Credit Management in Selected Microfinance Institutions in Central Uganda

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***Abstract* - This study investigated the degree of credit management and level of financial sustainability in selected Micro Finance Institutions (MFIs) in central Uganda. The ex-post facto, descriptive comparative and descriptive correlation designs were employed. A minimum sample of 277 was used in data collection and analysis. The data were analyzed using means and Fisher's one way analysis of variance. The findings revealed that; (i) satisfactory degree of credit management overall mean of 3.07. (ii) There is significant difference in the degree of credit management according to district sig of 0.017. It was concluded that strong coordination of the credit department increases financial sustainability in MFIs. Basing on the findings, the researchers recommended that MFIs should establish optimum credit policy in terms of ideal credit standards, credit terms, and debt monitoring and collection strategies to promote financial sustainability of MFIs.**

Key Words: **Credit Management, Microfinance Institutions**

I. INTRODUCTION

In order to bring financial services closer to the people where big financial institutions can not reach, to enhance poverty reduction of the masses and foster economic growth, the government of Uganda is using microfinance institutions (MFIs) as agents of its program "prosperity for all". In order for these MFIs to properly fulfill their obligations and also flourish in a robust business environment, they have to improve their performance.

[29] While emphasizing insufficient credit policies in MFIs observed that only 3.5% of the MFIs in the World were financially sustainable, 7% of the MFIs were tending towards financial sustainability with operating costs averaging 15-25% of their total costs. The other 89.5% of the MFIs will either fold or require subsidies to be made available to finance their operations unless they are transformed from welfare approach (depending on grants and subsidies in a regulated environment) to peruse the institutional approach to financial sustainability while maintaining a sustainable credit policy.

[24] Reported a tremendous turnaround on selected Indonesian MFIs that revised credit policies and doubled their profits and archived financial sustainability in the period 2004-2006. The operating environment for MFIs in Uganda is liberalized, regulated by the MDI Act 2003, MDI regulations Act 2004, Company Act Cap.85, and the Co-operative society statute 1991 alongside the Association of Microfinance Institutions in Uganda. Apex institutions namely Ministry of Finance, Bank of Uganda, Microfinance Support centre limited, Uganda Institute of Bankers and Uganda Cooperative Alliance supervise the conduct of Microfinance business in which the government has a poverty eradication agenda and financial sustainability for MFIs.

The Government of Uganda assured MFIs in a conducive environment, enacted MDI Act 2003 and regulation Act 2004 besides the Medium Term Competitive Strategy (MTCS) in which further commitment towards financial sustainability of MFIs was declared. Leading MFIs in Central Uganda include: PRIDE Microfinance limited, Micro Enterprise Development Network, Finance Trust (U) limited, Tier 4 NGO's Savings and Credit Cooperative Societies (SACCOS) and Opportunity Uganda.

The MFIs and MDIs in Central Uganda are not using financially sustainable credit policies. Consequently Bank Of Uganda reported reduction in profits for MDIs by UGX 2.4 billions from UGX 8.2 billions with profitability declining in 2007 which threatens their future survival [18] Liberalization of Uganda's banking industry has created an increasingly competitive landscape in the banking sector. The service providers are all in constant search for new product services and strategies for ensuring sustainable growth, increased market share, competitiveness and profitability

Low performance of MFIs in Uganda has been documented by several researchers for example [4] [5] [19]. [20] and [27]. In 2009 the ministry of trade and industry issued a report that MFIs were faced with poor Loan portfolio because of poor recovery. It was further indicated that the bad debts had a very big effect on MFI ability to recycle their financial resources and that were a threat to their profitability and survival. The report also indicated that many MFIs were formant and were about to close. Credit management refers to guidelines and procedures MFIs is use for granting credit to applicants while monitoring their credit performance for timely collection of loans. The credit management variables of this include credit standards, credit terms, and credit monitoring and collection strategy.

II. LITERATURE REVIEW

2.1 Credit Standards

Several researchers have attempted to study credit standards and financial sustainability of MFIs for example

[22] asserts that good credit standards ensure that MFIs offer credit to the financially strong and most reliable clients with well laid down credit terms. [28] Noted that there exists a direct relationship between credit appraisal and financial performance. He argued that the MFI's choice of credit policy between stringent and lenient is a function of both the competitive business environment and the company's strategic business goals and objectives while [23] found that the more liberal and well defined the credit appraisal and approval procedures, the higher the likely hood the level of receivables because more customers are willing to take credit and vice versa.

