

The Effects of Credit Terms on Loan Performance of SACCOS in Mbarara City

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Abstract

The study was carried out on the effects of credit terms on loan performance of savings and credit cooperatives (SACCOs) in Uganda: A case study of selected SACCOs in Mbarara City. The study adopted both a Case study and cross-sectional research designs with a population size of 429 consisting of directors, managers and employees. The total sample size was 207. The study used simple random to select both employees and board members while purposive sampling used to select managers. Questionnaires were administered to 189 both employees and board members while 18 SACCO managers were interviewed. Data was analysed both quantitatively using SPSS 20 and qualitative approach thematically. The study found out that Credit management (credit terms, client appraisal have a high significant effect on loan performance of SACCOs in Mbarara City. However, credit risk control as credit management practice has a low significant effect on loan performance. The study recommends that SACCOs in Mbarara City should employ credit management practices like loan insurance, monitoring system of clients in their SACCOs, clear policy of joint liability between clients and SACCOs, independent risk screening teams to assess clients, and restructuring some loans for struggling clients before selling off their collaterals in order to reduce on the rate of non-performing loans thus increasing their loan performance.

Key words: Credit terms, Loan Performance.

Background.

Globally, evidence from European emerging financial markets in Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Romania and Slovakia revealed that that non-performing loans were sharply increasing and the attributable reasons were competitions from large commercial banks, change in economic conditions and unfavorable government policies among others (Škarica, 2016). Ireland, Slovenia and Cyprus registering the highest Non-performing loans ratio in Europe at 19.3% in 2015 and at 20% in 2016 and the main attributable reason was poor credit risk control (Nițescu, 2016).

In Africa, the situation has not been different. Especially in Ghana, gross non-performing loans (NPLs) rose by 34% at the close of May 2014; consequently, asset quality, as measured by the ratio of gross NPLs to gross loans, continued to deteriorate, from 12% at the close of 2013 to 12.84% as at May 2014 and this raised notable asset performance concerns (Bending, 2015). Non-performing loans were also found to be a challenge and on an increase in almost 54 countries of Africa and this has hindered their financial institutions from development and thus affecting the economic growth of these countries (Ozili, 2019).

In Uganda, as at December 31, 2016, the overall financial condition and performance of the SACCOs was rated as poor due to insufficient credit risk control measure. During 2016, Bank of Uganda continued to administer the Deposit Protection Funds (DPF) for Commercial Banks and Credit Institutions but the and non-performing loans increased by 2.5% a and 3.2% in 2015 and 2016 respectively (Bank-Of-Uganda-report, 2016) and loan portfolio for SACCOs dropped by 3.46% and 4.25% in 2015 and 2016 respectively (Okwee, 2016)

Problem Statement.

Sound credit management is a pre-requisite for a financial institution's stability and efficient loan performance. Proper credit management of any financial institution improves on loan repayment rate, reduces non-performing loans and default rates (Kithinji, 2010). SACCOs in Uganda have put in place good policies on credit management such as good credit terms in form of reduced interest rates, good client appraisal mechanisms and good credit risk control systems (USAID, 2016). Despite these good credit management policies, their loan performance is still poor (Mugenyi, 2015). For instance, the loan portfolio for SACCOs in Uganda dropped by 3.46% and 4.25% in 2015 and 2016 respectively (Okwee, 2016) and non-performing loans increased by 2.5% a and 3.2% in 2015 and 2016 respectively (Bank-Of-Uganda-report, 2016). In Mbarara City, SACCOs registered a decline in average total loan portfolio from Shs 17,784,000 in 2015 to Shs.

