholding relevant policies and procedures, and distributing risk-related reports. For the Microfinance institution, transactions involving credit risk are a key source of earnings, in line with its business strategy. In addition to assessments of individual credit risk assets, including loans, the Commercial banksconducts comprehensive risk management from the perspective of its overall credit risk portfolio. In this way, the Commercial banksseeks to generate earnings commensurate with its level of credit risk.

According to Janson (2002), the services offered by investment microfinance institutions play an important role in the development of Kenya's economy and general infrastructure. This development has been achieved through lending to prospective customers in private investments, as well as those in the corporate sector. However, funds acquired from customer deposits the main source of lending funds have long since become a commodity, bought and sold for the highest possible profit by micro finance institutions. These institutions review their loan agreements in a manner which has worried investors, which sometimes have no option but to raise capital by borrowing from microfinance institutions in the form of mortgages. Small-scale borrowers usually repay the loans with income from employment and the net effect to the lenders is an increase in profit margins.

# Credit risk governance practices

Credit risk is the risk of loss due to debtor’s non-payment of the principal or interest on a loan or a specific line of credit. Credit risk of banks is recognized as a key feature of the liquidity panic in the US financial system and the global financial crisis of 2008. This risk has been attributed to poor governance practices, although very few studies have actually tried to measure the impact of governance on credit risk for financial firms directly. An extensive literature has emerged focusing on the effects of corporate governance on shareholders, and the conflicts of interest between managers and shareholders, following the agency model of Jensen and Meckling

Credit risk is the risk of loss due to debtor’s non-payment of the principal or interest on a loan or a specific line of credit. Credit risk of banks is recognized as a key feature of the liquidity panic in the US financial system and the global financial crisis of 2008.1 This risk has been attributed to poor governance practices, although very few studies have actually tried to measure the impact of governance on credit risk for financial firms directly. An extensive literature has emerged focusing on the effects of corporate governance on shareholders, and the conflicts of interest between managers and shareholders, following the agency model of Jensen and Meckling

Currently, two main approaches to modeling default probability are used as benchmarks in the literature: reduced-form credit models and structural credit models. The reduced-form approach does not provide an explicit link between default and the structure of the firm. As such, it is of little use in establishing the role of governance variables or other variables internal to the firm on credit risk (Duffie and Singleton, 1999).

Corporate governance mechanisms that protect the interests of shareholders may not necessarily benefit creditors. On the one hand, as Myers (1977) shows, the debt overhang problem could induce underinvestment, particularly in cases of financial distress. Firms near financial distress may not be able to exploit promising valuable projects, which will lower their expected future cash flows. This represents an indirect cost of debt. On the other hand, when firm is highly levered, the risk shifting problem exists (Jensen and Meckling (1976)). Firms have incentives to take excess risky investment to increase both the mean and the variance of future cash flows. As a consequence, their creditors bear higher default risk, while shareholders benefit if the project is successful (i.e. levered equity’s payoff is convex in cash flows).

# Conceptual framework

**Independent variable** **Dependent variable**

**Profitability**

* Return on assets
* Loan recovery
* Improved liquidity

**Credit risk management**

* Credit monitoring
* Debt collection practices
* Credit risk governance practices
* Credit appraisal
* Credit rating
* Credit policy
* Compliance with lending procedures
* Business environment

 Intervening variable

# Figure 2.1: Conceptual framework

**Source: Adopted from Chodecai (2004) model and modified by the researcher**

The conceptual framework reflects two variables namely credit risk management as the independent variable and profitability of commercial banks as the dependent variable. In other words, it’s conceptualized that profitability of commercial banks depends on credit risk management. In this study, the indicators of credit risk management include credit monitoring, debt collection practices and credit risk governance practices can lead to a direct impact on profitability by affecting performance indicators such as loan recovery, return on assets and liquidity. However, despite the relationship between the independent variable and dependent variable, other intervening variables exist and can affect both variable outcomes. For example, effective credit monitoring in credit risk management can lead to improved loan recovery in bank’s profitability; however, an intervening variable such as banks credit policy can affect customer’s creditability hence can interfering as a blockage to affect this change. All the above elements of the independent variable were assessed and their relationship with profitability of commercial banks.

# CHAPTER THREE

# METHODOLOGY

# Introduction

This chapter presents the research methodology that was used to accomplish the research undertaking. Methodology refers to the detailed procedures used to realize the objectives of the study (Asmin 2005). Methodology includes the clarification of the research design, sampling techniques, instruments as well as the data analysis procedures. Research is a systematic and purposive investigation of events or phenomena or development with respect to their origin, nature, causes and effects or possible future implications.

# Research design

According to Mugenda and Mugenda (2003) a research design is the basic plan which guides the data collection and analysis phase of the research project. The research design consisted of research approach, research strategy, research duration and research classification. The study also adopted a cross sectional research design.

# Research approach

In the research approach the researcher posed a phenomenological approach where researcher directly asks questions to the respondents. This research approach allowed the interviewer to probe the richness of respondent’s emotions and motivations of related to the topic. The research approach is important because it can be used to test the validity of the research hypothesis

# Research strategy

The study used a case study as the research strategy and for purposes of this study it is Barclays Bank Uganda, Kitooro Branch. The researcher asked broad questions and collecting data from respondents to find out the role of credit risk management on profitability of Barclays Bank. The case study strategy was used to analyse persons, events, decisions and policies in credit risk management and profitability. Amin (2005) explains that a case study allows the researcher to have an in-depth understanding of the subject being studied.

# Research duration

The study mainly explored data from a time period of three operational years that is from 2015 up to 2018 because this is the time when Barclays Bank was more exposed to credit risk management problems.

# Research classification

The study used quantitative research which is generally associated with the positivist paradigm. It involved collecting and converting data into numerical form hence use of statistical calculations where conclusions will be drawn. In order to predict possible relationship between the variables, the study used various instruments such as self-administered questionnaire and interview guide form.

# Study Population

According to Koffi (2002) study population is the totality of respondents from which the sample size is derived. The study population comprised of 67 individuals. These included management team, assets and liability officers, compliance officers, field officers, audit, customer advisory and information technology department. These were mainly chosen because they are expected to have enough knowledge relevant in understanding the credit policy at Barclays Bank since their responsibilities and roles reflect directly to financial aspects of the bank.

# Sample size and selection method

The researcher used judgmental sampling selecting respondents deemed knowledgeable and positioned to provide policy issues on the study. Rapport was developed with respondents to build confidence in that the study is intended for good purpose as to fulfill the objective of the study.

The study used the Yamane formula of sampling because the target population from which the sample size is to be determined is more that 5% of the study population hence the study will use the Yamane (1967:886) formula of sample determination. In addition, Coffi (2002) observes that in many cases, a researcher is un-able to cover the entire population, in which case he/she takes part of the population known as a sample. He further expounds that the researcher is forced to sample in order to save money, time and other resources.

The sample size was determined using the following formula by Yamane (1967:886).

n = N

**Where**

n = Sample size

N= Population size

e = margin of error at 95% confidence level

e = Margin of error/0.05

 1 + N (e2)

n= 67

 1 + 67 (0.052)

n= 67

 1 + 67 (0.0025)

n= 57

# Table 3.1: Population and sample size distribution

|  |  |  |  |
| --- | --- | --- | --- |
| **Respondents**  | **Population**  | **Sample size** | **Sampling method** |
| Management | 3 | 3 | Census  |
| Credit officers | 9 | 8 | Simple random sampling |
| Risk management team | 15 | 13 | Simple random sampling |
| Assets and liability officers | 8 | 8 | Census  |
| Compliance officers | 11 | 9 | Purposive sampling |
| Field officers | 10 | 10  | Census |
| Audit | 3 | 2 | Purposive sampling |
| Customer advisors | 4 | 2 | Purposive sampling |
| IT department | 4 | 2 | Purposive sampling |
| **Total**  | **67** | **57** |  |

**Source: Primary data (2019)**

# Background information of respondents

In this section, respondents were asked to provide their background information and their responses are presented in tables.

# Gender of respondents

Respondents were asked to identify their gender category. Responses to the question are shown in table 3.2

|  |
| --- |
| Table 3.2: Gender |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Male | 27 | 47.4 | 47.4 | 47.4 |
| Female | 30 | 52.6 | 52.6 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in Table 3.2, results indicate that majority of the respondents were females, represented by 52.6% and minority males represented by 47.4%. This can be interpreted to mean that both male and female were well represented in this study and thus the finding of the study did not suffer from gender bias.

# Age group of respondents

Respondents were asked to identify their age groups. Responses to the question are shown in table 3.3

|  |
| --- |
| Table 3.3: Age group |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | 20-30 | 12 | 21.1 | 21.1 | 21.1 |
| 31-40 | 21 | 36.8 | 36.8 | 57.9 |
| 41-50 | 18 | 31.6 | 31.6 | 89.5 |
| Above 50 years | 6 | 10.5 | 10.5 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

Results in Table 3.3 indicate that 36.8% were aged between 31-40 years and 31.6% were aged between 41-50 years. This can be interpreted to mean that this is the most active age group used in bank to implement effective credit management policy. 21.1% were aged between 20-30 years while 10.5% were aged above 50 years. This is an indication that respondents were well represented in terms of age.

# Number of years served in Barclays Bank

Respondents were asked to identify how long (in years) they had served in the bank. Responses are shown in table 3.4

|  |
| --- |
| Table 3.4: Number of years served in Barclays Bank |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Less than a year | 5 | 8.8 | 8.8 | 8.8 |
| 1-4 years | 17 | 29.8 | 29.8 | 38.6 |
| 5-7 years | 24 | 42.1 | 42.1 | 80.7 |
| 8 years and above | 11 | 19.3 | 19.3 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

Results in Table 3.4 indicate that majority of the respondents 42.1% had served for a period between 5-7 years, 29.8% had served for a period of 1-4 years. Since this is the majority it can be interpreted to mean that respondents had served for a recognizable number of years to have knowledge about credit risk management in the bank and as such provide relevant and reliable information.

