

Lending Policy And Its Impact On Financial Performance Of Microfinance Institutions In Uganda. A Case Of Pride Microfinance Katwe Branch

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Abstract

The study aimed at lending policy and its impact on financial performance of microfinance institutions in Uganda. a case of pride microfinance Katwe branch. The study utilized a mixed-methods research design, integrating both qualitative and quantitative techniques. This approach allowed for a holistic exploration of the topic by capturing both the depth of individual experiences and perceptions (qualitative) and the breadth of trends and patterns in numerical data (quantitative). The Pride Microfinance Katwe Branch was chosen as the primary case study location due to its significance within the microfinance landscape of Uganda. The selection criteria included the branch's prominence, geographical representation, and relevance to the broader economic diversity observed in the Katwe area. The findings of the study shown the relationship between lending policy and financial performance (dependent variable). It shown that through bivariate means, the correlation between lending policy and financial performance was $(r) = 0.541$. This implied that there was a moderate positive relationship between the two variables since the significant value lending policy results into a corresponding positive change in financial performance in Pride Microfinance and vice versa. There is a need to emphasize the lending policies already in place to ensure that every employee of the MFI is obliged to adhere to them. This can be achieved through continuous training of staff, putting in place reward policies to those who work within the limits of the policies but without compromising creativity and innovation of the staff.

Key words: Lending Policy, Financial Performance and Microfinance Institutions

Background of the study

(Alex & Kazaara, 2023), states that microfinance institutions use different procedures to ensure that the collection of loaned funds is affected, they can issue warning letters, they can visit clients to pressure them to pay, confiscate savings, pressure guarantors or sue clients. In general, there are various options to help secure debt collection. But among them, the researcher determines the most effective methods (Akankwasa et al., 2022).

That the behavior of microfinance institutions is crucial in explaining their level of delinquency (Gracious, 2023). For example, an institution that has a very aggressive lending policy is expected to have

higher levels of delinquent loans. In this sense, the most analyzed group of variables is credit growth, type of business and incentives to adopt higher risk policies. One of the most important factors in determining the delinquency rate of financial institutions is the rate of credit expansion, as there could be a significant increase in the rate of credit growth along with a reduction in the level of requirements placed on applicants (Polycarp et al., 2023). Also (Polycarp et al., 2023) found some evidence that past loan growth contributes to explaining current delinquency. One possible cause of delinquency is motivating managers to adopt higher

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risk loan portfolio policies. Entities facing higher solvency problems could start a kind of "leakage forward" seeking expansion in more profitable segments but facing higher risk scenarios (Annet et al., 2023). However, an aggressive credit policy can help institutions in qualitative growth. This study lays down aspects to close this gap.

Adverse selection also affects those institutions that are trying to quickly increase their share of the credit market, because if one entity were to try to acquire the clients of another institution, the latter would likely fire its worst clients. If this expansion takes place in a new area or segment, adverse selection problems could be compounded because the first clients to come to the company would be the worst. Credit lending policies are the main tool used by microfinance institutions to screen their clients for loan extensions, to ensure the safety of loans, to ensure that loans are collected within specified periods and that low-value buyers are forced to pay (Collins et al., 2023).

Credit loan terms are the terms under which a business provides credit to customers (Kakuru 2010). Credit terms specify the period for which credit is provided to customers and any discount (Pande, 2010 Foulks 2006). According to (District et al., 2023), the term of the loan is one of the most important variables in microfinance. This is the period during which the entire loan must be repaid. The loan maturity affects the repayment schedule, the return to the microfinance institution, the client's financial burden and the final sustainability of the loan (Damasus et al., 2023). The more the organization adapts the terms of the loan to the needs of its client, the easier it is for clients to

obtain a loan and the more likely it is that payments will be made in full.

(Winny et al., 2023) noted that clients must be able to meet various forms of collateral, whether it is compulsory savings, personal guarantees, household or business assets. This (K. Faridah et al., 2023) collateral serves as a credit condition because it must be met before credit is granted and credit standards because it helps determine the creditworthiness of potential clients. Microfinance institutions also use credit terms to determine the class of people they should serve. For example, microfinance institutions use credit conditions to ensure that the poorest of the poor do not get access to credit (N. Faridah et al., 2023).