12, 690,000 in 2016 (Mpiira et al., 2016), their loan recovery rate declined from 87.9% of the total loans in 2015 to 81.8% of the total loans in 2016 (Nuwagaba, 2016). In June 2016, non-performing loans to total loans was 3.5% increased to 5.0% in June 2017, declined to 4.4% in June 2018 and slightly declined but remained at 3.9% in June, 2019 (Bank-Of-Uganda-report, 2019). By Dec 2019, Non-performing loans increased to 4.71% and by March 2020, the Non-performing loans increased to 5.41% (Bank-Of-Uganda-report, 2020). If the trend continues with high rate of non-performing loans, many SACCOs in Mbarara City are likely to make closes and hence negatively affecting the development of the Mbarara and the entire nation at large. It is not clearly indicated whether cash management is one of the elements that has led to continued high rate of non-performing loans in SACCOs in Mbarara City. Therefore, this study was conducted to find out the effects of Credit terms on the Loan Performance of SACCOs in Mbarara City.

Literature Review.

Theoretical frame work.

Agency Theory

The study was underpinned by the Agency Theory which was first stated by Stephen Ross and Barry Mitnick in 1970 (Mitnick, 2013). Agency Theory addresses a relationship where one party (the principal) delegates work to another party (the agent). The Agency Theory explains the relationships that exist when one party is retained to act on behalf of another party. The theory shows that given the natural preference to maximize one's own utility, conflicts are bound to arise. Knowledge of such potential conflicts can serve to reduce the cost of the resolution of these conflicts (Arthurs, Hoskisson, Busenitz, & Johnson, 2008).

Audits provide a significant purpose of encouraging confidence and reinforcing trust in financial information. Several theories have emerged to explain the demand and supply of audit services in increasing accountability sectors in governance agencies. The Agency Theory appears to be the most economic theory of accountability to explain the development of audit and its vital role in today's economy (Gomes, Carnegie, & Lima Rodrigues, 2008).

An agency relationship therefore occurs when one or more principals in the capacity of owner(s) engage another person as their agent to undertake a task on their behalf. In order to be effective, this task implies the delegation of some decision-making authority to the agent. This appointment of responsibility by the principal and the resulting division of labor contribute to a proficient and

productive activity. The decision-making might be impacted by other factors such as financial rewards or labor market opportunities that are not directly congruent (Kivistö, 2008).

Credit terms and loan performance of SACCOs

Credit terms refers to the conditions under which a financial institution advances credit to its customers (Moti et al., 2012). The credit terms will specify the credit period and interest rates. In addition, the credit period refers to the period of time in which the credit is granted and the length of the credit period is influenced by Collateral value, Credit risk, the size of the account and market competition (Moti et al., 2012).

A study on credit period and loan performance in In Nigeria revealed that a both short and long credit periods, negatively affect loan performance while a moderate period had positive effect on loan performance (Kolapo, Ayeni, & Oke, 2012). Limited access to credit can also negatively affect financial survival if firms operate under poor economic conditions and high interest rates. On the other hand, if credit is accessible and reasonably priced, firms can address their liquidity constraints in turn aiding financial performance (Ahmed, Faizan, Malik, & Ali, 2015). The results of regression and correlation analysis showed that the credit terms has positive and significant impact on the loan performance, while the collection policy has positive but insignificant impact on loan performance (Abiola & Olausi, 2014).

In assessing the creditworthiness of borrowers, banks apply standard and stringent requirements to determine the performance of the business and the ability to repay the loans (Hellmann, Murdock, & Stiglitz, 2000). Suppliers of credit may also choose to offer high interest rates and credit rationing that would leave significant numbers of potential borrowers without access to credit (Arora & Kumar, 2014). Lack of available external finance can result in firms being unable to adequately fund operations and pursue market opportunities hence hindering their performance (Nyangoma, 2012).

A study on credit terms revealed that favorable credit terms enhance access to finance and favour repayment and thus leading to better loan performance of the lending financial institution (Garikipati, 2010). The study also adds that if a firm can invest in more ventures and increase its sales volume. Higher sales volume and production will lead to increased revenues and profitability which means improved financial performance (Garikipati, 2010). Given the strong relationship between lenders and borrowers it is highly unlikely that the borrower fails to honour his debt,

otherwise it would be very difficult to find other banks' financial performance is improved (Ivashina & Scharfstein, 2010).