# Level of education attained

Respondents were asked to identify their levels of education. Responses to the question are shown in table 3.5

|  |
| --- |
| Table 3.5: Level of education attained |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | PhD | 6 | 10.5 | 10.5 | 10.5 |
| Masters | 19 | 33.3 | 33.3 | 43.9 |
| Bachelor | 26 | 45.6 | 45.6 | 89.5 |
| Diploma | 5 | 8.8 | 8.8 | 98.2 |
| UACE | 1 | 1.8 | 1.8 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

Results in Table 3.5 indicate that majority of respondents that is 45.6% had bachelors; this was followed by 33.3% who had masters. Since this was the majority it can be interpreted to mean that majority of the respondents had university bachelor as their highest level of education. It also means that they have enough knowledge about credit management and how it can influence profitability. Given that all respondents had minimum of UACE, it follows that they could read and understand the questions in the questionnaires and hence provided valid responses.

# Sampling method

According to McCabe (2005), sampling methods are important in identifying the population of interest. In this study, the following are the sampling methods that were used in the study.

Purposive sampling: This method is used to select respondents from credit officers, compliance officers, audit, customer advisors and I.T department. This method is important because it is dictated by the nature of the study which aims at getting information from specific respondents.

Convenience sampling was also used by the researcher for convenience purposes just in case the selected staffs are not available at the time of the interview.

Simple random sampling was also used respondents from risk management team and credit officers. This method is important because it gives respondents equal chances of participating in the study and as such eliminating elements of bias.

Census and stratified sampling was used in organising the units in the population into strata using common characteristics. In this way the different characteristics of the population was represented.

# Data collection sources

According to Weiner, (1995), data collection is a standout amongst the most essential stages in carrying on a research. It helps in figuring out what sort of data is needed

**Primary data**

Primary data was collected through interviews and questionnaires in order to save time. The questionnaires were self-administered by the respondents.

**Secondary data**

Secondary data was collected through document reviews and other sources such as textbooks, business reports/ manuals, journals so as to get enough relevant information about the research topic.

# Data collection procedure

In order to collect required data from Barclays Bank, the researcher obtained an introductory letter from the Dean of School of Business Administration of Nkumba University. The letter was delivered to the branch manager of Barclays Bank in Kitooro to seek permission to conduct the research in their institution and permission was granted.

# Data collection methods

Primary data was collected through self-administered questionnaires interviewing method in order to save time. Secondary data was collected through documentary review.

# Interview

Andrea (2014) states that interview method of data collection is a verbal conversation between two people with the objective of collecting relevant information for the purpose of research. Therefore, the purpose of the research interview is to explore the views, experiences, beliefs and/or motivations of individuals on specific matters that are particularly appropriate for exploring sensitive topics, where participants may not want to talk about such issues in a group environment.

# Survey method

Groves (1989) defines this method as a field of applied [statistics](https://en.wikipedia.org/wiki/Statistics) of [human research surveys](https://en.wikipedia.org/wiki/Survey_%28human_research%29), and surveymethodology studies involve the [sampling](https://en.wikipedia.org/wiki/Sample_%28statistics%29) of individual units from a [population](https://en.wikipedia.org/wiki/Population_%28statistics%29) and the associated [survey data collection](https://en.wikipedia.org/wiki/Survey_data_collection) techniques, such as [questionnaire construction](https://en.wikipedia.org/wiki/Questionnaire_construction) and methods for improving the number and accuracy of responses to surveys. Survey method was used because it saves time.

# Document review

According to Brent (1997), document review involves systematic datacollection from existing records. This method was used to gather information about the study variables that is credit risk management and profitability. The study used document checklist as part of the method, this method was used because a lot of information can be reviewed to provide the most reliable and relevant information.

# Data collection instruments

The study mainly used self-administered questionnaires and interview guide to collect data from respondents

**Self-administered questionnaires (SAQs)**

The study used self-administered questionnaires (Appendix A) to collect data from the primary respondents. The self-administered questionnaires contained questions on variables like personal profile, credit risk management and profitability. The instrument was administered to valid respondents. The questionnaire comprised of statements requiring the respondents to opt for one out of the five opinions using the 5-point Likert scale with strongly disagree=1, disagree=2, not sure=3, agree=4 and strongly agree=5.

Saunders et al (2003), points out that the questionnaire collects a lot of data in a short period of time from scattered respondents and it allows the respondents time consult their records where necessary and enables busy respondents to fill at their convenience.

**Interview guide**

Andrea (2014) states that, an interview is a verbal conversation between two or more people with the objective of collecting relevant information for a given study; For management respondents face to face interviews were conducted alongside self administered questionnaires so as to enhance response to questions generally regarded as sensitive. The interview was conducted to fill the information groups that might arise through the use of questionnaires. The researcher used structured and face to face interviews because they provided first-hand information; data was collected because it is less costly and has the ability to clarify questions. In this method, interview guides were drafted and questions were asked and then note responses corresponding the asked questions.

# Validity of the instruments

Rankin, (2013) states that this is a pre-test of the research instrument to establish its validity was done. The instrument was given to two experts who gave their opinions on the relevance of the questions using a 5- point scale of relevant to not relevant. It was further pre-tested by administering it to probable respondents (n=10) and test their understandability of the items. Items that were found not to be relevant were then eliminated and those found not to be understood were adjusted for understandability for the final research instrument that was used.

# Reliability of the instrument

To ascertain the reliability of the instruments, the study used the test retest method; where the same score on test one is expected to be the same as test two. The study also employed the coefficient alpha, also known as the Cronbach’s Alpha The researcher established the reliability of the questionnaire using correlation coefficient r value which was represented by r<0.72 by using pretesting. To establish the reliability of the research instruments, the researcher administered the questionnaires and pilot test them using ten (10) respondents after which the researcher made the necessary corrections to the questionnaires.

# Data processing

The collected data was edited, coded and cross checked for completeness using Ms Excel and transported to SPSS for analysis.

# Data analysis

After processing the summarized data was analysed using both descriptive statistics and inferential statistics were used. Inferential statistics based on correlation and regression analysis to test the hypothesis for generalization.

# Limitations of the study

Time constraint: The researcher faced a problem of inadequate time required for the research study. Comprehensive research study involves a great deal of collecting, analyzing and processing hence requires a lot of time which may was not enough for the researcher. However the researcher overcame this limitation by designing a work plan or timeframe which served as a guide in time management.

Financial constraint: The researcher also faced a problem of inadequate funds to cater for transport and stationery. The researcher used a relatively small sample so as to minimize on the cost.

# Ethical issues

Ethical issues were considered during data collection, the researcher obeyed the rules and rights of the respondents. This was done so as to ensure that the rights to privacy and protection of the respondents will not be infringed. Assurance of no other use of the information given apart from the study purpose was also granted. Furthermore, in relation to ethics and confidentiality in research, the researcher ensured the responsibility of ensuring that information about the subjects and their responses remained confidential and that they are used for no purpose other than the research for which it was intended.

# CHAPTER FOUR

# CREDIT MONITORING AND RETURN ON ASSETS

# Introduction

This chapter deals with the first objective of the study; how has credit monitoring enhanced return on assets in Barclays Bank Uganda. It aims at examining the situation at Barclays Bank with the intention of establishing whether management has endeavored to enhance on return on assets through credit monitoring.

There is certainly nothing more important to banks than the credit they grant to their teeming customers for it constitutes the largest single income-generating asset in their portfolios. This explains why banks spend enormous resources in estimating, monitoring and managing credit quality. Thus, when banks grant loans, they expect the customers to repay the principal and interest in accordance with agreed repayment terms. However, when credits go bad, it can be fatal to the banks; which often lead to bank distress and failure.

The need for banks to manage loans efficiently has thus become more important given the recurring incidences of bank distress and failure. Consequently, regulatory agencies have responded by issuing series of stringent credit guidelines and mandatory codes of corporate best practices which are believed to minimize banks ‘exposure to credit default and adjusted risks.

In an attempt to explore whether Barclays Bank has improved on return on assets through credit monitoring, responses are presented in tables in this section. All 57 questionnaires distributed to respondents were filled and returned, hence representing a response rate of 100%.

# Barclays bank ensures monitoring of all loaned credit

Ben et al, (2010) explains that credit monitoring is an integral part of lending activity in banks, though adequate precautions are taken during assessment and sanction of a loan, a banker has to be more vigilant after sanction of the loan. Respondents were asked whether Barclays bank ensure monitoring of all loaned credit. Responses are shown in table 4.1

|  |
| --- |
| Table 4.1: Barclays ensures monitoring of all loaned credit |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 2 | 3.5 | 3.5 | 3.5 |
| Disagree | 5 | 8.8 | 8.8 | 12.3 |
| Not sure | 8 | 14.0 | 14.0 | 26.3 |
| Agree | 18 | 31.6 | 31.6 | 57.9 |
| Strongly agree | 24 | 42.1 | 42.1 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.1, results show that 42.1% strongly agreed, 31.6% agreed, 14.0% were not sure, 8.8% disagreed while 3.5% strongly disagreed. Since majority of the respondents 73.7% generally agreed, it can be interpreted to mean that Barclays bank recognises the need to put in place a very sound and effective credit monitoring system for watching the borrower’s account from various angles. Respondents stated that on the basis of the record of recovery of interest and other payables in the borrower account, the banks classify the accounts as Standard, Sub-standard, Doubtful and Loss Assets. This is in line with Ayadi (2012) who asserts that in the event of the borrower not servicing the interest/installment and other payables for a period of maximum 90 days in a term loan account or an overdraft/cash credit and other borrower accounts remaining out of order for a period of more than 90 days, the account is classified as Sub-standard.

