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# CREDIT RECOVERY PROCEDURES ON LOAN PORTFOLIO PERFORMANCE IN CENTENARY BANK

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**ABSTRACT**

The general objective of the study was to examine the relationship between loan recovery practices and loan portfolio performance of commercial banks in Uganda. Specifically it focused on centenary bank Entebbe Road branch. The researcher used a case study and correlation survey. The target populating was centenary bank Entebbe road branch staff and customers. Among the staff included; loan officers, banking of ficers, managers, credit Administrators, customer service consultants and management trainees in total this population was 120 and the researcher sampled 92 basing on Kre_jcie & Morgan ( 1970) table. The data was collected using questionnaires and interviews and analysis was done using regression analysis, and correlation coefficients for the quantitative the findings revealed that credit recovery procedures significantly and positively affect loan portfolio performance in Centenary Bank (adjusted $R^2$ =0.780*, p value= 0.000). The researcher recommended that bank should closely watch the reminder strategies, educate and sensitize customers and other users of the financial , recruiting recovery officers, adopting group recovery policy, facilitating the recovery process and the enforcement, create a department for follow up action and carrying out standard loan appraisal, formulate a separate legal department and recovery department at each branch, involve LCs chair persons, use guarantors all these will help increase Loan Portfolio Performance.

**Key words**: Loan portfolio performance, credit recovery Procedures, Commercial Banks

**Background to the study.**

Banking with regard to credit evolved in the 16th Century following the increase in trade in England during the time of King George VI. The major goal of banking at that time was to extend credit to the general public with the aim of getting profits (Brownbridge, 1998). By the time of the Industrial revolution in the 19th Century, banking had become a vibrant industry, focused on innovation. Many banks made a lot of profits through extending credit to entrepreneurs and industrialists.

The concept of credit extension and management dates back in history but was not appreciated until after the Second World War when it was largely recognized in Europe and later to Africa [Kitui, 2015]. In Africa, the concept of credit was largely appreciated in the 1950's when most banks started opening the credit sections and departments to give loans to white settlers. A substantial number of locally owned banks have failed mainly because of nonperforming loans (Brownbridge, 1998). A CBN/NDIC collaborative study of distress in Nigerian financial institutions in 1995 revealed that factors such as bad loans and advances, bad credit policy, bad management among other factors are responsible for bank and other financial distress (Okpara, 2009). Before Uganda's independence in 1962, the banking sector was dominated mainly by foreign owned commercial banks (Bategeka, 2009). In 1966 the National Bank of India which later became the

Grindlays Bank in Uganda did not extend loans to Ugandans without collateral security (Abuka and Egesa, 2010). According to Brownbridge (1998), it was observed that the foreign banks were not advancing credit to the local business community and as such in 1965 through an Act of Parliament the banks started extending credit to the local business community. Given this development there was need for a regulatory and institutional framework for banks to ensure control. Through the bank of Uganda Act of 1966, Bank of Uganda was established to regulate the banking industry in Uganda and in order to strengthen regulation the government enacted the Banking Act 1969 to provide a frame work for the regulation and supervision of banks in Uganda. This was the first official act for the regulation of banks in Uganda.

In Uganda, the financial sector, like many others, had recovered from the economic decadence that resulted from a 15-year turmoil (1971 to 1986) and by the end of 2007, the BoU regulated financial institutions consisted of 16 commercial banks, 4 credit institutions, 4 MDIs, 2 leasing firms, 19 insurance companies, and 84 forex bureaus. This saw an increase in commercial bank branches up to 290 where Clients increased from below 300,000 to over 3.5 million by 2007 (Association of Microfinance Institutions in Uganda, 2008) and to 658 branches in 2015 (Association of Microfinance Institutions in Uganda, 2015). This trend has continued to explode till date as worsened by the Covid-19 Pandemic.

As the number of banks grows however, several challenges emerge that call for the need to have very sound risk management systems in order to avoid the 1990's scenario which saw several banks closed because of non-performing loans. According to the Bank of Uganda report (1999), four banks namely ;International

Credit Bank (ICB), Greenland Bank, Cooperative Bank and Trust Bank, were closed by the Central Bank because of financial distress and bank failure as a result of nonperforming loans.