Loans are commonly rescheduled to accommodate a borrower in financial difficulty and, replace the outstanding balance on an older loan with a new loan and is paid over a longer period thus, to avoid a default (Auboin, 2009). A study about the role of collateral and personal guarantees in relationship lending in Japan's SME loan market, revealed that attaching a collateral forces the customer to pay in time and selling the collateral is always the last option for the bank which may finally kill the mutual understanding between the bank and the customer (Ono & Uesugi, 2009).

A study conducted on the performance of financial institutions in Uganda found out positive effects on the performance of Ugandan financial institutions (Irbad H.M & Jayaprakash M.G, 2018).

Methodology.

The study adopted a cross-sectional research design with both quantitative and qualitative approaches. The study population included; 209 directors, 18 managers and 202 employees of the 18 SACCOs in Mbarara City (Mbarara-District-Statistical-Abstract, 2015). The researcher used simple random sampling and purposive techniques and data was collected using questionnaire survey and interview methods. Quantitative data collected was managed using SPSS version 25 to ensure proper analysis while qualitative data was analyzed using thematic and content analysis.

Analysis and Results.

Effects of credit terms on loan performance of SACCOs in Mbarara City

The researcher provided descriptive statistics to establish the effect of credit terms on loan performance of SACCOs in Mbarara City. Still in this section, 5 Likert scale was used as follows: Strongly Disagree (SD =1), Disagree (D =2), Neutral (N=3), Agree (A=4), Strongly Agree (SA=5). Data is presented in descriptive statistics as Frequency (F), Percentage (%), Mean and Standard deviation Std.dev on the table.

Responses on the effect of credit Terms on Loan performance of SACCOs

	Credit Terms	S D		D		N		A		SA		Mean	Std.dev
		F	%	F	%	F	%	F	%	F	%		
1	Our credit terms (credit period, interest, and payment rate) are generally favorable and encourage borrowing	5	2.6	1 1	5.8	4 1	21. 7	7 1	37. 6	6 1	32. 3	3.9101	1.0039 0
2	We sometimes revise the credit period of loan especially to our struggling customers	4 6	24. 3	1 1	5.8	2 5	13. 2	4 2	22. 2	6 5	34. 4	3.3651	1.5841 8
3	Our interest and credit period are favourable to encourage top up among our clients	2 5	13. 2	2 1	11. 1	4 6	24. 3	7 5	39. 7	2 2	11. 6	3.2540	1.2024 1
4	We sometimes revise the payments rate to our clients who have failed to pay back a full amount to pay back only the principal amount.	4 8	25. 4	3 1	16. 4	6 4	33. 9	3 6	19. 0	1 0	5.3	2.6243	1.2035 6
5	When a customer fails to pay back the loan in the credit period, we restructure the loan other than sell the collateral security	7 3	38. 6	4 4	23. 3	2 5	13. 2	2 2	11. 6	2 5	13. 2	2.3757	1.4297 9

Results revealed that majority (69.9%) of respondents agreed that credit terms (credit period, interest, and payment rate) of SACCOs in Mbarara City are generally favorable and encourage borrowing, 21.7% were neutral while 8.4% disagreed with the statement. From the mean value of 3.9101 and the standard deviation of 1.00390 which confirms that credit terms of SACCOs in Mbarara City are generally favorable and encourage borrowing.

In regard with credit terms, eight (8) respondents said that “ *our terms are favourable to clients since we discuss with our clients on terms and conditions before giving them loans*” while four (4) respondents added that “*one of the terms we give our clients is payment scheduling of the credit when the client has failed to meet the periodical payments*”. While three (3) respondents asserted that “*such terms and conditions make it easy for clients to borrow with a lot of ease because they understand the loan they take and payback period of the loan*” However, three (3) respondents added that “*our terms are not favourable compared to especially interest is high compared to commercial banks, we give short term loans yet people need long term loans and amount of loan is tagged on savings and membership.*” Findings imply that credit terms of SACCOs in Mbarara City are generally favorable and encourage borrowing and hence positively affect (enhance) loan performance in SACCOs.