# Barclays offers loans on basis of institution’s policy

Hull (2007) explains that commercial banks have by-laws for that deal with defaulters so as to ensure avoidance of financial misfortunes by the banks but to lead to sustained financial stability. Respondents were asked whether Barclays bank offers loans on a basis of credit policy, results are shown in table 4.2

|  |
| --- |
| Table 4.2: Barclays offers loans on basis of institution’s policy |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Not sure | 4 | 7.0 | 7.0 | 7.0 |
| Agree | 22 | 38.6 | 38.6 | 45.6 |
| Strongly agree | 31 | 54.4 | 54.4 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.2, results show that majority of the respondents generally agreed, this was presented by 54.4% and 38.6% who strongly agreed and agreed respectively. This can be interpreted to mean that credit loans are offered to clients with guidance of stipulated guidelines as stated in the credit policy. During one interview session, a credit officer expressed that;

*“The credit policy is the foundation of extending loans to clients and all credit management activities and as such it is mandatory to making decisions in line with guidelines of the lending rationale and practices. At Barclays bank the credit policy governs all credit and credit related exposures whether fund based or non-fund based. This implies that our duties as credit officers, in every activity be it credit appraisals, the duties performed are supposed to be in line with the credit policy, this is what we do”.*

# Unit increase in credit monitoring increases on return on assets

Toni (2008) points out that banks keep asset costs down by monitoring asset expenses monthly. Banks profitability is expected to increase as its portfolio of loans grows in relation to other more secure assets, taking into account the known relationship between risk and return. Respondents were asked whether a unit increase in the dimension of credit monitoring can increase return on assets. Results are presented in table 4.3

|  |
| --- |
| Table 4.3: Unit increase in credit monitoring increases on return on assets |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 5 | 8.8 | 8.8 | 8.8 |
| Disagree | 9 | 15.8 | 15.8 | 24.6 |
| Not sure | 3 | 5.3 | 5.3 | 29.8 |
| Agree | 20 | 35.1 | 35.1 | 64.9 |
| Strongly agree | 20 | 35.1 | 35.1 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.3, results show that 35.1% strongly agreed and agreed respectively, 5.3% were not sure, and 15.8% disagreed while 8.8% strongly disagreed to the statement. Since majority of the respondents 70.2% generally agreed, it can be interpreted to mean that higher operating costs in credit monitoring increases the ratio of loans to assets as long as interest rates on loans are liberalized and the bank applies markup pricing.

Berger (2012) warns that a greater relative proportion of loans in the portfolio of the bank is usually coupled with a greater liquidity risk arising from the inability of banks to accommodate decreases in liabilities or to fund increases on the assets side of the balance sheet due to poor credit monitoring; consequently, a bank holding a low proportion of liquid assets (with greater liquidity risk) is more likely to earn high profits.

# The bank has a clear system of tracking non-performing loans

According to Dietrich (2010) non-performing loans have been a hindrance to economic stability and growth of economies. Non-performing loans continued to improve underpinned by higher reclassification of non-performing loans to performing status and recoveries, as well as efforts to achieve healthier balance sheets via loan write-offs. On the question of whether Barclays bank has a clear system of tracking non-performing loans, responses are shown in table 4.4

|  |
| --- |
| Table 4.4: The bank has a clear system of tracking non-performing loans |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 15 | 26.3 | 26.3 | 26.3 |
| Disagree | 21 | 36.8 | 36.8 | 63.2 |
| Not sure | 4 | 7.0 | 7.0 | 70.2 |
| Agree | 11 | 19.3 | 19.3 | 89.5 |
| Strongly agree | 6 | 10.5 | 10.5 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.4, results show that 10.5% of the respondents strongly agreed, 19.3% agreed, 7.0% were not sure, 36.8% disagreed while 26.3% strongly disagreed. Since majority of the respondents 63.2% generally disagreed, it can be interpreted to mean that the bank does not have a clearly defined system that tracks non-performing loans.

*“Respondents stated that the bank has guidance on issues related to non-performing loans but lacks a clear implementation system in place to effectively track defaulters. This has been a major contributing factor in increasing levels of non-performing loans in the bank”.*

Dietrich (2010) further notes that guidance in non-performing loans does not intend to substitute or supersede any applicable regulatory or accounting requirement or guidance regulations or directives and their national transpositions or equivalent, but can be an effective tool in reducing on non-performing loans.

# Credit advanced to clients is effectively monitored in terms of repayment

Tijan (2016) explains that the lending banks’ function of loan monitoring plays an important role in sustaining quality loan portfolios and protects risk assets against deterioration thereby keeping non-performing loans (NPLs) within acceptable standards. On the question of whether credit advanced to clients is monitored in terms of repayment, responses are shown in table 4.5

|  |
| --- |
| Table 4.5: Credit advanced to clients is effectively monitored in terms of repayment |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 10 | 17.5 | 17.5 | 17.5 |
| Disagree | 8 | 14.0 | 14.0 | 31.6 |
| Not sure | 5 | 8.8 | 8.8 | 40.4 |
| Agree | 17 | 29.8 | 29.8 | 70.2 |
| Strongly agree | 17 | 29.8 | 29.8 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.5, results show that majority of the respondents generally agreed, this was presented by 29.8% who both strongly agreed and agreed to the statement. 8.8% of the respondents were not sure, 14.0% disagreed while 17.5% strongly disagreed. This can be interpreted to mean that Barclays bank makes routine monitoring of lenders in order to have better risk management and lower portfolio losses. Respondents stated that after the loan is approved, the bank has to retain the borrower until the loan becomes due, which might not be for several years. It was also revealed that Barclays bank has adopted to technology to maximise efficiency and improve on risk management capabilities, this is in collaboration with bank’s focus to develop customer relationships, build the opportunity pipeline, get the loan on the books as quickly as possible and move on to the next deal. This means that Barclays bank is effective in reducing portfolio for losses.

# Customers always make timely payments as per credit terms

Mbanga (2015) explains that before loans are awarded to a borrower, an agreement is reached between two parties that is institution and borrower to pay back the loaned money within the agreed period of time. Commercial banks make an effort in ensuring that it does not get exposed to credit risk due to delay in loan repayment since it usually leads to failure to pay back loan. On the question of whether customers always make timely payments as per credit terms, responses are shown in table 4.6

|  |
| --- |
| Table 4.6: Customers always make timely payments as per credit terms |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 20 | 35.1 | 35.1 | 35.1 |
| Disagree | 21 | 36.8 | 36.8 | 71.9 |
| Not sure | 2 | 3.5 | 3.5 | 75.4 |
| Agree | 6 | 10.5 | 10.5 | 86.0 |
| Strongly agree | 8 | 14.0 | 14.0 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.6, results show that 35.1% strongly disagreed, 36.8% disagreed, 3.5 were not sure, 10.5% agreed while 14.0% strongly agreed. It is indicated that 71.9% of the respondents generally disagreed to the statement, this means that than often clients do not comply with credit period given which leads to delayed profit for Barclays bank hence the accumulated non-performing loans are as a result of non-compliance from clients. Respondents state that clients who entirely fail to repay back loan or pay late expose the institution to credit risk. If clients don’t comply with payment period, the institution is exposed to risk of not having cash to carter for client deposits, loss of income and excessive concentration of credit risk and counterfeit collateral. This implies that failure to be in compliance with financial debt covenants by any amount, no matter how small, may technically result in a loan default, which can have serious consequences.

# Credit monitoring ensures credit default is low

Respondents were asked whether credit monitoring ensures credit default is low, responses to this question are shown in table 4.7

|  |
| --- |
| Table 4.7: Credit monitoring insures credit default is low |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 4 | 7.0 | 7.0 | 7.0 |
| Disagree | 6 | 10.5 | 10.5 | 17.5 |
| Not sure | 3 | 5.3 | 5.3 | 22.8 |
| Agree | 19 | 33.3 | 33.3 | 56.1 |
| Strongly agree | 25 | 43.9 | 43.9 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.7, results show that 43.9% of the respondents strongly agreed, 33.3% agreed, 5.3% were not sure, 10.5% disagreed and 7.0 strongly disagreed with the statement. Since majority of the respondents that is 77.2% generally agreed, it can be interpreted to mean that Barclays bank is paying more attention to the supervision and management of risks with credit monitoring with an effort of reducing the amount of bad debt in the bank.

During an interview session, one respondent expressed that;

*“Credit loans are those extended to a client without any guaranty and at Barclays such loans are most commonly extended to enterprises or firms. In this case our credit management personnel will always a borrower with good credit standing or with a good business relationship with our bank. In some cases, if the bank deems necessary, the borrower will need to prove qualifications by providing its financial reports to the bank before the loan is issued. Monitoring of the loan will later be considered by routine follow up of the enterprises financial reports throughout the loan period”.*

This means Barclays bank has necessary steps on how to reduce on credit default through monitoring of financial reports of the borrower.

# Effective debt collection reduces on effects of non-performing loans

Hull (2007) explains that microfinance institutions have by-laws for that deal with defaulters so as to ensure avoidance of financial misfortunes by commercial banks but to lead to reduced non-performing loans. This can help the bank to improve its profitability through earned interest amounts. Respondents were asked whether Barclays bank has an effective debt collection to reduce on effects on non-performing loans, and responses are shown in table 4.8

|  |
| --- |
| Table 4.8: Effective debt collection reduces on effects of non-performing loans |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Not sure | 8 | 14.0 | 14.0 | 14.0 |
| Agree | 24 | 42.1 | 42.1 | 56.1 |
| Strongly agree | 25 | 43.9 | 43.9 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.8, results show that 43.9% of the respondents strongly agreed, 42.1% agreed and 14.0 were not sure, none of the respondents strongly disagreed nor disagreed. 86% of the respondents generally agreed to the statement which implies that Barclays bank debt collection process is effective to collect overdue accounts and tends to generate payment of bad debts more quickly. Management stated that the bank uses various debt collection methods such as notifying delinquent customers through mobile app notifications as customers receive late payment messages through the platform. It was also revealed that clients often respond to a debt repayment reminder if the collection message is friendly, helpful and is delivered through a trusted source. This means that Barclays bank does not hold non-performing loans for a long time hence increase in bank’s profitability.

# Barclays bank has effective screening process of debtors

Respondents were asked whether the bank has an effective screening process of debtors. Responses to this question are shown in table 4.9

|  |
| --- |
| Table 4.9: Barclays bank has effective screening process of debtors |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 9 | 15.8 | 15.8 | 15.8 |
| Disagree | 11 | 19.3 | 19.3 | 35.1 |
| Not sure | 4 | 7.0 | 7.0 | 42.1 |
| Agree | 18 | 31.6 | 31.6 | 73.7 |
| Strongly agree | 15 | 26.3 | 26.3 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.9, results show that 26.3% of the respondents strongly agreed, 31.6% agreed, 7.0% were not sure, 19.3% disagreed while 15.8% strongly disagreed. This response had a majority of 57.9% who generally agreed, this means that Barclays endeavors to carry out required process of determining credit worthiness of creditors before loans are provided. Respondents stated that the bank determines the borrower’s ability and willingness to pay because this is a major factor that defines a bank’s credit policies. Wall (2013) warns that commercial banks must have software systems, business processes, and methods for handling compliance requirements. A configurable screening solution enables commercial banks to determine how they prioritize an alert, who handles escalations, and what is tracked and reported. It empowers banks to define efficient workflows that save operators’ time and shorten alert decision, which minimizes the impact on their operations. It was also noted that a flexible screening tool doesn’t require banks to tear out and replace existing systems. Seamlessly integrating into the business reduces infrastructure costs, the time to deployment, and the amount of training required.