Over the years the provision for bad debts has become a major cost to banks within the financial market in Uganda. This is as a result of the ever-increasing loan book over the years by the Ugandan banks which has presented a number of challenges to management with concerns about the quality of mortgage, business and personal loans that are booked by the banks. The purpose of the study was to examine the relationship between loan recovery practices and loan portfolio performance of commercial banks in Uganda.,Specifically, it focused on centenary bank Entebbe Road branch

**Theoretical framework**

The study was guided by the Loanable funds theory (1930) by the Swedish Economist Knut Wicksell. Later on according to Laidler (2009), economists like Ohlin, Myrdal, Lindahl, Robertson and Viner considerably improved and contributed to this theory. In economics, the loanable funds doctrine is a theory of the market interest rate. According to this approach, the interest rate is determined by the demand for and supply of loanable funds. The term loanable funds include all forms of credit, such as loans, bonds, or savings deposits (Laidler, 2009). According to this theory, rate of interest is determined by the demand for and supply of loanable funds. In this regard this theory is more realistic and broader than the classical theory of interest.

The demand for money as an asset was theorized to depend on the interest foregone by not holding bonds (here, the term "bonds" can be understood to also represent stocks and other less liquid assets in general, as well as government bonds). Interest rates, he argues, cannot be a reward for saving as such because, if a person hoards his savings in cash, keeping it under his mattress say, he will receive no interest, although he has nevertheless refrained from consuming all his current income. Investments that are more liquid are easier to sell fast for full value (Milkovich, 2016).

In relation to this study, issues of credit and how it's managed in commercial institutions in Uganda have created gaps hence either directly or indirectly affecting the institutions profitability, analyzed what an effective credit risk management system entail and observed the establishment of a suitable credit risk environment which operates under a sound credit granting process with an appropriate credit administration that emphasizes Assessment, scoring, monitoring, evaluation and control over credit risk. Credit policies provide direction and guidance to credit officers involved in the assessment, scoring and approval of credit (Ahmed and Malik,2015). This is largely motivated by the desire to score out bad loans that probably may increase the risk of default hence affecting profitability. However, theory ignores board approval on matters of credit risk yet the credit risk most of the time is a concern of the board.

## Literature Review

### Credit Recovery Procedures and Loan Portfolio Performance

Credit policy is looked at as a framework guideline formulated by the organization to be followed in processing of credit extension to borrowers. Commercial banks set credit policies to ensure control and minimize losses. Credit policy is looked at as an institutions method of analyzing credit requests and its decision criteria for accepting and rejecting applications. According to Kakuru (2007) credit policy is a set of policy actions designed to minimize costs associated with credit while maximizing the benefits from it. The objective of this policy is to have optimal investment in debtors. Optimal investment is that level of investment where there is a tradeoff between the benefit and costs associated with it. In other words, at optimal level of investment, both objectives of profitability and liquidity are realized.

Credit extending organizations particularly have been taking stringent measures to mitigate any forthcoming financial losses caused by mismanagement in loan allocations and credit recoveries (Nikolaidou & Vogiazas, 2014). In fact, previous studies indicate that such institutions need to have strong and effective credit risk management policies for ensuring consistent loan recoveries from clients (Frank, Simon, & Josephine, 2014). Therefore, if loans are not well-recovered, it may result in losses of high level and even failure of financial institutions (Chijoriga, 2011). The following studies have laboured to track the effect of loan recovery procedures by financial institutions on loan portfolio performance.

Kagoyire and Shukla (2016) analyzed the effect of credit management on the financial performance of commercial banks in Rwanda using a descriptive survey design and a target population of study consisted of 57 employees of Equity bank in credit department. Primary data was collected using questionnaires which were administered, analyzed using descriptive and inferential statistics. The study found that client appraisal, credit risk control and collection policy had effect on financial performance of Equity Bank. The study established that there was strong relationship between financial performance of Equity bank and client appraisal, credit risk control and collection policy. The study established that client appraisal, credit risk control and collection policy significantly influenced financial performance of Equity Bank. Collection policy was found to have had a higher effect on financial performance and that a stringent policy was more effective in debt recovery than a lenient policy. Since the study by Kagoyire and Shukla (2016) was only descriptive, they must have omitted qualitative and in-depth feedback which ought to have generated explanations behind given statistical expressions. This methodological gap was addressed by also collecting respondents' opinions on interviews to generate triangulated findings.