Study participants were asked whether SACCOs in Mbarara City sometimes revise the credit period especially to struggling customers. Regarding to the statement, findings show that majority (56.6%) of respondents agreed that SACCOs sometimes revise the credit period especially to struggling customers, 13.2% were neutral while 31.1% of the respondents disagreed with the statement.

Basing on the mean value of 3.3651 and standard deviation of 1.58418 confirm that SACCOs sometimes revise the terms and conditions of the loan. This is justified by the statement made by respondents interviewed, six (6) respondents that “*our credit terms are set by the Board of Directors since we are cooperatives*”. While three (3) respondents revealed that “*our credit terms are set and revised by the board through the AGM.*” Two (2) respondents added that “*we sometimes revise the payment schedules for our struggling customers/clients for favorable loan payment.*” While two (2) respondents asserted that “*some struggling customers come to office and report their inability to change their repayment schedule in case of any economic status or business failure*”. In addition, two (2) respondents also added that “*credit period are revised in every annual meeting which help our clients taking up our loans*”. However, three (3) respondents asserted that “*we don’t revise the credit period of the client’s loan and no restructuring of the loan.*” This implies that SACCOs in Mbarara City sometimes revise the credit period especially to struggling customers. Extending credit period encourages customers to borrow again thus improving loan performance in SACCOs.

Concerning whether SACCOs in Mbarara City have interest and credit period that are favourable to encourage top up among their clients. Findings show that majority (51.3%) of respondents

agreed that SACCOs have interest and credit period that are favourable to encourage top up among their clients, 24.3 % were neutral while 24.3 % disagreed with the statement.

Basing on the mean value of 3.2540 and standard deviation of 1.20241 affirm that SACCOs in Mbarara City have interest and credit period that are favourable to encourage top up among their clients. During interviews conducted, eight (8) respondents revealed that *“we top up outstanding loans of the clients and we do this mostly to truth worthy customers and ding well customers instead of going and get a loan elsewhere and reschedule the payment.”* Six (6) respondents added that *“we restructure the payback period extending it in the meeting upon the customer’s request”*. However, four (4) respondents added that *“With top up of loan, we don’t give people another loan,; instead we need the person to first pay off the first loan and recover the first loan and give another one.”* This implies that SACCOs in Mbarara City have interest rate and credit period that are favourable to encourage top up among their clients thus affecting their loan performance.

Study participants were asked whether SACCOs sometimes revise the payments rate to our clients who have failed to pay pack a full amount to pay back only the principle amount. Findings revealed that majority (41.9%) of respondents disagreed that SACCOs sometimes revise the payments rate to clients who have failed to pay pack a full amount to pay back only the principle amount, 33.9% were neutral and 24.3% of respondents agreed with the statement. The mean value of 2.6243 and standard deviation of 1.20356 confirm that SACCOs in Mbarara City sometimes don’t revise the payments rate to clients who have failed to pay back a full amount to pay back only the principle amount.

From the interviews with managers, three (3) respondents revealed that *“SACCOs in Mbarara City, for some few customers request them to pay back the principal after assessing that the project in which they invested the money never succeeded but some misuse the money and are forced to pay both principal and interest”* but most of them did not support the statement. Three (3) respondents added that *“if a customer fails to pay his/her loan, we reschedule the loan extending the loan period in favour of our customers.”* However, seven (7) respondents asserted that *“We threaten the clients with police authorities, court belief of the institution to recover the money or sell the collateral security given to the SACCO or we force the guarantors to pay the money.”* Five (5) respondents added that *“we consider the collateral security in relation to repayment of loan.”* Basing on the findings, it shows that SACCOs in Mbarara City rarely request clients who have failed to pay back a full amount to pay back only the principal.