# Bank has credit policies that improve prudential oversight of asset quality

Migiri (2002) observed that the credit policy is put in place to strategize a bank’s lending philosophy and also provide specific procedures and means of monitoring the lending activity. The guiding principle in credit appraisal is to ensure that only those borrowers who require credit and are able to meet repayment obligations can access credit. On the question of whether the bank has credit policies that improve prudential oversight of asset quality, responses to this question are shown in table 4.10

|  |
| --- |
| Table 4.10: Bank has credit policies that improve prudential oversight of asset quality |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 1 | 1.8 | 1.8 | 1.8 |
| Disagree | 3 | 5.3 | 5.3 | 7.0 |
| Not sure | 5 | 8.8 | 8.8 | 15.8 |
| Agree | 21 | 36.8 | 36.8 | 52.6 |
| Strongly agree | 27 | 47.4 | 47.4 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 4.10, results show that 47.4% of the respondents strongly agreed, 36.8% agreed, 8.8% were not sure, 5.3% disagreed while 1.8% strongly disagreed. Results show that 84.2% of the respondents generally agreed to the statement, this means that Barclays has a sound credit policy which has been effective in improving prudential oversight of asset quality. Respondents stated that Barclays bank has a credit policy that establishes a set of minimum standards, and applies a common language and methodology (assessment of risk, pricing, documentation, securities, authorization, and ethics), for measurement and reporting of nonperforming assets, loan classification and provisioning. It was also stated that the bank’s credit policy sets out the bank’s lending philosophy and specific procedures and means of monitoring the lending activity which is regularly evaluated in order to ensure sustainability in profits.

# CHAPTER FIVE

# DEBT COLLECTION AND LOAN RECOVERY

# Introduction

This chapter deals with the second objective of the study; how has debt collection enhanced loan recovery in Barclays Bank Uganda. It aims at examining the situation at Barclays Bank with the intention of establishing whether management has endeavored to enhance on loan recovery through debt collection.

Many commercial banks take necessary measures to ensure timely recovery and consequent reduction of non-performing loans. Ambrose (2015) notes that loan recovery be it fresh loans or old loans, is central to commercial bank’s management, this management process needs to start at the loan initiating stage itself. Effective management of loan recovery comprises of two pronged strategy which relates to arresting of the defaults, the second is the handling of loan delinquencies where tenets of financial sector reforms are revolutionary which creates a sense of urgency in the minds of staff of bank and gives them a message that either they perform or perish..

Johns (2000) points out that commercial banks need to increase budgetary allocations towards improving capacity and motivation level of debt collection staff and also to invest in research and development towards more effective debt collection strategies.

In an attempt to explore whether Barclays Bank has improved on loan recovery through debt collection, responses are presented in tables in this section.

# Barclays bank ensures effective debt collection

Blank (2006) notes, that commercial banks should view debt collections as an essential piece of the credit cycle, not just the final step. During the collections process, commercial banks receive feedback on policies and activities within each sub- process of the lending cycle: promotion, evaluation, approval, and disbursement. Respondents were asked whether Barclays bank ensures an effective debt collection and responses are shown in table 5.1

|  |
| --- |
| Table 5.1: Barclays ensures effective debt collection |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 5 | 8.8 | 8.8 | 8.8 |
| Disagree | 10 | 17.5 | 17.5 | 26.3 |
| Not sure | 1 | 1.8 | 1.8 | 28.1 |
| Agree | 20 | 35.1 | 35.1 | 63.2 |
| Strongly agree | 21 | 36.8 | 36.8 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 5.1, results show that 36.8% of the respondents strongly agreed, 35.1% agreed, 1.8% were not sure, 17.5% disagreed and 8.8% strongly agreed. Since majority of the respondents generally agreed that is 71.9%, this means that the debt collection process can help the institution to improve its profitability through earned interest amounts.

During an interview session, one respondent expressed that;

*“At Barclays bank, the debt collection emphasises a significant level of interaction with our clients and this begins with a careful analysis of the client’s situation and continues through the timely and frequent contact over the duration of the loan. The clients are usually offered payment alternatives that are timely and appropriate to each client situation to foster easy debt collection process. Another issue is that collection activities are recorded to facilitate continuous monitoring and follow-up as well as control of client compliance with negotiated agreements”.*

This means that Barclays bank ensures that all necessary activities under debt collection process are effectively conducted.

# Effective debt collection reduces on bad debts

Respondents were asked whether effective debt collection reduces on bad debts and results are shown in table 5.2

|  |
| --- |
| Table 5.2: Effective debt collection reduces on bad debts |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 6 | 10.5 | 10.5 | 10.5 |
| Disagree | 5 | 8.8 | 8.8 | 19.3 |
| Not sure | 3 | 5.3 | 5.3 | 24.6 |
| Agree | 16 | 28.1 | 28.1 | 52.6 |
| Strongly agree | 27 | 47.4 | 47.4 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 5.2, results show that 47.4% strongly agreed, 28.1% agreed, 5.3% were not sure, 8.8% disagreed while 10.5% strongly agreed. 75.5% of the respondents generally agreed to the statement which means that debt collection at Barclays bank if properly utilised can mitigate losses in terms of bad debts which can ultimately expose the bank to losses.

Deakins, (2008) warns that that major problems start with the inexperienced credit staff that provide wrong information and make wrong predictions which exposes the commercial bank to risk of bad debts. He further notes that some elements of credit debt collection (credit officer and field officers) have the required level skills and as such can view risk at the individual, customer and portfolio levels. This means that the Barclays bank know if loan loss reserves can adequately cover potential short-term credit losses.

# Barclays bank has experienced debt collection officers

Respondents were also asked whether the commercial bank has experienced debt collection officers. Responses to this question are shown in table 5.3

|  |
| --- |
| Table 5.3: Barclays has experienced debt collection officers |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 19 | 33.3 | 33.3 | 33.3 |
| Disagree | 22 | 38.6 | 38.6 | 71.9 |
| Not sure | 5 | 8.8 | 8.8 | 80.7 |
| Agree | 9 | 15.8 | 15.8 | 96.5 |
| Strongly agree | 2 | 3.5 | 3.5 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 5.3, results show that 33.3% of the respondents strongly disagreed, 38.6% disagreed, 8.8% were not sure, 15.8% agreed while 3.5% agreed to the statement. 71.9% of the respondents generally disagreed, this means that Barclays bank has debt collection officers who do not effectively perform their roles to implement the institution’s credit administration because some lack the necessary experience.

Muriu, (2011) explains that some debt collection officers are fresh graduates who don’t fully understand the practical side of credit management and as such situations of processing errors and inadequate or wrong information on various loan accounts. This means that it is because of the inexperienced debt collection officers that borrowers submit counterfeit collateral hence exposing the institution to credit risk and reducing its profitability position.

# Credit officers ensure to perform credit appraisal on clients

Pandey (2008) explains that prudent management and administration of the overall loan account, including establishment of sound lending and collection policies are of vital importance if commercial banks are to be continuously operated in an acceptable manner. Respondents were also asked whether credit officers ensure to perform credit appraisal on clients and results are shown in table 5.4

|  |
| --- |
| Table 5.4: Credit officers ensure to perform credit appraisal on clients |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Not sure | 5 | 8.8 | 8.8 | 8.8 |
| Agree | 21 | 36.8 | 36.8 | 45.6 |
| Strongly agree | 31 | 54.4 | 54.4 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 5.4, results show that majority of respondents generally agreed, this was presented by 54.4% who strongly agreed, 36.8% agreed while 8.8% were not sure. This means that Barclays bank credit officers conduct credit appraisals on clients before loans are issued. Barclays bank performs credit appraisals of their borrowers to determine the credit worthiness of the individual before actually granting the loan. Respondents stated that Barclays bank’s credit appraisal focus on evaluating the credit worthiness of the future expected stream of cash flow with the amount of risk attached to them. It was also stated that credit worthiness is assessed with parameters such as willingness of borrower to pay back money and repayment capacity. This implies that Barclays bank takes necessary precaution in recovering loans*.*

The findings are in line with the argument of Binks et al (1992) who stated that to optimise loan repayment by customers or clients, commercial banks should tighten their credit appraisal methods and techniques. This requires highly skilled staff with good background of project evaluation techniques.

# The credit appraisal methods are effective

Myers et al (2003) observed that most of lending under commercial banks is done to social groups (Self-help groups/joint liability groups). It is expected that if one member of the group doesn’t repay the loan amount, the other members would repay that member’s loan as they are jointly liable to repay the loan as a group. This is because the formal methods to assess the creditworthiness of this segment of clients are not easily implementable. On the question of whether Barclays bank has effective credit appraisal methods, results are summarized in table 5.4

|  |
| --- |
| Table 5.4: The credit appraisal methods are effective |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 7 | 12.3 | 12.3 | 12.3 |
| Disagree | 11 | 19.3 | 19.3 | 31.6 |
| Not sure | 4 | 7.0 | 7.0 | 38.6 |
| Agree | 18 | 31.6 | 31.6 | 70.2 |
| Strongly agree | 17 | 29.8 | 29.8 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 5.4, results show that 29.8% strongly agreed, 31.6% agreed, 7.0% were not sure, 19.3% disagreed and 12.3% strongly disagreed. Since majority of the respondents 61.4% generally agreed, this means that Barclays bank has effectively and constantly evaluated loan books and brings about qualitative improvements in credit administration. Respondents stated that Barclays bank uses loan review mechanism especially for large value accounts with responsibilities assigned in various areas such as, evaluating the effectiveness of loan administration, maintaining the integrity of credit grading process, assessing the loan loss provision, portfolio quality. This implies that the institution can easily detect problems accounts early and mitigate probable losses either through loan restructuring or the usually termination of poor quality loans.