Norell (2010) agrees with Steans (2010) that credit recovery is affected from the moment the client submits the application form. If the size of the loan is too large for the cash needs of the business, I will switch to personal use. When the loan is due, the client cannot repay without capitalizing the business (Racheal, Kazaara, et al., 2023). In other words, the client must use the equity of the business to repay the loan, a position he is always reluctant to accept. To Norell 2010 and Steans 2010 this problem is caused by two main factors namely; the loan evaluation process and the amount of the loan granted.

Ghatak (2010) noted that some microfinance institutions have proposed short-term repayment schedules on a weekly and fortnightly basis; on this basis, they meet with clients and remind them to pay their loans. The use of group guarantees worked as a collection tool. Group members meet regularly and remind each other to fulfill their commitments as

agreed. (Paul et al., 2023) agreed with Hulme that it is important for microfinance institutions to normally seize the assets that have been pledged if the client defaults on the loan. This sends a message to other borrowers that the microfinance institution is very serious about loan repayment and this will deter other clients from defaulting (Akankwasa et al., 2022).

According to Craig (2015), in agreement with Hulme (2010), microfinance institutions take into account the marital status of clients, work abilities; historical background and previous dealings with customers such as bankers, customers, suppliers to create character. Any material non-compliance with the policy disqualifies the client, while clients who meet the conditions of the policy are eligible to receive services (Gracious, 2023).

More than the clients targeted by microfinance institutions, they also have very little capital base and ownership rights. The capital burden is therefore offset by sound collateral alternatives. However, in some institutions the emphasis is primarily on capital in the case of individual loans (Annet et al., 2023). With such

minimum requirements, a special category of the population is served.

According to (Ntirandekura & Christopher, 2022), knowledge among micro-entrepreneurs that management is not serious about loan recovery usually starts with small default rates. Overtime, clients copy each other and develop a habit of slow or late payments, and the default rate manifests itself in delinquency problems. Kasozi further noted that unpredictable crises such as illness or death in the family also cause difficulties in loan recovery. (Ntirandekura & Friday, 2022) noted that borrowers are usually asked to take care of extended family and if they refuse, they are considered disloyal to them. They feel compelled to help, even if they borrow funds from microfinance institutions.

A company that applies a very strict credit policy will only sell to financially strong customers. Such a policy leads to no loss of bad debts and lower credit administration costs because collection will be higher (Ntirandekura et al., 2022), Campsey and Brigham 1985. Under such circumstances, credit policies are loose; the company gets

Problem Statement

The study aimed at lending policy and its impact on financial performance of microfinance institutions in Uganda. a case of pride microfinance Katwe branch

Main Objective

To determine the relationship between lending policy and financial performance of microfinance institutions in Uganda. a case of pride microfinance Katwe branch

Methodology

The study utilized a mixed-methods research design, integrating both qualitative and quantitative techniques. This approach allowed for a holistic exploration of the topic by capturing both the depth of individual experiences and perceptions (qualitative) and the breadth of trends and patterns in numerical data (quantitative). The Pride Microfinance Katwe Branch was chosen as the primary case study location due to its significance within the

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microfinance landscape of Uganda. The selection criteria included the branch's prominence, geographical representation, and relevance to the broader economic diversity observed in the Katwe area. Financial data for the specified period, including key performance indicators such as profitability ratios, portfolio quality metrics, liquidity measures, and operational efficiency indices, were collected from official financial reports and records of Pride Microfinance Katwe Branch. A structured survey instrument was designed to collect quantitative data. The survey included questions related to the specific elements of lending policies, loan terms, interest rates, risk management practices, and clients' perceptions of the lending process. The survey was administered to a representative sample of clients and employees of Pride Microfinance Katwe Branch. Descriptive statistics, including means, standard deviations, and frequencies, were computed using SPSS to provide a summary of the collected quantitative data (Nelson et al., 2022). Inferential statistical techniques, such as regression analysis, were employed to examine the relationships between lending policies and various financial performance indicators. This allowed for the identification of significant associations and the quantification of the impact of lending policies on financial outcomes.

