CREDIT APPRAISAL AND APPROVAL PROCEDURES AND FINANCIAL PERFORMANCE OF MICROFINANCE INSTITUTIONS IN CENTRAL UGANDA.

Dr. Ssendagi Muhamad
St Lawrence University, School of Postgraduate Studies
Email: ssendagimoh@gmail.com

Abstract

The purpose of this study was to establish the effectiveness of Credit appraisal and approval procedures on the financial performance of microfinance institutions in Central Uganda. The study objectives included (i) to analyze the credit appraisal and approval procedures by Microfinance Institutions, (ii) to examine perception of credit staff towards the existing credit appraisal and approval procedures in Microfinance Institutions in Central Uganda and (iii) to assess the relationship between Credit appraisal and approval procedures and the financial performance of microfinance institutions in Central Uganda. The study adopted both positivist and interpretivist approaches. The study used a sample of 41 Microfinance Institutions in Central Uganda. The study revealed that MFIs use client appraisal and approval procedures in credit management to a great extent. The results indicated that credit standards accounted for only 17.3% variations in financial performance of Microfinance Institutions.

Furthermore, the study established that client appraisal and approval is a viable mechanism of mitigating credit risk. It also established that there was no significant relationship between credit appraisal and approval procedures and financial performance. The researcher recommended that there is need for MFIs to enhance credit standards so as to improve the financial performance of Microfinance Institutions.

Introduction

Formal microfinance can be traced back to the pioneer work of the Grameen Bank in Bangladesh and Accion International in Latin America in the late 1970s (Accion International,2006 and 2007; Chu,2006;

Ledgerdwood,2002; Christen,1997). The major thrust of Grameen Bank was to promote access to financial services for the poor to enhance their participation in productive activities. For Accion International, the primary objective was to promote access to financial services for those unable to access them from the traditional formal financial sector. The two roles ascribed to microfinance have become key driving forces for promoting access to formal financial services for low income earners and reducing poverty (Kalpana, 2005; Fernando, 2002; Littlefield et al., 2003; Mathie, 2002; Morduch, 2006; Schreiner, 2003).

Since 1976, after the emergency of Grameen Bank, the number of institutions providing microfinance has grown rapidly especially in developing countries. Many Non Governmental Organizations and traditional banks have joined the business of microfinance and thereby bringing the total number of households served worldwide by microfinance programmes to about 67 millions (Bogan, Johnson& Mhlanga,2004). As the number of MFIs continues to grow and competition becoming investable in the industry, concerns for the survival and long term sustainability of these institutions also continue to grow. Throughout the World, financial sustainability of microfinance institutions has been one of the issues that has recently captured the attention of many researchers due to its importance in the livelihood of microfinance institutions

In Uganda at the beginning of the 1990s there was no specialized formal financial institution delivering microfinance, but a handful of non-governmental organizations (NGOs) and government programs doing so. The last 22 years have experienced a rapid expansion of the industry. By December 2005 the number of active MFIs was about 750 the majority of which were saving and credit cooperatives (SACCOs) (MOFPED,2006). In 2004 and 2005 four formally non-Bank of Uganda (BOU)-regulated MFIs or tier 4 MFIs, namely Finca-Uganda, Uganda Microfinance Union(UMU), Pride-Uganda and Uganda Women's Finance Trust (UWFT) transformed into BOU-regulated MFIs following the enactment of the Micro Finance Deposit-taking Institutions(MDI) Act, 2003.
As the microfinance industry has evolved and rapidly expanded both globally and in Uganda, questions regarding sustainability have come to the fore.

The closure of banks and bank branches as well as the drive for prudent operations and efficiency of the banking industry gave microfinance institutions the chance to fill the gap and expand rapidly from the mid-1990s onwards. The microfinance industry in Uganda was a natural offshoot of the general dynamics of the country's economy, which left rural and other low income people lacking financial services in the last three decades. The economic breakdown of the late 1970s and 1980s caused many banks to close upcountry branches and community based financial institutions like SACCOs also closed down. Attempts to reverse this through massive branch opening by the then UCB in the 1980s was not successful as many of the branches made perpetual losses and were closed down. This was exacerbated by the massive failures of four banks in 1998, including the Cooperative Bank which then had the second largest branch network and agency arrangements for its microfinance sub-branches. The issues highlighted above left rural and other poor people in Uganda without formal financial services.

Microfinance was and is still seen as the most obvious vehicle for delivering financial services to the urban and peri-urban low income earners as well as to the rural population.