# Amount of non-performing loans is reduced

Idarus (2005) observes that when commercial banks lend money to borrowers, the available capital is reduced as it is locked in non-performing loans on promise to pay back with interest. It is therefore imperative that debt collection ensures that the right procedures are followed during the time of collecting loans to ensure that borrowers pay back in time and as such reduces non-performing loans. On the question of whether the amount of non-performing loans is reduced, results are shown in table 5.6

|  |
| --- |
| Table 5.6: Amount of non-performing loans is reduced |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 18 | 31.6 | 31.6 | 31.6 |
| Disagree | 22 | 38.6 | 38.6 | 70.2 |
| Not sure | 3 | 5.3 | 5.3 | 75.4 |
| Agree | 6 | 10.5 | 10.5 | 86.0 |
| Strongly agree | 8 | 14.0 | 14.0 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 5.6, results show that majority of the respondents that is 38.6% disagreed, 31.6% strongly disagreed, 5.3 were not sure, 10.5% agreed while 14.0% strongly agreed. Since majority of the respondents 70.2% generally disagreed, it means that the debt collection process and overall credit risk management at the bank has been ineffective in ensuring loans granted are paid back in time and with agreed interest. In line with this argument, Idarus (2005) further ascertains that if the evaluation not covered under credit appraisal for borrowers, then the institution is likely to not get back the money awarded as loans hence reducing on capital locked with debtors.

# Debt collection is done in line with credit policy

Basel (2015) asserts that at some point, a customer to whom credit has been extended will not pay on time. With all of the security and other policies and procedures in place for the bank to make sure it is paid, the penultimate step is to have a collections policy. There are numerous steps and factors to consider when crafting a collections policy, but the first step is the same as each other aspect of credit policy as a whole and it should be written down, and consistently applied. On the question f whether debt collection is done in line with credit policy, responses are shown in table 5.7

|  |
| --- |
| Table 5.7: Debt collection is done in line with credit policy |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Not sure | 5 | 8.8 | 8.8 | 8.8 |
| Agree | 23 | 40.4 | 40.4 | 49.1 |
| Strongly agree | 29 | 50.9 | 50.9 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 5.7, results show that 50.9% of the respondents strongly agreed, 40.4% agreed while 8.8% were not sure. Since majority of respondents 91.3% generally agreed, it can be interpreted to mean that debt collection is operated in line with stipulated guidelines as stated in the credit policy. During one interview session, a credit officer expressed that;

*”Barclays bank has a set of procedures that are used to ensure effective debt collection and these procedures are clearly stipulated in the bank’s credit policy. The credit policy systemizes the steps taken by debt collection officers to recover amounts due from debtors. The bank’s credit policy is very clear on how these are to be performed, for instance, when the customer is supposed to be contacted, how they should be contacted, how disputes are resolved. It is imperative that all debt collection officers follow the rules as indicated in the credit policy”.*

# Debt collection takes in regard the credit worthiness of a client

Neves (2012) explains that granting credit approval depends on the willingness of the creditor to lend money in the current economy and that same lender's assessment of the ability and willingness of the borrower to return the money or pay for the goods obtained plus interest in a timely fashion. Respondents were asked whether debt collection takes in regard the credit worthiness of a client and responses are shown in table 5.8

|  |
| --- |
| Table 5.8: Debt collection takes in regard the credit worthiness of a client |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 11 | 19.3 | 19.3 | 19.3 |
| Disagree | 6 | 10.5 | 10.5 | 29.8 |
| Not sure | 7 | 12.3 | 12.3 | 42.1 |
| Agree | 15 | 26.3 | 26.3 | 68.4 |
| Strongly agree | 18 | 31.6 | 31.6 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 5.8, results show that 31.6% of the respondents strongly agreed, 26.3% agreed, 12.3% were not sure, 10.5% disagreed while 19.3% strongly disagreed. Since majority of the respondents that is 57.9% generally agreed, this means that debt collection officers determine the terms and times of collecting loaned money from a client depending on the different client situation in terms of credit worthiness. Respondents stated that a history of trustworthiness, a moral character, and expectations of continued performance demonstrate a debtor's ability to pay and ultimately reflects banks approach in time of collecting debt from the client. Creditors give more favorable terms to those with high credit ratings via lower point structures and interest costs.

# Debt collection reduces capital locked with debtors

Idarus (2005) observes that when microfinance institutions lend money to borrowers, the available capital is reduced as it is locked with debtors on promise to pay back with interest. It is therefore imperative that capital appraisal ensures that the right procedures are followed during the time loans are awarded to borrowers to ensure that borrowers pay back in time and as such reduces capital locked with debtors. On the question of whether debt collection can be used to reduce on capital locked with debtors, results obtained are presented in table 5.9

|  |
| --- |
| Table 5.9: Debt collection reduces capital locked with debtors |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 5 | 8.8 | 8.8 | 8.8 |
| Disagree | 7 | 12.3 | 12.3 | 21.1 |
| Not sure | 8 | 14.0 | 14.0 | 35.1 |
| Agree | 17 | 29.8 | 29.8 | 64.9 |
| Strongly agree | 20 | 35.1 | 35.1 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

According to results in table 5.9, results indicate that 29.8% agreed and 35.1% strongly agreed, since this is the majority it can be interpreted to mean that effective debt collection reduces on credit risk by ensuring that loans granted are paid back in time and with agreed interest. In line with this argument, Idarus (2005) further ascertains that if the evaluation covered under debt collection for borrowers, then the institution is likely to get back the money awarded as loans hence reducing on capital locked with debtors.

# CHAPTER SIX

# CREDIT RISK GOVERNANCE AND LIQUIDITY

# Introduction

This chapter deals with the third objective of the study; how credit risk governance has ensured improved liquidity in Barclays bank Uganda. The chapter aims at examining the situation at Barclays with the intention of establishing whether management has endeavored to improve liquidity.

The global environment for banking is undergoing fundamental paradigm shifts amid slowly progressing structural changes in the world economy, with no sign of a turnaround most of these trends are likely to continue for the next 10 years and pose serious challenges to the world’s banks.

Due to the financial crisis, numerous banking regulations have been introduced over the last few years, making the process of managing banks’ balance sheets more and more complicated. Maximizing revenue while managing risk and regulatory compliance has become increasingly difficult. Moreover, regulators now require that the management of all of an organization’s levels be consistent throughout. As more macro-prudential regulations pressure banks to make sure they do not become a threat to global financial stability, banks are finding that raising revenue simply by conducting an already increasingly risky business is becoming more difficult.

In an attempt to explore whether Barclays bank improves on liquidity through credit risk governance, respondents were asked questions and the responses are presented in the tables that follow.

# Credit risk governance is implements under credit policy

Patrick et.al, (2014) explains that banks should focus more on proactively managing, rather than merely establishing, risk appetite, and making sure that all of the activities of their individual business segments are in sync. Given how quickly market conditions can change and therefore how quickly financial risks can emerge commercial banks need to be nimble and rapidly adapt to conditions as they evolve. Respondents were asked whether Barclays bank implements credit risk governance under credit policy and responses are shown in table 6.1

|  |
| --- |
| Table 6.1: Credit risk governance is implemented under credit policy |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Not sure | 9 | 15.8 | 15.8 | 15.8 |
| Agree | 21 | 36.8 | 36.8 | 52.6 |
| Strongly agree | 27 | 47.4 | 47.4 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 6.1, results show that majority of respondents generally agreed to the statement, this was presented by 47.4% who strongly agreed and 36.8% who agreed respectively. 15.8% were not sure, since majority 84.2% agreed, this means that Barclays bank follows credit policy which reduces on chances of credit crunch and also decline in asset prices. Respondents stated that the bank has a credit policy which serves as a regulatory framework; this follows the financial crisis that leads banks to achieve a major objective of preventing risk. However, respondents also stated that risk governance in Barclays bank has had undesirable side effects because the bank has downsized its trading operations, liquidity in fixed income markets has also declined considerably, greatly increasing price fluctuations in the government and corporate bond markets in advanced economies.

# Credit risk governance processes enhances profitability

Ellen (2014) notes that commercial banks consider risk management as a core element of their business strategy. Risk governance is proactive, and helps the bank to identify the possible events that could impact smooth operations. It also increases the likelihood of successfully achieving the institution’s objectives. Respondents were asked whether credit risk governance enhances profitability, responses to this question are shown in table 6.2

|  |
| --- |
| Table 6.2: Credit risk governance processes enhances profitability |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 8 | 14.0 | 14.0 | 14.0 |
| Disagree | 9 | 15.8 | 15.8 | 29.8 |
| Not sure | 2 | 3.5 | 3.5 | 33.3 |
| Agree | 19 | 33.3 | 33.3 | 66.7 |
| Strongly agree | 19 | 33.3 | 33.3 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 6.2, results show that majority of respondents generally agreed, this was represented by 33.3% who both strongly agreed and agreed, 3.5% were not sure, 15.8% disagreed and 14.0% strongly disagreed. This means that the risk governance is a major contributing factor in determining the bank’s profitability. During an interview session, one respondent expressed that;

*“In any banking institution, credit risk governance can increase on profitability in various ways such as improving on efficiency which ensures that the bank is always prepared for risk, another way of improving on profitability is by reducing on costs, enhancing stakeholder confidence. Also Barclays bank appreciates the practice of risk governance because it is most effective when it is a continuous and disciplined process within bank’s operation. The practices of risk governance are used in a proactive manner in that it avoids the need for time consuming and costly crisis management, this makes our resilience to increase and reducing on credit risk, hence greater profitability”.*

# Credit and field officers have relevant training on credit management

Opio (2000) warns that most commercial banks require credit officers to have at least a bachelor’s degree in a discipline such as accounting, finance or business. Coursework or professional experience in banking and sales can also be helpful for credit officer and field officer positions. Respondents were asked whether Barclays bank offers training for credit and field officers on credit management and responses are shown in table 6.3

|  |
| --- |
| Table 6.3: Credit and field officers have relevant training on credit management |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 15 | 26.3 | 26.3 | 26.3 |
| Disagree | 20 | 35.1 | 35.1 | 61.4 |
| Not sure | 3 | 5.3 | 5.3 | 66.7 |
| Agree | 10 | 17.5 | 17.5 | 84.2 |
| Strongly agree | 9 | 15.8 | 15.8 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 6.3, results show that 26.3% strongly disagreed, 35.1% disagreed, 5.3% were not sure, 17.5% agreed while 15.8% strongly agreed, results show that majority of respondents that is 61.4% generally disagreed. This means this implies that inefficiencies in debt collection are as a result of unskilled personnel. During one of the interview sessions, one respondent from field officers stated that;

*“A number of credit officers and field officers, we haven’t quite well understood role of customer service play in collection of debt, yet this is important and management demands that while collecting debts, we ensure that the customer is retained in good faith. We did not get training on how to improve interpersonal skills so it is really hard to work as a team, we also lack phone skills, and new collectors are not given instruction on what questions to ask and how to ask them in a manner that can elicit response”.*

This implies that poor performance of risk governance which leads to high non-performing loans in Barclays bank is due to lack of trained credit officers and field officers.