[3] Found that the best time to manage credit risk and control delinquency is when evaluating a credit applicant or when performing up dates on active customers which determine the MFI's performance in terms of growth, sustainability and harvest stages. [26] Failure to make accurate assessment of credit applicant's character is the leading cause of poor quality of accounts receivables in MFIs. [16] in his study on credit management issues in Uganda's Microfinance sector using the central region as a case study, reported that there is a weak positive relationship between credit appraisal and approval procedures and performance of microfinance Institutions due to lack of proper credit vetting procedures especially for new clients, insufficient information for credit applicants as well as limited reference bureaus in the country. [25] argued that client screening before credit appraisal is best done using the credit scoring guidelines using the 5Cs (character, capacity, capital, collateral and condition).this is line with [7] who argued that care should be taken to asses both the existing and potential capacity of the applicant to finance the future credit obligations because current capacity may be misleading. [20] in her study credit management and financial performance of Media Houses in Uganda found that in order to ensure proper credit vetting and follow up, the credit control and sales and marketing teams work hand in hand, some times they move together to the field to check on clients, more so before credit approval consultation is made from both teams. However none of these studies related to credit appraisal and approval procedure on sustainability of MFIs, a gap this study is set to fill.

2.2 Credit Terms

[23] contends that , the more liberal the credit terms , the higher the level of receivables because more are willing to take up micro credit and enjoy benefits and vice versa. [11] findings suggested that a MFI which insists on payment in accordance with agreed credit terms and which is prepared to take action to recover due debts is most likely to be paid in full and on time and this promotes growth and sustainability. He however noted that there is a challenge of loosing slow paying customers to competitors. [6] highlighted the need to have well set credit terms with in a credit policy that are agreeable to both the client and the firm. It is vital in management of trade credit and tracking of overall financial performance. There is a proportional relationship between credit terms and financial performance in that if credit terms are agreeable to both parties, the better the management of the trade credit and as such financial performance. [15] In his study on financial policy and performance of banking sector in Uganda, revealed that there exist a moderate positive relationship between credit terms and financial performance. [20] in her study credit management and financial performance of media house in Uganda, case study of New Vision printing and publishing company limited, found that different categories of customers need different credit terms depending on credit history, volume of business transaction and it is the flexibility of credit terms that results into increased customer base and timely payment which improves the firm's financial performance. While only one study was on credit management, none was directly linking to sustainability of MFIs, and none was on Central Uganda, gaps the proposed study will fill.

2.3 Debt Monitoring and Collection Strategy

[25] argued that a MFI that has control over the volume of credit and collection strategy incorporated in its credit policy is most likely to realize profits through granting credit and becomes financially sustainable. Other debt collection strategy such as involvement of senior management in debt collection ensures the debt collection strategy positively lead to financial sustainability. They added that reliance on telephone communication to follow up debts as opposed to personal visits sometimes make the debt collection strategy ineffective as some clients are not committal on their phone agreement regarding debt settlement.

Factoring of receivables enables the firm to pass over the responsibility for debt collection to factor house [3]. [26] Further argued that slow paying debtors need to be handled cautiously to avoid collection errors especially where long term patronage of business is desirable, legal procedures should not be used as they tend to mark a final point of business dealings between the two parties. [22] Noted that a debt collection policy is needed because not all customers pay at the same time as some are slow payers while others are non-payers. He further stresses that the policy should lay clear cut collection procedures and specify which department between sales and finance is responsible for what actions in as far as debt collection is concerned. [27] In her study financial policy and sustainability in eight selected local-non government organizations in Kampala district, findings revealed a weak but positive relationship between the debt collection strategy and financial performance. However, none of the cited studies was on the Central Uganda context, a gap the proposed study intends to fill.

According to [1], there is a positive relationship between credit monitoring and financial sustainability; credit monitoring is a key function of credit policy and ultimately affects sustainability. It therefore needs an organization of a team in such away that they are competent in handling emergency work like getting outstanding balances as well as

more detailed work like accounting reconciliations. Credit monitoring attributes such as timely notification of customer as they approach credit limits, prompt updating of client account with payments and regular sending of customer statements lead to minimum defaulting.

Problems of credit monitoring were also observed by [27] when he stated that frequent transfers of credit staff adversely affects their morale and loose interest in discharging their duties and this serious when the transferred credit staff gets limited time to handover his/her portfolio, which may lead to loan default. [20], adds that credit management process deserve special emphasis, because proper credit monitoring greatly influences the success or failure of financial institutions. On the problems of loan monitoring [14] concurred with [28], when he noted that client screening is not exact science. Even the most careful screening will reach some borrowers who are either not willing or able to repay or both. MFIs are limited in their screening capacity because they need to keep the costs per loan to a minimum. At some point additional dollars spent on screening are not cost effective. Today's booming business can be quickly undermined by competitors, changes in regulations or personal crisis. All these problems make monitoring a necessity if loan default is to be minimized or eradicated. [20], revealed that companies that have fully fledged credit control and internal audit sections, their clients are closely monitored which causes timely payment with better working relationships with clients, it is the key reasons responsible for better financial performance. While all these studies were on credit monitoring, none of them was specifically on sustainability MFIs in central Uganda, a gap this study intended to fill.

Credit management involves policies and practical MFIs follow in receiving payments from their customers. It involves setting clear written guidelines that set the terms and conditions of credit [22]. Past studies revealed that credit management deserves special emphasis because greatly influences the growth of MFIs. [11], revealed that a MFI which insists on payment in accordance with agreed credit terms and which is prepared to take action to recover due debts is most likely to be paid in full and on time.

Null Hypothesis

The null hypothesis tested in this study was that: There is no significant difference in the degree of credit management among the selected MFIs according to district.