As it has been argued" unsustainable MFIs might help the poor now, but they will not help the poor in the future because the MFIs will be gone" (Schreiner, 2003). Moreover, it has been reported that it may better not have MFIs than having unsustainable ones (Nyamsogoro, 2010 and Ganka, 2010). A study on microfinance credit appraisal and approval procedures is a topic of considerable interest by many researchers. However, most studies undertaken in the past few years focused mainly on credit models used by MFIs and theitr impact on profitability. Absence of empirical studies on the effectiveness of appraisal and approval procedures on the financial performance of microfinance institutions was a principal motivation behind this study.

Many microfinance institutions use different policies and initiatives by management policy to aim at profitability and among these include marketing. The microfinance market has evolved over the past decades and has grown at a remarkable pace. It is estimated that today there are

between 7000-10,000 established microfinance institutions. According to Nakazibwe (2010), the number of outstanding loans is very high, so the potential demand is much higher than the loans and services already provided and the market of microfinance institutions is expanding further and thus profitability. In expanding outreach, more and more commercial banks have discovered the potential and the demand for MFIs services and are now providing a range of services for micro entrepreneurs. This shift has been accompanied by another trend towards commercialization of microfinance institution industry characterized by increased competition: a shift from donor assistance towards capital markets a great focus on financial performance. Despite the above initiatives the portfolio performance of microfinance institutions has remained poor/ low as evidenced by Nakazibwe (2010), As a result of the poor loan credit appraisal and approval procedures by the institutions leading to institutions collapse and break downs, MFIs are formed every year but survive for a short time (Bank of Uganda, 2011). Poor financial performance of MFIs in Central Uganda leads to several undesirable outcomes such as not serving customers on long term basis, loosing resources contributed by members, increased unemployment and poverty levels. yet if MFIs are to perform well and be financially sustainable to serve their customers a long time, the factors affecting their financial performance have to be clearly identified. It is against this background that the researcher was motivated to investigate the effectiveness of loan appraisal and approval procedures on financial performance of microfinance institutions in Central Uganda.

According to the Ministry of Finance, Planning and Economic Development (MFPED) (2011), even when most MFIs clients do not have financial records to support their applications for required loans, prudent screening should not be based on verbal explanations. Loan applicants have to submit the details regarding why they need the loans. To Martin (2012) these details are usually submitted in form of project proposals explaining the nature of the business for which a loan is required. Therefore the a analysis of creditworthiness of an applicant is based on the submitted project proposal

Elsewhere, Chandra (2005) argued that credit appraisal and approval refers to the minimum quality of credit worthiness of a credit applicant that is acceptable to the firm. He further argued that a firm should lower its

quality standard for accounts accepted as long as the profitability of sales generated exceeds the added costs of the receivables. If new customers are attracted by the relaxed standards, collecting from these less credit worthy customers is likely to be slower than collecting from existing customers. The same Chandra continued to say that a more liberal extension of credit may cause certain existing customers to be less conscientious about paying their bills on time.

Jae (1998) 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 yet Hampton (2003), argued that to get information on the five Cs a firm may rely on the following; financial statements, bank references, experience of the firm, prices and yields on securities.

Van Hone (1996, 2002) noted that client screening involves obtaining information on loan applicants, and then using the information to analyze and determine the creditworthiness of the applicants so as to make credit decisions. Van Hone (1996, 2002) went on to show that the information is obtained from the applicants' financial statements, credit ratings and reports, trade checking and experience in business. He observed that this information helps in the analysis of not only the creditworthiness and the ability of the applicant to meet the minimum standards for qualifying for the loan being applied for, but also the probability of bad debts. All this is done so as to take an informed decision as to the extension of any loan. Van Hone was, however, generally dealing with the management of financial policy in general but not with particular reference to micro finance institutions. None the less, his observations can guide a study into how these institutions go about their client screening and how this affects their financial sustainability.

Brealey et al (2004) argued that the decision to offer credit depends on the probability of payment; you should grant credit if the expected profit from doing so is greater than the profits from refusing. The same Brealey emphasized that prompt payment is usually a good omen but beware of the customer who establishes a high credit limit on the basis of small payments and then disappears, leaving you with a large unpaid bill. Gitman (1988) adds that to decide whether the firm should relax its credit standards, the

additional profit contribute, on from sales must be compared to the sum of the costs of the marginal investment in accounts receivable and the cost of the marginal bad debts. If the additional profits contributed are greater than marginal costs, credit standards should be relaxed otherwise the present standards should remain unchanged. The empirical result on the relationship between credit standards and sustainability of firms is mixed. A number of studies provide empirical evidence supporting a positive relationship between credit standards and performance of firms or profitability (Roden and Lewellen, 1995; Champion, 1999; Berger and Bonaccorsi di patti, 2006) negative relationship between credit standards and firm's performance or profitability (Rajan and Zingales, 1995; Wald, 1999; Booth et al, 2001; Fama and French, 2002).