# Customers comply with stipulated credit period given

Respondents were asked whether customers comply with stipulated credit period given. Responses to this question are shown in table 6.4

|  |
| --- |
| Table 6.4: Customers comply with stipulated credit period given |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 5 | 8.8 | 8.8 | 8.8 |
| Disagree | 8 | 14.0 | 14.0 | 22.8 |
| Not sure | 5 | 8.8 | 8.8 | 31.6 |
| Agree | 20 | 35.1 | 35.1 | 66.7 |
| Strongly agree | 19 | 33.3 | 33.3 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 6.4, results show that 33.3% strongly agreed, 35.1% agreed, 8.8% were not sure, 14.0% disagreed while 8.8% strongly disagreed. A total of 68.4% respondents generally agreed to the statement, this means that the credit period given to customers is met without fail as the penalty can be more costly. During an interview session one respondent from credit department expressed that;

*“In issuing out a loan, clients are given a credit period in which the loan and interest are supposed to be fully cleared and this is signed in a loan agreement. The loan agreement lays an obligation to the borrower to ensure payments are always made in time and in the right amounts as per the agreement. At Barclays we can say all borrowers abide by this stipulation, this is majorly because the alternative is much more costly with penalties and increased amounts. The credit period usually runs through making monthly payments within an agreed period of time at which the full amount is expected to have been settled, most clients happily or unhappily comply”.*

# Credit governance ensure charged interest rates fetch enough profits

Hall (2002) explained that the banking sector's [profitability](https://www.investopedia.com/terms/u/underlying-profit.asp) increases with interest rate hikes. Institutions in the banking sector such as retail banks, commercial banks, investment banks, insurance companies and brokerages have massive cash holdings due to customer balances and business activities. On the question of whether Barclays bank credit governance that charged interest rates fetch enough profits, responses are shown in table 6.5

|  |
| --- |
| Table 6.5: Credit governance ensures charged interest rates fetch enough profits |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Not sure | 3 | 5.3 | 5.3 | 5.3 |
| Agree | 21 | 36.8 | 36.8 | 42.1 |
| Strongly agree | 33 | 57.9 | 57.9 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 6.5, results show that majority of the respondents generally agreed, this was presented by 57.9% who strongly agreed, 36.8% who agreed while 5.3% were not sure. This means that the interest rates charged by Barclays bank have an effect on profitability. Respondents stated that increases in the [interest rate](https://www.investopedia.com/terms/i/interestrate.asp) directly increase the yield on this cash, and the proceeds go directly to earnings. The benefit of higher interest rates is most notable for brokerages, commercial banks and regional banks. Hall (2002) adds to this argument and states that banks hold their customers' [cash](https://www.investopedia.com/terms/c/cash.asp) in accounts that pay out set interest rates below short-term rates. They profit off of the marginal difference between the [yield](https://www.investopedia.com/terms/y/yield.asp) they generate with this cash invested in [short-term notes](https://www.investopedia.com/terms/s/short-term-note.asp) and the interest they pay out to customers. This means that when rates rise, this spread increases, with extra income going straight to earnings.

# Credit risk governance ensures effective monitoring of debtors

Over a period of time, there has been an increased emphasis in monitoring the account. For instance, microfinance institutions make monthly return on information, where earlier it used to be quarterly. Everything is computerized so it's easy for the borrowers to give the required information, their actual sales against what their projections were, what they have done. Respondents were asked whether credit risk governance ensures effective monitoring of debtors and responses are shown in table 6.6

|  |
| --- |
| Table 6.6: Credit risk governance ensures effective monitoring of debtors |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 5 | 8.8 | 8.8 | 8.8 |
| Disagree | 7 | 12.3 | 12.3 | 21.1 |
| Not sure | 3 | 5.3 | 5.3 | 26.3 |
| Agree | 15 | 26.3 | 26.3 | 52.6 |
| Strongly agree | 27 | 47.4 | 47.4 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 6.6, results show that 47.4% strongly agreed, 26.3% agreed, 5.3% were not sure, 12.3% disagreed while 8.8% strongly disagreed. Since majority of respondents generally agreed, it can be interpreted to mean that Barclays bank is handling credit risk challenges through credit risk governance. Respondents also stated that senior management through risk governance ensure to implement the credit risk strategy by developing policies and procedures for identifying, measuring, monitoring and controlling credit risk through policies and procedures that address credit risk in the bank’s activities and at both the individual credit and portfolio levels.

# Failure to pay back loan affects bank’s profitability

Respondents were asked whether failure to pay back loan in Barclays bank affects profitability. Responses to this question are shown in table 6.7

|  |
| --- |
| Table 6.7: Failure to pay back loan affects bank’s profitability |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Agree | 25 | 43.9 | 43.9 | 43.9 |
| Strongly agree | 32 | 56.1 | 56.1 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 6.7, results show that 56.1% strongly agreed while 43.9% agreed to the statement. This means that there is a certain level of risk the institution faces of not getting paid; this affects profitability position of the bank. Respondents stated that failure to pay back loans cause trouble with cash flow and hinder ability to meet the bank’s financial obligations due increase in non-performing loans. During one of the interview sessions, one respondent from management expressed that;

“*When customers are asked to pay in the stipulated time, the institution will easily determine its income but when clients fail to pay, this is complicated because as much as some customers pay in time, it is much more likely that the rest will completely fail to pay, this creates serious problems since it affects the cash flow in a negative way”.*

# Customers provide sufficient collateral to cover offered loans

Respondents were asked whether customers provide sufficient collateral to cover offered loans. Responses to this question are shown in table 6.8

|  |
| --- |
| Table 6.8: Customers provide sufficient collateral to cover offered loans |
|  | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Strongly disagree | 16 | 28.1 | 28.1 | 28.1 |
| Disagree | 18 | 31.6 | 31.6 | 59.7 |
| Not sure | 2 | 3.5 | 3.5 | 63.2 |
| Agree | 13 | 22.8 | 22.8 | 86.0 |
| Strongly agree | 8 | 14.0 | 14.0 | 100.0 |
| Total | 57 | 100.0 | 100.0 |  |

**Source: Primary data (2019)**

As seen in table 6.8, results show that majority of the respondents generally disagreed that is 28.1% strongly disagreed, 31.6% disagreed, 3.5% were not sure, 22.8% agreed while 14.0% strongly agreed. Since majority of respondents generally disagreed it can be interpreted to mean that collateral value proved by borrowers does not always cover loan awarded and this is due to credit officer’s failure to effectively carry out credit appraisal as to determine the value of collateral and the creditworthiness of the borrower. In support of this finding, Ssewagudde (2000) warns that a borrower who submits collateral that cannot cover a loan in case of failure to pay is not credit worthy and as such the institution has no protection from loan agreement. There are several inconsistencies in determining value of collateral through appraisal since the process is performed by unskilled personnel. This means that the microfinance is exposed to losses and reduces on its profitability.

# Hypothesis testing

H0: There is no significant relationship between credit risk management and profitability in Barclays Bank Uganda and H1: There is a significant relationship between credit risk management and profitability in Barclays Bank Uganda.

# Regression analysis

Multiple regression analysis was performed in order to establish the extent to which credit risk management explained the degree of variance in profitability. The result obtained is presented in the model summary table 6.9

|  |
| --- |
| Table 6.9: Regression Analysis Model Summary |
| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
| 1 | .499a | .249 | .243 | 1.20571 |
| a. Predictors: (Constant), Credit risk management |

Table 6.9 shows that the adjusted R square, which is the variability in the dependent variable (profitability of Barclays bank), explained by the regression, is 0.243 or 24.3%; this means that 24.3% of the variability in profitability of Barclays bank is explained by the independent credit risk management (credit monitoring, debt collection and credit risk governance). The remaining 75.7% is explained by other factors outside the scope of the current study. The R value from the summary model is 0.499 which is the correlation coefficient.

**ANOVA (Analysis of variance)**

ANOVA analysis was performed to test the equivalent hypothesis that there is no significant relationship between credit risk management and profitability of Barclays bank. The results are summarized in table 6.10

|  |
| --- |
| Table 6.12: ANOVAa |
| Model | Sum of Squares | df | Mean Square | F | Sig. |
| 1 | Regression | 61.066 | 1 | 61.066 | 42.007 | .000b |
| Residual | 184.624 | 127 | 1.454 |  |  |
| Total | 245.690 | 128 |  |  |  |
| a. Dependent Variable: Profitability (Return on assets, Loan recovery, Liquidity) |
| b. Predictors: (Constant), Credit monitoring, debt collection and credit risk governance |

Analysis of variance (ANOVA) in table 6.10 was used to test the null hypothesis.

F= 42.007, p<000, the null hypothesis that there is no significant relationship between credit risk management and profitability is rejected. This means that there is a significant relationship between credit risk management and profitability in Barclays bank.

The regression coefficient is not zero and therefore improvement in credit risk management will lead to improvement in performance of profitability in Barclays bank.

|  |
| --- |
| Table 6.11: Coefficientsa |
| Model | Unstandardized Coefficients | Standardized Coefficients | t | Sig. |
| B | Std. Error | Beta |
| 1 | (Constant) | -1.460 | .551 |  | -2.650 | .011 |
| Credit monitoring | .053 | .177 | .041 | 2.321 | .000 |
| Debt collection | .848 | .138 | .792 | 6.149 | .000 |
| Credit risk governance | .362 | .178 | .150 | 2.034 | .047 |
| a. Dependent Variable: Profitability of Barclays bank |

The regression matrix table 6.11 tests which independent variable is more important to the dependent variable. The results show that; debt collection [β=0.792, p<0.0005, t-statistic=6.149, p<0.0005] influences Profitability of Barclays bank more than other variables. However all other variables are significant because their Betas are twice larger than the corresponding standard errors and their t-statistics are greater than 2; Any independent variable with a t-statistic greater than two indicates a strong correlation with the dependent variable.