III. METHODOLOGY

The study employed the ex-post facto and descriptive comparative strategies, the data were collected using researcher devised questionnaires with items on credit management. A minimum sample size of 277 was determined statistically. Respondents were selected simple random sampling. The Cronbach's Alpha coefficient test indicated that the questionnaires were acceptable at above 0.7 (α = 0.77) and the contentment validity index was 0.68 above 0.5. The data were analyzed using summary statistics such as means and ranks, while the null hypothesis was tested using Fisher's one way analysis of variance (ANOVA).

IV. FINDINGS

Degree of Credit management in terms of credit standards, credit terms, debt monitoring and collection strategy in the selected Microfinance Institutions in Central Uganda.

The overall findings indicated satisfactory credit management in the selected Microfinance Institutions in Central Uganda (overall mean=3.07).

Table 1: Degree of Credit Management In Terms of Credit Terms, Credit Standards, Debt Monitoring and Collection Strategy

Category	Average mean	Rank	Interpretation
Credit terms	3.22	1	Satisfactory
Credit standards	3.14	2	Satisfactory
Debt monitoring and collection strategy	2.85	3	Satisfactory

Key For Interpretation of Means

Mean range	Description / Response mode	Interpretation
3.26 – 4.00	Strongly agree	Very satisfactory
2.51 – 3.25	Agree	Satisfactory
1.76 – 2.5	Disagree	Fairly satisfactory
1.00 – 1. 75	Strongly disagree	Unsatisfactory

The findings in table 1 indicate satisfactory credit management among microfinance institutions in Uganda. There is satisfactory credit standards (mean = 3.14), satisfactory credit terms (mean = 3.22), and satisfactory debt monitoring and collection strategies (mean = 2.85).

The findings in this study indicate that MFIs in central Uganda have the ability to appraise the credibility of potential customers before credit is granted in order to mitigate the credit risk. These findings are also in agreement with [2] who stipulated that in evaluating a potential customer's ability to pay, consideration should be given to the firm's integrity, financial soundness, collateral to be pledged and current economic conditions. [13] Observed that the greatest challenge of financial institutions is the construction of legal bargaining agreements coupled with enforceable collateral provisions. Findings are also supported by [22], [11] and [23] who argued that the more liberal and well defined the credit appraisal and approval procedures are, the higher the likelihood the level of receivables because more customers are willing to take credit. This is also in line with [3] who found out that the best time to manage credit risk and control delinquency is when evaluating credit applicants which determine the sustainability of MFIs. This was also documented by [26] who contends that failure to make accurate assessment of credit applicant's character is leading cause of poor quality of accounts receivables in MFIs.

[16], observed a number of reasons for poor performance of MFIs in Uganda such as lack of proper credit vetting procedures especially for new applicants, insufficient information on credit applicants as well as limited reference bureaus in the country, while [20] argued that to ensure proper credit vetting and follow up, the credit control, sales and marketing teams need to work hand in hand and sometimes more together in the field of check on clients. [17], contends that if credit terms are agreeable to both parties, the better the management of credit and as such financial performance. [20] Showed that different categories of customers need different credit terms dependency on the client's credit history and volume of business transaction and added that it is the flexibility of credit terms that results into increased customer base and timely payment which impress the firm's performance.

Table 2. Difference In The Degree Of Credit Management According To Districts

Categories	Districts	Mean	F	Sig	Interpretation	Decision on Ho
credit standards	Kampala	3.1815	.665	.574	No significant difference	Accepted
	Mukono	3.0978				
	Mpigi	3.0933				
	Wakiso	3.1574				
credit terms	Kampala	3.0652	5.574	001	Significant difference	Rejected
	Mukono	3.3174				
	Mpigi	3.2867				
	Wakiso	3.3926				
Debt monitoring	Kampala	2.7895	3.607	.014	Significant difference	Rejected
	Mukono	2.9039				
	Mpigi	2.7787				
	Wakiso	2.9650				
Overall Credit management	Kampala	3.0121	3.469	.017	Significant difference	Rejected
	Mukono	3.1064				
	Mpigi	3.0529				
	Wakiso	3.1717				

The underlying assumption here was that credit management do not differ significantly in the selected MFIs in central Uganda. The one way ANOVA was used to verify this hypothesis and as indicated in table 2, the hypothesis was accepted for credit standards and rejected for credit terms and debt monitoring and collection strategy.

V. CONCLUSION

The overall degree of credit management in selected MFIs in central Uganda was rated satisfactory (overall mean =3.07). The satisfactory degrees however varied in respect to credit terms (Average mean =3.22), credit standards (average mean=3.14), debt monitoring and collection strategy (average mean=2.85). This evidently shows that Microfinance

Institutions need to have appropriate credit policy to be financially sustainable.

VI. RECOMMENDATIONS

Microfinance Institutions should develop ideal credit policies in terms of credit standards, credit terms, and debt monitoring and collection strategy. Care should be taken when evaluating credit applicants, the credit policy should not be too stringent but at the same time it should not be too liberal.

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