Ross et al (2003) stipulated that credit information commonly used to assess credit worthiness include; financial statements such as balance sheets, credit reports on a customer, payment history with other firms and banks. Thus, Credit standards are the criteria which a firm follows in selecting customers for the purpose of credit extension (Bhalla, 2004). Pandey, (1996) adds that it is important to appraise the credibility of the potential customer in order to mitigate the credit risk, which is the risk associated to non-payment of the credit obtained by the applicant. This process involves the applicant being screened to assess their ability to repay back. This is done by gathering relevant information about their payment history with the MFI and other MFIs, information from credit reference bureaus about the client's credit worthiness and ability to manage the business. Credit standards influence the quality of the firm's customers in terms of time taken by customers to repay credit obligation and the default rate (Pandey, 1996). Pandey further observed that on the basis of past practice and experience, the financial or credit manager should be able to form a reasonable judgment regarding the chances of default. To estimate the probability of default, many firms use the traditional and subjective guidelines referred to as the five C's that is character, capacity, capital, collateral and condition (Ross and Westerfield 1998, Pandey 2004)

Character

It is the willingness of the applicant to meet credit obligations (Kakuru, 2003). Experienced credit managers frequently argue that character is the most important issue in any credit evaluation process, since it helps the

financial manager to ascertain whether the customer will make honest efforts to honor his/her credit obligations (Weston &Eugene, 1982). In analyzing the customer's character , a combination of the following aspects are usually evaluated : bank/trade references, marital status, attachment to central government agencies, level of education, contact person, occupational stability and historical background of the applicant are quite relevant (Garrison, 2003). Anthony (2006) found a significant relationship between character of the clients and performance of microfinance institutions. This suggests the need for MFIs to consider the character of the clients when appraising customers.

Capacity

Is the measure of the credit applicant's ability to operate successfully in the foreseeable future (Godfrey, 1992). Greengard, (2003) argued that care should be taken to assess both the existing and potential capacity to generate revenues in the future to finance the obligations because current capacity may be misleading. In analyzing capacity, the credit management should examine issues such as audited financial statements, bank references, previous experience with the applicant, the amount and the purpose of the credit required (Hazel, 1993). If the customer's capacity assessment is low, then granting less credit with closer monitoring would be the most appropriate credit decision. Anthony (2006) found a significant relationship between capacity of the clients to repay and performance of microfinance institutions. Anthony further continues to argue that capacity to repay is critical in client appraisal and microfinance institutions should consider the capability of the customers they are awarding loans to repay.

Capital

It is a measure of the means by which the credit applicant will pay his obligations (Rafuse, 1996 and Hariss & Grahan, 1999). It is the contribution of the customer in the business and is measured by the tangible net worth (Assets- liabilities).it is undesirable to grant credit to persons who have little stake in a given business concern.

Collateral or security

It is the security against failure to pay. It is represented by the assets offered by the customer as a pledge for security of the credit extended. The collateral should be evaluated as being easily marketable, safe or free from any claims

and it is the last thing to consider in credit evaluation, (Kakuru, 2003). Gitman (1991) found a significant relationship between collateral attached and performance of microfinance institutions. Microfinance institutions therefore should evaluate the collateral used as security when appraising the clients, this is because incase of any default the MFIs will recover the collateral in order to service the loan.

Condition

Ross et al (2001) defined condition as the general economic conditions in the customer's line of business. Condition describes an assessment of the impact of the general economic, social, legal, political condition prevailing at that time that may affect the customer's ability and willingness to meet his/her obligations . Although they are beyond the applicant's control, it is useful that their likely impact be assessed and they greatly influence the final credit analysis decision. If the environmental assessment does not show good results then granting unrestricted credit would be a wrong decision. Haron et al (2012) did not find a significant relationship between conditions and performance of microfinance institutions in Meru town Kenya while Abedi (2000) found condition to be important in client appraisal.

Several researchers have attempted to study credit standards and financial sustainability of MFIs for example Ouma (1996) found a no significant relationship between credit appraisal and performance of banks while Olomola (2002) found a positive and significant relationship between credit standards and performance of small firms in Nigeria. Pandey, (2004), asserts that good credit standards ensure that MFIs offer credit to the financially strong and most reliable clients with well laid down credit terms.