# CHAPTER SEVEN

# TOWARDS HARMONISING CREDIT RISK MANAGEMENT AND PROFITABILITY

# Introduction

This chapter sets out to link study findings to the literature review by discussing the findings in relationship with literature review, and then suggest a way forward. Implications are, deduced, from the findings, discussed and interpreted basing on the research hypotheses of the study.

# Credit monitoring and return on assets

On the question of whether credit monitoring has ensured return on assets in Barclays bank, 42.1% strongly agreed, 31.6% agreed that the bank conducts credit monitoring for all loaned credit, hence bank recognises the need to put in place a very sound and effective credit monitoring system for watching the borrower’s account. It was also revealed that 54.4% and 38.6% strongly agreed and agreed respectively that offers loans on basis of institution’s policy. Furthermore, it was stated that 35.1% strongly agreed and agreed respectively that a unit increase in the dimension of credit monitoring can increase in return on assets as long as interest rates on loans are liberalized and the bank applies markup pricing. 36.8% disagreed while 26.3% strongly disagreed that to the statement that the bank has a clear system of tracking non-performing loans, which meant that the bank does not have a clearly defined system that tracks non-performing loans. 29.8% both strongly agreed and agreed to the statement that credit advanced to clients is effectively monitored in terms of repayment thus bank makes routine monitoring of lenders in order to have better risk management and lower portfolio losses. Findings also showed that 71.9% of the respondents generally disagreed to the statement that customers always make timely payments as per credit terms, this meant that clients do not comply with credit period given which leads to delayed profit for Barclays bank hence the accumulated non-performing loans are as a result of non-compliance from clients.

Monitoring of the credit portfolio and individual accounts is essential in order to maintain the quality of the credit portfolio of the bank in a sound condition. In line with the national practices, it is imperative for the banks to implement prudential norms of income recognition and asset classification of the individual borrowing accounts in the credit portfolio.

Periodical monitoring of the actual performance of the business of the borrower vis-a-vis projections accepted at the time of appraisal of credit facilities. Periodical performance as against the projected level of sales, operating profits, inventory and debt levels, cash flow, etc., have to be obtained and monitored.

On the basis of the record of recovery of interest and other payables in the borrower account, the banks classify the accounts as Standard, Sub-standard, Doubtful and Loss Assets. In the event of the borrower not servicing the interest/installment and other payables for a period of maximum 90 days in a term loan account or an overdraft/cash credit and other borrower accounts remaining out of order for a period of more than 90 days, the account is classified as Sub-standard.

Safety of the bank’s exposure in credit asset is of paramount importance. The safety is dependent upon risk factors, which are identified and accepted while taking credit exposure. Any event that could result in materializing of these risks into default or even delay in repayment must be diagnosed and identified early.

The normal sanction covenants such as maintenance of margin, payment of interest in time, submission of stock statement, submission of other statements by the borrowers, review of accounts at appropriate times, etc., together with the loan-specific stipulations such as raising of the promoter’s contribution, creation of mortgage of a property after completion of the legal formalities will provide the basic framework to obtain and use various monitoring tools.

The focus of the monitoring process is always to ensure the safety of funds lent and see that the account is conducted as per the terms and conditions of the sanction. It is necessary to understand that recovery of overdue amounts or critical amounts in Standard Assets causing concern is essentially a short-term strategy. An in-depth analysis of the problems facing the borrowing unit has to be made and necessary remedial measures need to be initiated for ensuring long-term viability of the unit.

Monitoring function in a bank should cover all the three stages, viz., pre- disbursement, during disbursement and post-disbursement phases of an advance account. The pre-disbursement stage covers obtaining satisfactory credit reports from existing lenders, post-sanction but pre-disbursement inspection report, execution of the stipulated security documents, including creation of collateral security/mortgage as per terms of the sanction, obtaining letters of guarantee from the guarantors, if any. The other formalities such as vetting of documents by legal experts and ensuring disbursement by the other participating banks and financial institutions are also required as the responsibility of the monitoring department.

# Debt collection and loan recovery

On the question of whether debt collection has enhanced loan recovery in Barclays bank, 36.8% of the respondents strongly agreed, 35.1% agreed that the bank ensures effective debt collection process. In addition, it was stated that 47.4% strongly agreed, 28.1% agreed to the statement that effective debt collection reduces on bad debts if properly utilised and can mitigate losses in terms of bad debts which can ultimately expose the bank to losses. It was also revealed that 33.3% of the respondents strongly disagreed and 38.6% disagreed to the statement that Barclays has experienced debt collection officers, it was stated that collection officers do not effectively perform their roles to implement the institution’s credit administration because some lack the necessary experience. 54.4% who strongly agreed and 36.8% agreed respectively that credit officers ensure to perform credit appraisal on clients, which meant that bank’s credit officer’ conduct credit appraisals on clients before loans are issued. It was also stated that 29.8% strongly agreed and 31.6% agreed that the credit appraisal methods are effective where they constantly evaluate loan books and brings about qualitative improvements in credit administration. 38.6% disagreed and 31.6% strongly disagreed to the statement that amount of non-performing loans is reduced, it was revealed that debt collection process and overall credit risk management at the bank has been ineffective in ensuring loans granted are paid back in time and with agreed interest

Bank’s sustainability and levels of development basically depend on high recovery levels of its loan portfolio. Therefore, the policies and implementation of the collection actions and disciplines have unquestionable importance and must be carried out constantly and with the consistency required by the results of the analysis of the loan portfolio, Credit collection policies manual (2007). Hunt (2007) gives an overview of the debt collection industry and provides details about its institutional structure and regulatory environment. Hynes (2008) examines the process of debt collection in state courts and finds that consumers who are sued by creditors or debt collectors are drawn from areas with lower socio-economic characteristics. In contrast to the large corporate finance literature on investor and creditor rights that followed there has been little work on lender rights in retail credit markets

According to Atrill (2006), there is evidence that some commercial banks are challenged in managing their working capital despite their high investments in current assets in proportion to their total assets and this has been a major cause of their high failure rates as compared to large businesses. According to him, majority of the banks operate without effective and sound credit control department implying that both the expertise and the information required to make sound judgments concerning terms of services may not be available. They also lack proper debt collection procedures, hence, they tend to experience increased risks of late payment and default by debtors who tend to increase where there is an exclusive concern for growth; in this case, commercial banks may not be too willing to extend credit to customers who have poor credit risks. Also, in a recent study by Bowen *et al.,* (2009) debt collection was identified by 55% to be among the top five major challenges facing financial institutions, this not only threatens its profitability but also long term sustainability.

Arguments by Pike et al., (2008) reveal that financial institutions feel that the management of debtor days is the most important measurement of the effectiveness of their credit management processes followed by their achievement of cash collection targets. It is interesting to note that a number of countries are implementing or have implemented interest charges on late payments in an attempt to support small business. Generally the interest rates on these late payments are quite high. In Australia the Late Payment Bill was not passed but other government bodies are seeking remedies to the problem. Generally it was agreed that the longer a debt remains outstanding, the greater the risk of it becoming uncollectible.

The client should see collections as an ongoing rather than sporadic activity, which means that it is very important that the various actors in the process such as call centers, loan officers, and collections agents act in a coordinated and timely manner. The client must feel that the commercial banks have their finger on the pulse of the situation at all times, acting quickly, flexibly, and definitively to control the situation. It is also extremely important that collections activities be directed at all individuals involved in the loan including spouse, guarantors, family, or friends who served as references in accordance with the client’s risk profile and probability of repayment.

Generally, micro entrepreneurs do not provide collateral guarantees to commercial banks. Therefore, many institutions develop non-traditional mechanisms that are basically a type of psychological pressure, called “non-traditional guarantees.” Often, these non-traditional guarantees cannot be executed for legal reasons or because the cost of executing them is greater than the value of the guarantee itself. This makes it even more important that collections activities are founded on efficient strategies and timely negotiations prior to recurring to legal collections, unless all previous actions have proven inefficient for reasons external to the collections process.

In order to achieve healthy, sustainable growth, Commercial banks must plan collections strategies prior to launching a new program or product. The following subsections discuss the “best practice” for collections as well as examples, where applicable, of Commercial banks in which they have been implemented. These practices come into play well before the loan is delinquent, striving to create proactive strategies to diminish the occurrence of overdue loans. They recognize the valuable role that well-trained internal and external collections staff performs. They offer suggestions for the precise collection and maintenance of data, segmentation of clients and offering of “collections products” or payment alternatives tailored to the needs of the client. And, finally, they provide a listing of policies and procedures that contribute to successful collection of delinquent loans.

# Credit risk governance and improved liquidity

On the question of whether credit risk governance has ensured improved liquidity, 47.4% strongly agreed and 36.8% who agreed respectively that credit risk governance is implemented under credit policy which meant that the bank follows credit policy which reduces on chances of credit crunch and also decline in asset prices. 33.3% who both strongly agreed and agreed that credit risk governance processes can enhances profitability. It was also revealed that 26.3% strongly disagreed and 35.1% disagreed that credit and field officers have relevant training on credit management, which implied that inefficiencies in debt collection are as a result of unskilled personnel. 33.3% strongly agreed and 35.1% agreed that customers comply with stipulated credit period given because credit period given to customers is met without fail as the penalty can be more costly. 57.9% strongly agreed, 36.8% who agreed that credit governance ensures charged interest rates fetch enough profits. 47.4% strongly agreed and 26.3% agreed that Credit risk governance ensures effective monitoring of debtors

The field of risk is inherently complex. Additional complexity has resulted from the rapid development of financial markets, products, and financial services organizations over the past two decades, and the concurrent accumulation of a large body of thought and vast amounts of regulation on risk topics. This has sometimes had the unintended consequence of obscuring, rather than illuminating, the underlying rationale of risk management.

Risk governance principles are, above all, the responsibility of the Board of Directors and of the most senior executives and management bodies of a banking institution. The members of those bodies have to articulate and elaborate those principles in internal policies, and to communicate them effectively throughout the organization. They also have to oversee the implementation of those principles through management decisions and actions. Bank Board members and senior executives are therefore one set of intended users of this document.

The design and implementation of a sound risk process is largely the responsibility of senior risk officers, business line managers, the dedicated risk management function as a whole, as well as other control functions within the bank, such as financial control and internal audit. Those constitute another set of intended users of this document.

Financial institutions need to determine their appetite for different types and levels of risk, carefully taking into consideration their organizational capacity to manage such risks. The comprehensive understanding of that risk appetite throughout the various levels of an organization should drive the balancing of risk and return, the allocation of capital, product pricing, as well as incentives and remuneration structures for employees, management, and Board members. Business strategy as the backbone of revenue pursuits needs to be developed and continuously brought in line with that risk appetite.