Results

Table 1: Correlation Between Lending Policy and Financial Performance

		Lending Policy	Financial Performance
Lending Policy	Pearson Correlation	1	.541**
	Sig. (2-tailed)		.000
	N	212	212
Financial Performance	Pearson Correlation	.541**	1
	Sig. (2-tailed)	.000	
	N	212	212
**. Correlation is significant at the 0.01 level (2-tailed).			

Source; Primary Data, 2022

The findings of the study in Table 1 above show the relationship between lending policy and financial performance (dependent variable). It shows that through bivariate means, the correlation between lending policy and financial performance is $(r) = 0.541$ (Nelson et al., 2023). This implies that there is a moderate positive relationship between the two variables since the significant value lending policy results into a corresponding positive change in financial performance in Pride Microfinance and vice versa. Thus, this implies that there is a statistical relationship between lending policy and financial performance in Pride Microfinance Katwe branch.

Table 2: Model Summary for Loan Recovery Policy and Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.541 ^a	.293	.290	.48552
a. Predictors: (Constant), Lending Policy				

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Source; Primary Data, 2022

The Regression results as presented in Table 2 above show the, adjusted R square value of 0.329, it implies that lending policy only contributes 29.0% towards financial performance in Pride Microfinance Uganda limited, the remaining 71% of financial performance is influenced by other factors. This thus shows that there is a relationship between lending policy and financial performance in Pride Microfinance (Moses et al., 2023).

Table 3: ANOVA Values for Lending Policy and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1).	Regression	20.533	1	20.533	87.103	.000 ^b
	Residual	49.503	210	.236		
	Total	70.035	211			
Dependent Variable: Financial Performance						
Predictors: (Constant), Lending Policy						

Source; Primary Data, 2022

Results of the study in Table 3 above indicate that the regression model predicts the dependent variable significantly well. There is a statistical significance of the regression model indicated by F= 87.103 and Sig =0.000 which is less than 0.05. This is also supported by the regression mean square value of 20.533 compared to the residual mean square of 0.236 which is significant to zero. This thus confirms that, there is a relationship between lending policy and financial performance in Pride Microfinance Uganda limited, Katwe branch (Ntirandekura et al., 2022).

Table 4: Coefficients of Lending Policy and Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1).	(Constant)	2.341	.174		13.465	.000
	Lending Policy	.418	.045	.541	9.333	.000
Dependent Variable: Financial Performance						

Source; Primary Data, 2022

Results from Table 4 give t values and Beta. The t-values test the hypothesis that the coefficient is different from 0. To reject this, you need a t-value greater than 1.96 (for 95% confidence). The t-value for lending policy is 9.333 which are greater than 1.96. This implied lending policy influence the financial performance in Pride Microfinance considering a significant factor (Sig =0.000). Also, the standardized beta coefficients of 0.541 imply that one-unit increase in financial performance is caused by 0.541 units increase in lending policy based on the equation $Y = \beta x + C$ where Y= financial performance (Dependent variable), x = Lending policy (Independent variable, $\beta = 0.541$ and C=

constant (Akankwasa et al., 2022). This therefore means that there is a statistical relationship between Loan recovery policy and financial performance in Pride Microfinance Katwe branch.

Conclusion

The study concludes that; lending policy positively influences financial performance in Pride Microfinance Uganda limited, considering the Pearson product-moment correlation coefficient of $r = 0.541$. The positive value of (r) implies that a positive change in lending policy results into a corresponding positive change in financial performance in Pride Microfinance and vice-versa. Therefore, research objective three was achieved, and research question three was answered.

Recommendation

There is a need to emphasize the lending policies already in place to ensure that every employee of the MFI is obliged to adhere to them. This can be achieved through continuous training of staff, putting in place reward policies to those who work within the limits of the policies but without compromising creativity and innovation of the staff. There is also a need to put in place punishments for those loans officers who operate outside the institution rules and regulations. Although this will limit the number of borrowers, it will increase the institute's capacity to lend to only those where the risk of repaying is minimal. This will lead to reduction on the rate of non-performing loans hence financial performance in microfinance institutions such as Pride Microfinance Uganda limited.

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