Butterworth (1990), Abedi (2000),Van Horne, (2002), Migiri (2002) Horn (2007) and Lawrence (2007) noted that there exists a significant and positive relationship between credit appraisal and financial performance business firms. 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 Refuse, (1996), 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.

Burges (2001) found that the best time to manage credit risk and control delinquency is when evaluating a credit applicant or when performing updates on active customers which determines the MFI's performance in terms of growth, sustainability and harvest stages. Schmidt (2003), failure to make accurate assessment of credit applicant's character is the leading cause of poor quality of accounts receivables in MFIs. Matovu (2006) 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. Ross & Westerfield (1998) 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 Greengard, (2003), 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. Nalwanga, (2010), 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, sometimes 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 financial sustainability of MFIs, a gap this study was set to fill hence leading to a hypothesis; there is no positive and significant relationship between credit standards and financial performance of MFIs in Central Uganda.

Therefore, this study focused on determining the effectiveness of credit appraisal and approval procedures on financial performance of microfinance institutions in Central Uganda, with specific objectives being,

(i) To analyze the credit appraisal and approval procedures by Microfinance Institutions in Central Uganda.

(ii) To examine Perception of credit staff towards the existing credit appraisal and approval procedures in Microfinance Institutions in Central Uganda

(iii) To assess the relationship between Credit appraisal and approval

procedures and the financial performance of microfinance institutions in Central Uganda.

We hypothesize that there is no significant relationship between Credit appraisal and approval procedures and the financial performance of microfinance institutions in Central Uganda.

Geographically the study was conducted in twenty-two districts of central Uganda because that is where most of the MFIs are found and the axis of the economic development in the country.

We believe that findings of this study are beneficial to management of MFIs, their clients and owners of MFIs to appreciate the relationship between credit management and financial sustainability and as such address the areas that need improvement.

The government and activists of poverty action plan will utilize the study findings to identify areas that need intervention in MFIs. The study revealed the factors that affect sustainability of MFIs such as credit terms, debt monitoring and collection strategy.

It will also be useful to other researchers/scholars, as it will add to the existing body of knowledge especially on proper credit management and how it affects financial sustainability of MFIs.

METHODOLOGY

This study employed a descriptive research design. A descriptive study is more rigid, preplanned and structured, and is typically based on a large sample (Churchil & Iacobuci 2004). The purpose of descriptive research is to describe specific characteristics of study variables. In addition, it helps provide data that allows for identifying relationships or associations between two variables (Sekaran, (2000). Two techniques of descriptive research exist: cross sectional and longitudinal. Cross sectional studies collect information from a given sample of the population at only one point in time, while the latter deals with the same sample units of the population over time (Sarantokos, 2005). The cross sectional study is also referred to as a sample survey, whereby selected individuals are asked to respond to a set of standardized and structured questions about what they think, feel and do (Sekaran, 2000). Given the nature of the research objectives of the current study, and the adequate availability of prior evidence to formulate

hypothesized relationships for examination, a cross sectional study was the appropriate technique as opposed to a longitudinal study due to time constraints, and furthermore, this study does not attempt to study trends. The descriptive study was followed by a causal research. Field (2005) states that descriptive studies may show that two variables are related but are insufficient for examining cause and effect relationships. Therefore causal research is most appropriate when the relationship between the causal factors and the predictive power is under investigation (Field, 2005). This study examined credit appraisal and approval procedures and financial performance of MFIs thus the need for a causal research design.

According to Amin (2005) in this type of study design, either the entire population or a subset thereof is selected and from these individuals data is collected to help answer research questions of interest. The design was opted for amongst the many designs because it helps in collection of related data from a homogenous target population at one point in time. It is fast and can help get data from a large number of respondents at little cost or effort. The study was cross sectional because data was collected once from all respondents for a short period to reduce time and costs. Cross-sectional survey designs are common in social science researches and in this study the design was to collect data from a sample of 41 MFIs in Central Uganda that was used to generalize and draw general conclusions on all MFIs in Central Uganda (Linda, 2002; Cengage learning, 2012). Cross-sectional studies are useful for generating and clarifying hypothesis and they help laying the ground work for decisions about future follow up studies. Furthermore linear regression was used to establish relationships between credit appraisal and approval procedures and financial performance of MFIs .

A population of 46 Microfinance Institutions registered by the Association of Microfinance Institution of Uganda in Central Uganda was used as unit of analysis and the unit of inquiry was the credit staff in the MFIs in Central Uganda who are rich in information on credit management of Microfinance institutions.