Findings further, show that majority (61.9%) of the respondents disagreed that when a customer fails to pay back the loan in the credit period, we restructure the loan other than sell the collateral, 24.8% of respondents agreed, and 13.2% were neutral with the statement. The mean value of 2.3757 and standard deviation of 1.42979 shows that respondents disagreed that when a customer fails to pay back the loan in the credit period; we don't restructure the loan other than sell the collateral security.

Regarding the restructure of loan, six (6) respondents said that *“when some customers fail completely after we have tried all possible options, we sell their collateral as it is stipulated in the loan terms when extending credit to them”*. However, twelve (12) respondents asserted that *“we don't restructure the loan but we try all means to recover our money like selling the collateral security given to the SACCO or we force the guarantors to pay the money”* This implies that most SACCOs in Mbarara City sell the collateral when a customer fails to pay back the loan in the credit period but they don't restructure the loan improving on their loan performance.

Correlation between Credit Terms and Loan Performance of SACCOS in Mbarara City.

		CT	LP
CT	Pearson Correlation	1	0.612**
	Sig. (2-tailed)		0.000
	N	189	189
LP	Pearson Correlation	0.612**	1
	Sig. (2-tailed)	0.000	
	N	189	189
**. Correlation is significant at the 0.01 level (2-tailed).			

The above revealed that the Pearson correlation was 0.612** and it is statistically significant at the 0.01 level of significance (2-tailed) for 189 respondents. This shows that there is a substantial positive correlation between credit terms (CT) and Loan Performance (LP) which is statistically significant. Since the p-value (0.000) < 0.01, the null hypothesis “credit terms have no significant

effect on loan performance of SACCOS in Mbarara City” was thus rejected and the alternative hypothesis “credit terms have significant effect on loan performance of SACCOS in Mbarara City” was accepted. This implies that if credit terms are improved, then loan performance will also improve.

Discussion.

Credit terms on loan performance of SACCOs in Mbarara City

The study findings revealed that good credit terms positively affect their loan performance of SACCOs in Mbarara City. This finding is in agreement with past studies of Skees and Barnett who contend that favorable credit terms enhance access to finance and favour repayment and thus leading to better loan performance of the lending financial institution (Skees & Barnett, 2006).

Study findings revealed that favourable credit terms in terms of extending credit period greatly improve on loan performance of SACCOs in Mbarara City. However a study on credit period and loan performance revealed that a both short and long credit periods, negatively affect loan performance while a moderate period had positive effect on loan performance (Kolapo et al., 2012). Therefore, credit period can be extended but not made too long.

The study findings further showed that credit terms in form of loan rescheduling improve on loan performance of SACCOs in Mbarara City. This finding matches with Janson and others who contend that loans are commonly rescheduled to accommodate a borrower in financial difficulty and, replace the outstanding balance on an older loan with a new loan and is paid over a longer period thus, to avoid a default (Jansson, Rosales, & Westley, 2004).

It was also revealed from the study that credit term in terms of selling collateral security when a customer fails to pay back negatively loan performance. Therefore, there should be other options like loan rescheduling. This finding is in agreement with the study about the role of collateral and personal guarantees in relationship lending in Japan’s SME loan market, which revealed that attaching a collateral forces the customer to pay in time and selling the collateral is always the last option for the bank which may finally kill the mutual understanding between the bank and the customer (Ono & Uesugi, 2009).

Conclusion.

Credit terms and loan performance of SACCOs in Mbarara City

The study concludes that credit terms of SACCOs in Mbarara City have a positive significant effect on their loan performance and that, credit terms account for 37.5% of the variability in loan performance.

Recommendations.

SACCOs should always give a provision of loan structuring to some of struggling clients before selling off their collateral which may improve on the relationship between clients and the SACCOs, encourage clients to pay their loans and increase the rate of loan recovery.

SACCOs should have independent risk screening teams to assess the clients taking loans to reduce on non-performing loans and ensure increase in loan recovery and loan performance in their SACCOs.

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