In bridging the gap, therefore, Centenary Bank should enhance their collection policy by adapting a more stringent policy to a lenient policy for effective debt recovery. This study was investigated using a case study research design with the intention of providing in depth investigation of the underlying effect between the variables under study and this helped to find the effect of credit management practices on loan portfolio performance as a component of financial performance.

## Methodology

The study adopted a case study research design with intention of providing in depth investigation of underling effect between the variables under study. The study applied both quantitative and qualitative

approaches. The population under study was 120 employees who included top level, middle level and lower level staff of all departments in Centenary Bank. The study was based on a sample size of 92 that was drawn from a population of 120. The sample size of 92 was determined using Krejcie and Morgan (1970). In order to get the desired information, stratified random sampling was used to sample the staff from different functional departments of managing director's office, credit, procurement, finance, risk, internal audit, legal and compliance departments using a questionnaire as a tool of data collection. Purposive sampling involves selecting respondents who are knowledgeable and experienced. The key data collection instruments used were the questionnaires, and interview guide

## Findings

### Descriptive statistics of credit recovery procedures

In order to assess different credit recovery practices available in the bank, the following practices were presented to respondents and their opinions and responses generated are presented in Table 1 below.

**Table 1: Descriptive statistics on credit recovery procedures**

| Item measures for credit recovery practices | Mean | Standard Deviation | Agree | Min | Max |
|---|---|---|---|---|---|
| The bank reminds clients of their repayment installments prior to the due date through SMS/calls. | 3.81 | 0.5001 | 66.50% | 1 | 5 |
| The bank reminds clients of their repayment date through SMS/calls. | 2.22 | 0.3012 | 30.30% | 1 | 5 |
| The clients' files are tracked and surveyed from loan acquisition to final payment of the principal. | 4.045 | 0.7034 | 90.90% | | 5 |
| The bank tracks collateral from loan acquisition to repayment | 3.77 | 0.5567 | 64.80% | 1 | 5 |
| Defaulters are given stringent repayment conditions once they default on the first instalment | 3.88 | 0.3012 | 70.30% | 1 | 5 |
| The credit Department continuously assesses the accounts of Debtors | 3.98 | 0.3019 | 71% | 1 | 5 |
| **Grand Mean** | **3.545** | | | | |

Source*: Primary data, 2024* N= 68

Basing on survey findings presented in Table 1 above, it was established from the respondents that the bank reminds clients of their repayment installments prior to the due date through SMS/calls with the mean score of 3.810. In relation to the item that stated that the bank reminds clients of their repayment date through SMS/calls, the mean = 2.220 indicated that the majority disagreed with this particular practice.

Whether the clients' files are tracked and surveyed from loan acquisition to final payment of the principal, the mean score was 4.045 indicating high prevalence of this practice. As to whether the bank tracks collateral from loan acquisition to repayment, a mean of 3.777 indicated that the majority agreed with the item to that effect. As to whether defaulters are given stringent repayment conditions once they default on the first instalment, the mean = 3.88 indicated reasonable level of agreement.

Interviewee04 noted that "*action points from the recovery/management meetings are recorded and diligently followed up by management of Centenary Bank*.

Similarly, Mulumba (2016) noted that it is important to ensure good recovery of loans. This necessitates frequent contact with borrowers, creating an environment that the bank can be seen as a solver of problems and trusted advisor, development of the culture.

Interviewee07 noted that "*the bank's legal department has an effective mechanism for recovery of bad loans; they have dealt with many clients who have habitually defaulted on loans*.

Similarly, Centenary Bank Annual Report (2018) noted that internal performance measures include good loan recovery procedures of bank lending using legal means; bank profitability; operational ratios; developed benchmarks; and measuring productivity of loan officers.

When asked how often customers default in Centenary Bank;

Interviewee08 said "*customers default happens a bit so often that some customer default which she thinks happens because of sickness, poor management, priorities*.

To handle such cases, the steps to follow are already programmed in the system. The system automatically gives out reminders and if after the reminder the customer does not still pay, they phone them. They make the customer to understand that the bank payments should be a priority and points out the consequences the customer will face if he defaults. After this stage if the customer still doesn't pay, the proceedings will continue and even goes to court.

**The descriptive statistics of loan portfolio performance at the case study**

In order to examine the levels of loan portfolio performance available in the bank, the following measures were presented to respondents and their opinions and responses generated as presented in Table 2 below.