A sample of 41 Micro Finance Institutions was determined using Krejcie and Morgan table (1970). Seven respondents from the credit department from each Microfinance Institution constituted the unit of inquiry which

totals to 287 responses from the 41 Microfinance Institutions. The 287 responses were aggregated to make 41 cases of unit of analysis.

Simple random sampling was used to select the 41 MFIs from 46 whereby they all had an equal chance of participating in the research. Purposive sampling was employed to select the individual respondents from credit department included the MFI manager, Three Loan Appraisal Officers, Portfolio monitoring and delinquency Officer, loan manager and field supervisor. Purposive sampling was used because the researcher wanted to get respondents from credit department rich in information on credit management in MFIs.

Data was collected by use of primary and secondary sources for both the qualitative and quantitative approaches. Quantitative data from primary sources was obtained by administering questionnaires while for qualitative data was by interviewing of key informants by use of interview guide which helped in getting narrative statements that were common base for reaching conclusions as they provided collaborative evidence on data obtained from questionnaires. The face sheet was used to gather data on MFIs.

The researcher devised questionnaires to establish the perceptions of credit staff on the existing credit management and level of financial performance of MFIs in central Uganda.

Testing Predictor Power of Study Variables

In order to determine the effect of credit appraisal and approval procedures on financial performance, and to provide answers to objective three as well as testing the hypothesis relating to the same objective, regression analysis was performed in order to ascertain the influence and percentage of causation of credit appraisal and approval procedures on financial performance. The researcher found it necessary to test the hypothesis above by carrying out regression analysis, with the aim of establishing the predictor power of the variable.

Results and discussion

Study characteristics

The study targeted 287 respondents from which only 269 who responded

to the questionnaires making a response rate of 94%. This response rate was satisfactory to make conclusions for the study.

In the study the level of credit experience of the respondents was established to examine the number of years in credit department of the respondents. This information was necessary to obtain information on whether the respondents had work experience in credit management or not. The results indicated that only 24% hjad experience of less than one-year work experience in the credit department, this clearly indicates that most credit staff had enough work experience in credit management.

The findings revealed that 59% (24) of MFIs use group lending as a dominant delivery mechanism of MFIs in central Uganda compared to individual methodology, 41% (17). This implies that most MFIs in central Uganda have shifted from relying on the traditional collateral to collateral substitutes. Navajas et al (2000) argued that the lender that does not need physical collateral to judge creditworthiness could serve poorer clients and achieve higher sustainability ceteris pluribus than a lender that requires physical collateral.

The study sought to determine the institutions that had adopted credit management practices. The results indicated that 96.7% of the respondents indicated that their institutions had adopted credit management practices, whereas only 3.3% indicated that their institutions had not. This implies that a significant number of institutions had adopted the use of credit management practices.

The research findings on information regarding credit techniques used in scrutinizing credit applicants and loan appraisal revealed that 24% of the respondents use 5cs of credit appraisal model, 36% of the respondents use credit reference bureaus and 40% of the respondents use both models . This information implies that most microfinance institutions use 5cs of credit appraisal and credit reference bureaus to assess the credit worthiness of the credit applicants. The results agree with Pandey (2004) who noted that the 5cs credit model is a reliable measure of credit worthiness of credit applicants.

The study thought to examine Perception of credit staff towards the existing

Credit appraisal and approval procedures in microfinance institutions in Central Uganda and the results are indicated in table1. Pandey (2004) noted that good credit appraisal and approval procedures ensure that a firm sells mainly on cash basis and only offers credit to financially strong and most reliable clients . He further streamlined that credit appraisal and approval procedures had two components of credit standards and analysis as well as credit terms. Discussed below are the respondents' perceptions towards MFIs credit management in relation to credit standards.

Table 1 : Perception of credit staff towards the existing credit appraisal and approval procedures.

Category	Mean	Std. Deviation	t-statistic	Interpretation	Rank
Credit standards There is a credit vetting team that views and take decisions on credit applications	3.57	0.43	8.3***	Very satisfactory	1
Credit vetting of existing customers is done before additional credit is granted.	3.52	0.38	9.26***	Very satisfactory	2
The credit vetting policy, process and procedures in this institution are well documented.	3.44	0.3	11.47***	Very satisfactory	3
Loans officers and credit control staff are coordinated on vetting of customers.	3.40	0.26	13.08***	Very satisfactory	4
Clients' business is visited and vetted before credit approval.	3.37	0.23	14.65***	Very satisfactory	5
Collateral security is sought from a client before credit approval.	3.29	0.15	21.93***	Very satisfactory	6
Clients' bank statements are reviewed before credit approval	3.00	-0.14	-21.42***	Satisfactory	7