Even if on average the high return/ high risk and the low return/ low risk strategies are expected to produce similar net results, the types of people, systems and processes required by those strategies are by necessity very different. Those differences apply to both the revenue generation side of the business and to the risk management and mitigation side of it. Therefore, a bank’s management needs a good understanding of the tradeoffs between risk and return that result from different business strategies. It also needs to assess thoroughly which tradeoffs its institution is capable of taking – given its human and technological resources, knowledge base and position in the market. Without that understanding, pursuing any business strategy is at best uninformed and often worse irresponsible. Developing that understanding is the essence of risk appetite determination.

# CHAPTER EIGHT

# SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

# Introduction

This chapter comprises of the summary of findings, conclusion and recommendation of the study according to the study objectives. The study is about credit risk management and profitability. The recommendations are on a basis of the findings and relates to advice and the interventions that the researcher feels should be brought to the attention of Barclays bank to improve profitability. The study ends by presenting the areas that the researcher considers vital for further studies

# Summary of the findings

# Credit monitoring and return on assets

Results revealed that Barclays bank recognises the need to put in place a very sound and effective credit monitoring system for watching the borrower’s account from various angles. It was also revealed that higher operating costs in credit monitoring increases the ratio of loans to assets as long as interest rates on loans are liberalized and the bank applies markup pricing. Results also showed that bank does not have a clearly defined system that tracks non-performing loans. Respondents stated that the bank has guidance on issues related to non-performing loans but lacks a clear implementation system in place to effectively track defaulters. Barclays bank makes routine monitoring of lenders in order to have better risk management and lower portfolio losses. It was also stated that often clients do not comply with credit period given which leads to delayed profit for Barclays bank hence the accumulated non-performing loans are as a result of non-compliance from clients. Management stated that the bank uses various debt collection methods such as notifying delinquent customers through mobile app notifications as customers receive late payment messages through the platform.

# Debt collection and loan recovery

On this question results revealed that debt collection at Barclays bank if properly utilised can mitigate losses in terms of bad debts which can ultimately expose the bank to losses. Barclays bank has debt collection officers who do not effectively perform their roles to implement the institution’s credit administration because some lack the necessary experience. Respondents stated that Barclays bank’s credit appraisal focus on evaluating the credit worthiness of the future expected stream of cash flow with the amount of risk attached to them. Respondents stated that Barclays bank uses loan review mechanism especially for large value accounts with responsibilities assigned in various areas such as, evaluating the effectiveness of loan administration, maintaining the integrity of credit grading process, assessing the loan loss provision, portfolio quality. It was also revealed that debt collection officers determine the terms and times of collecting loaned money from a client depending on the different client situation in terms of credit worthiness.

# Credit risk governance and liquidity

It was revealed that Barclays bank follows credit policy which reduces on chances of credit crunch and also decline in asset prices. It was also stated that the risk governance is a major contributing factor in determining the bank’s profitability. The results also showed that the inefficiencies in debt collection are as a result of unskilled personnel. Respondents stated that increases in the [interest rate](https://www.investopedia.com/terms/i/interestrate.asp) directly increase the yield on this cash, and the proceeds go directly to earnings. The benefit of higher interest rates is most notable for brokerages, commercial banks and regional banks. Respondents also stated that senior management through risk governance ensure to implement the credit risk strategy by developing policies and procedures for identifying, measuring, monitoring and controlling credit risk through policies and procedures. Respondents stated that failure to pay back loans cause trouble with cash flow and hinder ability to meet the bank’s financial obligations due increase in non-performing loans.

# Conclusion

The involvement of credit officers and customers in formulating credit terms affects Barclays bank loan performance. Interest rates charged had a negative effect on the performance of the loans, the higher the interest rates the lower the loan performance.

Collection policies adopted by commercial banks had an effect on loan performance; stringent policy had a great impact on loan performance.

Credit risk controls adopted by the commercial banks have an effect on loan performance, credit insurance, signing of covenants with customers, diversification of loans, credit rating of customers, reports on financial conditions, and refrain from further borrowing had an effect on loan performance.

# Recommendations

The study recommends that credit risk identification should not be a one off thing as some risks could be hard to detect or overlooked by those tasked to identify them and therefore it should be a continuous process which is carried out at different places and by different individuals. It is important for the Barclays bank to formulate an appraisal process/ procedures, format that details ways of capturing all the credit risk.

The study also recommends that Barclays bank should enhance their credit risk monitoring techniques so as to improve their profitability.

The study also recommends that there is need for Barclays bank to enhance their client appraisal techniques so as to improve their financial performance.

The study recommends that Barclays bank should enhance their collection policy by adapting a more stringent policy to a lenient policy for effective debt recovery.

There is also need for Barclays bank to enhance their credit risk control this will help in decreasing default levels as well as their non-performing loans. This will help in improving their financial performance

# Areas of further studies

The study selects the following areas for future study;

Factors affecting profitability and liquidity in Uganda’s financial institutions

Impact of credit risk management on profitability of commercial banks in Uganda

Loan performance and profitability of microfinance institutions in Uganda

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# APPENDIX A: SELF ADMINISTRED QUESTIONAIRE

Dear respondent,

I am BIIBI JULIUS a student of Nkumba University pursuing a Master of Business Administration currently under taking my research. I am conducting a study about “the role of credit risk management on profitability of commercial banks in Uganda basing on a case study of Barclays Bank of Uganda”. You have been identified as a resourceful person and you are kindly requested to fill this questionnaire and the information given will be confidential and strictly used for academic purposes only. In case you are interested in recovering a copy of an abstract of this research, please indicate your email address at the end of this questionnaire.

Thank you for your cooperation

Yours, Biibi Julius

Researcher

**PART 1: BACKGROUND INFORMATION OF RESPONDENTS**

**“Please tick in brackets provided ( )**

1. Gender of respondent?

1. Male
2. Female

2. Age group (in years)

1. 20-30
2. 31-40
3. 41-50
4. Above 50

3. For how long have you worked in Barclays Bank Uganda?

1. Less than one year
2. 1-4 years
3. 5-7 years
4. 8 years and above

4) Indicate the highest level of education attained.

1. PhD
2. Masters
3. Degree
4. Diploma
5. UACE

**Under this section B-E, you are required to tick the answer that best gives your answer based on the 5 Likert scale below.**

**1. Strongly disagree (SD) 2. Disagree (D) 3. Not sure (NS) 4. Agree (A) 5. Strongly agree (SA)**

**SECTION B: Credit monitoring and return on assets in Barclays Bank Uganda.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Statement** | **1** | **2** | **3** | **4** | **5** |
| 1. Barclays ensures monitoring of all loaned credit |  |  |  |  |  |
| 2. Barclays offers loans on basis of institution’s policy |  |  |  |  |  |
|  3. Unit increase in credit monitoring increases on return on assets |  |  |  |  |  |
| 4. The bank has a clear system of tracking non-performing loans |  |  |  |  |  |
| 5. Credit advanced to clients is effectively monitored in terms of repayment  |  |  |  |  |  |
| 6. Customers always make timely payments as per credit terms |  |  |  |  |  |
| 7. Credit monitoring insures credit default is low  |  |  |  |  |  |
| 8. Effective debt collection reduces on effects of non-performing loans  |  |  |  |  |  |
| 9. Barclays bank has effective screening process of debtors |  |  |  |  |  |
| 10. Bank has credit policies that improve prudential oversight of asset quality |  |  |  |  |  |

**SECTION C: Debt collection and loan recovery in Barclays Bank Uganda.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Statement** | **1** | **2** | **3** | **4** | **5** |
| 1. Barclays ensures effective debt collection |  |  |  |  |  |
| 2. Effective debt collection reduces on bad debts  |  |  |  |  |  |
| 3. Barclays has experienced debt collection officers |  |  |  |  |  |
| 1. Credit officers ensure to perform credit appraisal on clients
 |  |  |  |  |  |
| 1. The credit appraisal methods are effective
 |  |  |  |  |  |
| 1. Amount of non-performing loans is reduced
 |  |  |  |  |  |
| 1. Debt collection reduces capital locked with debtors
 |  |  |  |  |  |
| 1. Debt collection is done in line with credit policy
 |  |  |  |  |  |
| 1. Debt collection takes in regard the credit worthiness of a client
 |  |  |  |  |  |

**Objective 3: Credit risk governance and improved liquidity in Barclays Bank Uganda.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Statement** | **1** | **2** | **3** | **4** | **5** |
| 1. Credit risk governance is implemented under credit policy |  |  |  |  |  |
| 2.Credit risk governance processes enhances profitability |  |  |  |  |  |
| 3. Credit and field officers have relevant training on credit management |  |  |  |  |  |
| 1. Customers comply with stipulated credit period given
 |  |  |  |  |  |
| 1. Credit governance ensures charged interest rates fetch enough profits
 |  |  |  |  |  |
| 1. Credit risk governance ensures effective monitoring of debtors
 |  |  |  |  |  |
| 1. Failure to pay back loan affects bank’s profitability
 |  |  |  |  |  |
| 1. Customers provide sufficient collateral to cover offered loans
 |  |  |  |  |  |

# APPENDIX B: INTERVIEW GUIDE

GUIDE LINES DISCUSSIONS AMONG RESPONDENTS

Location:

Date:

Time discussion started: time ended

**Introduction**

1. Introduce myself (my name and the University I study from)

2. Introduce respondents

3. Explain the purpose of the visit: “I want to understand the role of credit risk management on profitability of commercial banks in Uganda, basing on a case study of Barclays Bank Uganda.

Hereto, ask respondents if they are willing to participate in the group discussions.

Question:

1. Barclays ensures monitoring of all loaned credit

2. Unit increase in credit monitoring increases on return on assets

3. Barclays bank has fair interest rates that are profitably invested

4. Credit advanced to clients is effectively monitored in terms of repayment

5. Effective debt collection reduces on bad debts

6. Barclays has experienced debt collection officers

7. Credit officers ensure to perform credit appraisal on clients

8. Credit risk governance is implemented under credit policy

9. Credit governance ensures charged interest rates fetch enough profits

10. Credit risk governance ensures effective monitoring of debtors

11. Customers provide sufficient collateral to cover offered loans