**Table 2: Descriptive Statistics for Loan Portfolio Performance at the case study**

| Item measures for Loan portfolio performance | Mean | SD | Agree | Min | Max |
|---|---|---|---|---|---|
| The bank does alter the repayment period in case of default. | 2.807 | 0.7092 | 34.30% | 1 | 5 |
| Interest rates variation affects loan portfolio performance. | 2.201 | 0.9701 | 38.30% | 1 | 5 |

| | | | | | |
|---|---|---|---|---|---|
| The costs of loan recovery affect loan portfolio performance | 3.503 | .5.301 | 57.40% | 1 | 5 |
| Collusion between bank staff and clients during loan acquisition affects loan portfolio performance. | 2.746 | 0.6034 | 49.50% | 1 | 5 |
| Increased charges during repayment may affect the loan recovery process | 3.92 | 0.3012 | 51.30% | 1 | 5 |
| The structuring of some repayment schedules affects loan portfolio performance | 1.666 | 0.5567 | 27.80% | 1 | 5 |
| I expect an improvement in clients' loan repayment for the coming years. | 3.603 | 0.5301 | 61.40% | 1 | 5 |
| The bank registers an increase in the number of loan applicants. | 3.746 | 0.6034 | 68.50% | 1 | 5 |
| Loans not paid on time are eventually recovered | 1.52 | 0.3012 | 20.30% | 1 | 5 |
| The bank registers annual decline in loan related costs. | 1.666 | 0.5567 | 27.80% | 1 | 5 |
| **Grand Mean** | **2.738** | | | | |

Source: *Primary data, 2024* N= 68

Generally, the results as presented in the above Table 2 indicate a moderate low of almost all the items that measured loan portfolio performance based on the mean score of 2.738 which were scaled on the basis of a maximum score of 5 and the minimum score of 1 since the survey instrument had a 5 Likert scale

The quantitative results presented above reflect the perception of the respondents. However, there are findings from interviews and documentary reviews that give the status of the variables on loan portfolio performance.

Basing on survey findings, it was established from the respondents in relation to item 1 that stated that the bank does alter the repayment period in case of default; a mean score of 2.807 with SD= 0.7092 showed that the majority of the respondents disagreed with the item implying that the bank does not alter the repayment period in case of default.

When the respondents were asked to state whether the costs of loan recovery affect loan portfolio performance, a mean of 3.503 indicated the majority of respondents agreed with the item. In relation to item three, the respondents were required to state whether the costs of loan recovery affect loan portfolio performance.

The respondents were further asked to state whether collusion between bank staff and clients during loan acquisition affects loan portfolio performance. The statistical grand mean of 2.746 implied that the majority of respondents disagreed with the items provided.

In connection to the item that stated that increased charges during repayment may affect the loan recovery process. A mean value of 3.920 implied that the majority of the respondents agreed with the fact that an increase in loan charges may affect its recovery process.

In relation to the survey findings, the respondents revealed that the structuring of some repayment schedules affects loan portfolio performance. The computed test figures reveal that the mean score of 1.666 suggests that the majority of the respondents disagreed with the item implying that the structuring of some repayment schedules is not affecting loan portfolio performance.

In relation to the survey findings, the respondents revealed that they expect an improvement in clients' loan repayment for the coming years. The computed test figures revealed that the mean score of 3.603 suggests that the majority of the respondents agreed with the item implying that they do expect an improvement in clients' loan repayment for the coming years.

Interviewee02 noted that "*credit staff always present correct information or analysis to the loan committee*.

Mulumba (2016) noted that credit staff is supposed to provide information to loan management so as to work on the capital and non-performing loans, at least until further research has established on them. It also provides supervisors with an expression whether the regulated ratio has an effect on banks' profitability. A branch manager narrated a situation where there are collusion cases among credit staff and clients to secure approvals of fraudulent loans and this has led to loss of jobs and imprisonment.

As to whether the banks have ensured liquidity, it was observed that liquidity depends on the credit policy of the bank. Thus it can be deduced that a lending institution that accepts deposits must have a certain measure of liquidity to maintain its normal daily operations. Loans given to its customers are mostly not considered liquid meaning that they are investments over a longer period of time. Although a bank will keep a certain level of mandatory reserves, they may also choose to keep a percentage of their non-lending investing in short term securities to ensure that any monies needed can be accessed in the short term.