Additional information about credit applicants is always sought from external sources before credit is given.	2.85	-0.29	-9.83***	Satisfactory	8
Clients are screened to establish whether they are credit worthy with other MFIs	2.57	-0.57	-4.51***	Satisfactory	9
There are well established credit reference bureaus in the country.	2.44	-0.7	-3.49***	Fairly satisfactory	10
Average mean	**3.14**			Satisfactory	

Findings in table 1, indicated that there is sound criteria which MFIs follow in selecting customers for the purpose of credit extension. This is exhibited by the existence of very satisfactory credit vetting teams that view and take decisions on credit applications (mean = 3.57) credit vetting of existing customers before additional credit is granted (mean = 3.52), well documented credit vetting policy and procedures (mean = 3.44), well coordinated loan officers and credit control staff on retting customers (mean = 3.40), vetting of clients' business before credit approval (mean = 3.37), seeking of collateral security before credit approval (mean = 3.29), items that have been identified by credit staff as being satisfactory include Review of client's bank statements before credit approval (mean = 3.00) seeking of additional information about credit applicants from external sources before credit is granted (mean = 2.85) screening of clients to establish whether they are credit worthy with other MIFs (mean = 2.57) while items that are fairly satisfactory in the selected MFIs in central Uganda are existence of well-established credit reference bureaus in the country (mean=2.44).

Findings from interviews showed that MFIs are faced with a challenge of obtaining information about clients in the process of credit vetting since in Uganda credit reference bureaus are still weak. In addition, sometimes clients collude with MFIs and improper information is given. This leaves MFIs with the only alternative of relying on information provided by the clients, more so that already provided especially for existing clients.

Table 2 showing the level of financial performance of microfinance institutions

Category	Mean	SD	t-statistic	Interpretation	Rank
Financial performance Ratio or retained earnings to total capital is raising	3.42	0.39	8.77***	Very high	1
Measures to reduce dependency on donors and government are in place.	3.06	0.03	102***	High	2
Financing loans through donated capital is declining	3.05	0.02	152.5***	High	3
All costs of the MFI funds are always covered by the income.	3.05	0.02	152.5***	High	4
MFI always finances its investments out of its own funds	2.58	-0.45	-5.73***	High	5
Average mean	**3.03**			High	

The results in table 2 revealed that the level of financial performance of microfinance institutions is high. The items rated high include ratio or retained earnings to total capital is raising (mean = 3.42), measures to reduce dependency on donors and government are in place (mean = 3.06), financing loans, through donated capital is declining (mean = 3.05), MFI always finances its investments out of its own friends (mean = 2.58), all costs of the MFI friends are always covered by income (mean = 3.05). These results imply that MFIs in central Uganda are highly financially sustainable In an interview with some board members of various MFIs they also revealed that the majority of MFIs in Central Uganda are not financially sustainable and the low level of financial sustainability was attributed to; rampant embezzlement of funds in MFIs by managers themselves, supervisory committee members or members of the board. Some attributed the poor performance of MFIs to poor assessment of credit applicants due to incompetency of loan officers who at times approve applicants that do not qualify. Findings also revealed that board members and supervisory committee members are politicians who are not technical in management

of MFIs and also many times use their political influence to get loans and fail to pay which has also threatened the sustainability of MFIs in Central Uganda. It was also revealed that many clients get loans from various MFIs using the same collateral security because Clients are not screened to establish whether they are credit worthy with other MFIs. Such clients end up failing to honor their debt obligations and disappear from the MFIs while others completely change location to avoid the legal implications.

The last objective was to establish whether there is a significant relationship between credit appraisal and approval procedures and financial performance in MFIs in central Uganda. The researcher tested the hypothesis that there is no significant relationship between Credit appraisal and approval procedures and the financial performance of microfinance institutions in Central Uganda. To test this hypothesis, the researcher used linear regression. Linear regression was used to establish whether there is a linear relationship between predictor variable Credit appraisal and approval procedures and the criterion variable (financial performance). Regression analysis is important since it determines the relationships between two or more variables and also predicts the dependent variable The linear Regression results are shown the table 2 above.

Table 3 Linear Regression of credit appraisal and approval procedures on financial performance

	MODEL1		MODEL2		MODEL3	
VARIABLE	B	SE	B	SE	B	SE
Constant	2.557**	0.488	1.398**	0.603	1.081*	0.513
Credit standards	0.173	0.153	0.173	0.142	0.079	0.135
R2	0.031		0.204		0.451	
Adj R2	0.006		0.162		0.407	
ΔR2	0.031		0.173		0.247	
F	1.247		4.876		10.147	
SIG F	0.271		0.013		0.000	

Results from table 3 clearly show that there is no significant relationship between credit appraisal and approval procedures and financial performance (B=0.173, sig>0.05). This implies that stringent credit standards do not lead to financial performance of MFIs. Thus accepting the hypothesis set that there is a There is no significant relationship between Credit appraisal and approval procedures and the financial performance of microfinance institutions in Central Uganda.

This implies that credit standards do not significantly enhance financial performance of MFIs where documentation of credit vetting policy, process and procedures, seeking additional information about credit applicants from external sources before credit is given. Existence of a credit vetting team that views and take decisions on credit applications, Credit vetting of existing customers before additional credit is granted, existence of well-established credit reference bureaus in the country, screening of clients to establish whether they are credit worthy with other Micro Finance Institutions, visiting and vetting of Clients' business before credit approval, reviewing of Clients' bank statements before credit approval, coordination of Loans officers and credit control staff on vetting of customers, seeking of Collateral security from a client before credit approval do not enhance financial performance

From the regression results in table 2 the following model was derived;

Model: $Y = \alpha + \beta_1 X_1 + + e$

$Y = 2.557 + 0.173X_1$

(t=5.241, t =1.117, VIF=1.00)

In the model credit appraisal and approval procedures account for only 17.3% of variations in financial performance. This leads to rejection of hypothesis

Conclusion

From the findings of the study, the researcher generated the following conclusions. The conclusions were based on the study objectives;

There is a positive perception on existing credit management procedures in Microfinance institutions in Central Uganda

There is no significant relationship between Credit appraisal and approval procedures and the financial performance of microfinance institutions in Central Uganda

Recommendations

From the findings and conclusions reached in this study, the researcher derives the following recommendations Micro Finance Institutions should continue to have homogeneous credit management procedures in terms of documentation of credit vetting policy, process and procedures, additional information about credit applicants should always sought from external sources before credit is given, there should be a credit vetting team that views and take decisions on credit applications in , Credit vetting of existing customers is done before additional credit is granted , Clients are screened to establish credit worthiness with other Micro Finance Institutions, Clients' businesses are visited and vetted before credit approval in both, Clients' bank statements are reviewed before credit approval, Loans officers and credit control staff are coordinated on vetting of customers and Collateral security is sought from a client before credit approval this will enable MFIs to have appropriate standards for better financial performance.

References

Abedi, S. (2000). Highway to success, credit management Journal, http://leatherspinters.com

Amin, E.M. (2005). Social Science Research. Conception, Methodology & Analysis, Makerere University Kampala.

Anthony, B. (2006). "Banking initiatives" Nairobi, Kenyatta University. . Retrieved July 29th 2009 =-[Research department htt://www.bou.or.ug/ bouwebsite / export / sites / default / bou /bou downloads / research / survey / Bci-Q2-0809-Highlights pdf.

Berger,A. and Boccoris di patti, E. (2006). " Capital structure and firm performance: a new approach to testing agency theory and an application to the banking industry". Journal of Banking and Finance, Vol.30:1065-102

Bhalla, V.K. (1997). Financial Management & Policy, 1st Edition, New

Hazel, F.J. (1993). Financial institutions/ markets; A global perspective, McGraw, Hill, Inc, New York.

Kakuru, J. (2007), Finance decisions and business (2nd edition) Kampala. The business publishing group.

Krejcie & Morgan, (1970). Determining sample size for Research activities. Educational & psychological measurement.

Ledgerwood, J. (1999). Microfinance Handbook on sustainable Banking with the poor: An Institutional and Financial Perspective. The World Bank: Washington D.C.

Ledgerwood,J. (2002). Microfinance handbook on sustainable Banking with the poor. An institutional and financial perspective. The World Bank. Washington. D.C.

Littlefield, E., Morduch, J and Hashemi, S. (2003). Is microfinance an effective strategy to Reach the millennium Development Goals. CGPA: Washington, DC

Mathie, A. (2002). Including the Excluded: Lessons learned from poverty targeting strategies used by microfinance providers. Coady international institute: St Francis Xavier University.

Matovu, L. (2006). Credit management issues in Uganda micro finance sector, Unpublished Ph.D dissertation.

Ministry of Finance, Planning and Economic Development. (2011). Report on the performance of Micro Finance Institutions in Uganda, Kampala: Ministry of Finance, Planning and Economic Development

Nakazibwe, R. (2010). Governance issues and sustainability of savings and credit cooperatives in Uganda. Unpublished MBA Dissertation, Ndejje University, Kampala, Uganda.