***Relationship between*** **credit recovery procedures and perception with regard to loan portfolio performance**

**Table 3: Correlation results between credit recovery and financial performance**

| | | | Credit recovery | Financial performance |
|---|---|---|---|---|
| Spearman's rho | Credit recovery | Correlation Coefficient | 1.000 | . 885** |
| | | Sig. (2-tailed) | . | .022 |
| | | N | 76 | 76 |

| | Financial performance | Correlation Coefficient | 885** | 1.000<br>. |
|---|---|---|---|---|
| | | Sig. (2-tailed) | .022 | 76 |
| | | N | 76 | |

Findings revealed a strong positive relationship between credit recovery procedures and perception with regard to loan portfolio performance was (R=0.885) and statistically highly significant at p<0. 000. The relationship between credit recovery practices and loan portfolio performance in Centenary Bank is a strong positive and statistically highly significant implying that an improvement on credit recovery will lead to a significant improvement on loan portfolio performance in Centenary Bank. From all the results the alternate hypothesis earlier stated in chapter one is upheld.

**Regression Results for credit recovery practices and Loan portfolio performance in**

**Centenary Bank**.

In order to assess how credit recovery practices, affect loan portfolio performance, linear regression analysis was conducted using SPSS and the results are presented in the table 4.10 below.

Table 4.10: Regression Analysis for credit recovery procedures and loan portfolio performance

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | R square change | F Change | df1 | df2 | Sig. F Change |
| 1 | .885 | .783 | .780 | 1.0567 | .780 | 71.346 | 1 | 68 | .000 |

Predictors: (Constant), Credit recovery practices

From the Table 4, the regression model results for credit recovery practices and loan portfolio performance in Centenary Bank was positive and significant. The results of the adjusted R squared ($R^2$) which tells how a set of independent variables explains variations of a dependent variable yielded an adjusted R Square of 0.780. This means that the independent variable dimension of control environment accounts for 78.0% of the variations in perception with regard to loan portfolio performance in Centenary Bank.

The model further shows F-statistics value of credit recovery practices as being positive (71.346). Therefore, holding other factors constant, one unit of improvement in credit recovery practices would result into an improvement in loan portfolio performance in Centenary Bank by a magnitude of 0.780 units. The regression findings were in agreement with the earlier correlation findings and therefore serves to further explain that the alternate hypothesis that credit recovery practices significantly contributes to loan portfolio performance in Centenary Bank is confirmed and validated.

Table 5: Coefficients for credit recovery procedures and loan portfolio performance

| Independent variables | B | T | Sig |
|---|---|---|---|
| credit recovery procedures | .885 | 56.633 | 0.000 |

R=0.885; $R^2$= 0.783; F= 78.0); significant level at $P \leq 0.05$.

From table 5, the results of the simple regression analysis showed that there is significant positive relationship between credit recovery and loan portfolio performance in Centenary Bank (β=0.885) at level of significance ($P<0.01$).

**Recommendations and Conclussion**

The study recommends that; Credit risk management teams in banks should look at credit risk management as a continuous process that runs through post-approval as well. Post-approval processes being monitored by customized document associated with bookkeeping principles.

Banks should design instruments that collect as much information about a customer as possible and should not ignore any information collected but analyzed critically while doing their credit assessment.

Professionals stick to documented credit management processes which often incorporate familiarization with customers. The use of Know Your Customer concept should be also implemented in the other way round (Know Your Bank) thus outreach activities must be invested in by banks especially with the innovation of agency banking.

Also premised on the conclusions drawn from the study findings that improvement on credit appraisal will enhance improved loan portfolio performance in Centenary Bank, the researcher recommends that psychometric test be part of the credit appraisal processes so infer how the client and business will get closure or apart. Also implement the following: Move from manual interventions to automation for greater accuracy; Deploy analytics to improve credit decision; Engage with an offshore partner that has robust credit processing capabilities to mitigate losses from delinquency and reduce costs.

The researcher also recommends that Centenary bank staff should: As often as possible compile a watch list of possible defaulters thus define indicators that qualify the client to be in that watch list such as poor communication in the course of the relationship and take action as soon as any risk matures tight from the point of extending the loan

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