Nalwanga, B. I. (2010). Credit policy management financial performance of media houses in Uganda, case study of New Vision printing and publishing co. ltd. Unpublished Master's dissertation.

Navajas, S., Schereiner, M, Meyer, R.L. Gonzalez-vega, C and Rodriguez-

Delhi, Anmol publications PVT, Ltd.

Bhalla, V.K. (2004). International financial management, Text, and cases, Ammol Publications, PVT, LTD, New Delhi.

Brealey, R.A &Meyers, S.C. (1991). Principles of corporate finance (4th edition) New York. McGraw hill Inc.

Burgess, C., & Bryant. (2001). Revenue management the contribution of the finance functions to profitability. International journal of contemporary hospitality management, 13, issues 3,144-150 CMRC, (2008). Debt survey, Retrieved 27th July 2009, leads university Business School http://www.Cmrc.CO.UK/Surveys/debt survey.

Burns A.C. & Bush R.F. (2002). Marketing Research: Online Research Applications, volume 1.

Chandra ,C. (2005). Fundamentals of Financial Management, 3rd ed., New York. Tata McGraw-Hill Publishing Company Limited.
Changing? Harvard business review.

Chu, M. (2006). "Microfinance: Mobilizing Markets to Fight Poverty. The Latin American Experience". A paper presented at Building Broad-Based Economic Growth Seminor 47th Annual Meeting of Inter-American Development bank. Belo Horizonte: Brazil

Churchill & Lacobuci (2004). Research Methods: Concepts, Methodologies, Tools, and Applications. 3rd ed. New York

Ganka, D. (2010). Financial sustainability of rural microfinance institutions in Tanzania. PhD thesis, University of Greenwich, Australia.

Gitman, L. J. (1988). Principles of Managerial Finance, 5th edition, New York, Harper & Row publishers.

Godfrey, J., Hodgson, A., Holmes, S.S., & Kam, V. (1992). Accounting theory, Brisbane, Johnwiley and sons.

Haron, O. M; Masinde, J.S, Mugenda, N.G and Nelima, M.S. (2012). Effectiveness of credit management system on loan performance: Empirical evidence from microfinance sector in Kenya.

Mega, J. (2000). Microfinance and the poorest of the poor theory and evidence from Bolivia World Development 28(2) 333-346

Nyamsogoro, G.D. (2010). "Financial sustainability of rural microfinance institutions in Tanzania", PhD thesis, University of Greenwich, Australia.
Pandey, I.M. (1996). Financial management (7t edition), Vikas publishing House PVT ltd.

Pandey, I.M. (2004). Essentials of financial management 7th edition). Mumbaia Vikas publishers.

Perry, V & Morris, M (2005). Handbook of Consumer Finance Research. The Journal of Consumer Affairs, 39(2) 299-313.

Poutziouris, P. Z, Smymios, K X and Klein, S.B (2006). The Handbook of Research on Entrepreneurship in Agriculture and Rural-England. Journal of Sociology 38, 327-343.

Rafuse, M. J. (1996). Working capital management, an urgent need to refocus London: management decision publication.

Rajan, R. and Zingales, L. (1995). " What Do We Know About Capital Structure? Some Evidence from International Data" Journal of Finance, Vol.50:1421-60.

Robinson, M. (2003). The microfinance revolution: Sustainable finance for the poor, Vol. 1 Washington D.C.: World Bank.

Rosl, S.A, & Westerfield, R..W (1988). Corporate finance new York: McGraw will inc.

Ryan, P.A. (2002). Capital budgeting practices of the fortune 1000: how have things changed? Journal of Business and management, 8(4), 13-18
Sarantakos S. (2005). Social Research. 2nd ed. Palgrave Macmillan. ISBN

Schmidit, D., (2003) Standardicy THORRY Crecit decision Business finance archires Retrieved November, 23, 2008 from . business finance mag.com /article/credit and collections-gain-new-Cout.e

Schreiner, M. (2000). "Ways donors can help the evolution of sustainable microfinance organizations", Saving and development, Vol.24,pp.423-437.

Schreiner,M and Woller, G. (2003). Microenterprise Development Program in the united states and in the developing world. World development 31(9): 1567-1580.

Sekaran U. (2000). Innovative Methodologies in Enterprise Research. Newbury Park: Sage.

Sekaran, U. (2003). Research methods for business. A skill building approach. New York: John & Willey.

Van Horne,J.C., Wachowicz, M. Jr. (2001). Fundamentals of Financial Management, 11th ed., Prentice – Hall of India Private Limited.

Van Horne. J.C. (2002). Financial management and policy (12th ed.) New York person education inc.