

**THE EFFECT OF CREDIT RISK MANAGEMENT ON THE FINANCIAL  
PERFORMANCE OF COMMERCIAL BANKS IN UGANDA: A CASE STUDY OF  
ABSA BANK MUKONO DISTRICT**

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## **DECLARATION**

In accordance with the University's basic values of integrity and diligence, I got no illegal aid in writing my work. I thus affirm that, to the best of my knowledge, the work is entirely mine, with no evidence of plagiarism or any other unethical conduct. The only previously published material was used solely for reference purposes.

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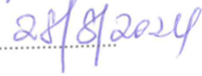
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## APPROVAL

This paper has been submitted for examination with my approval.

Signature.....

Mr. KISENYI VINCENT

Date.....

## **DEDICATION**

I dedicate this work to my dearest family which has shown heroic support throughout my academic struggle, to the staff of Rubaga Child development Centre, Jinja, and to the administration of Jinja full gospel church who have been a great inspiration in my life and they have given me all the support and guidance that a child would ever want from a parent. I want to thank them for the support, encouragement and advice to take up this course and laying a foundation for my career.

I also dedicate this work to my supervisor Mr. KISENYI VINCENT who enabled and guided me during the course of my research.

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## **ABSTRACT**

The study investigated the effect of credit risk management on the financial performance of commercial banks in Uganda, a case study of Absa bank, Mukono. The general objective of the study was to examine the effect of credit risk management on financial performance of commercial banks in Uganda, it was further guided by three other objectives that is to say ; To evaluate how the credit policies adopted by commercial banks in Uganda influence their overall financial performance, to analyse the effect of credit risk management practices on the financial health of commercial banks, to assess the relationship between credit analysis and financial performance.

A population of 22 respondents from Absa bank, Mukono was used. A simple random sampling technique was used and all the members of the finite population were given an equal chance to be included in the sample since the target respondents were either engaged or had an idea about the effect of credit risk management on financial performance of commercial banks, these were in a better position to respond to the research questions appropriately. This removed the possible bias that may have arisen as the result of research favouring some respondents. Data was collected using Questionnaires as a data collection instrument.

# CHAPTER ONE

## INTRODUCTION

### 1.0 Introduction

This section introduces us to the topic under study “The effect of Credit Risk Management on the Financial Performance of Commercial Banks, a case study of ABSA bank, Mukono district” The chapter consists of the background of the study, statement of the problem, objectives of the study, research questions, significance of the study and conceptual framework.

### 1.1 Background of the Study

The banking industry in Uganda has expanded tremendously over the past ten years. There are now 25 licensed commercial banks in the nation, as opposed to just 21 in 2008. As of the end of December 2022, the estimated value of all bank assets was Ushs45.44 trillion, or almost US\$12.3 billion. Of the total banking assets, the top 10 commercial banks have 82.18 percent, and the remaining 15 commercial banks hold 17.82 percent. Furthermore, 57.54 percent of all national banking assets are held by the top five. As of June 30, 2023, the nation's entire banking assets were valued at US\$48.3 trillion, an increase from roughly US\$12.9 million during the same period the previous year, a source revealed to the Daily Monitor.

According to the Bank of Uganda, as of March 31, 2017, there were 24 banks in Uganda. Among them are the following: The following banks operate in Uganda: ABC Capital Bank Limited, ABSA Bank, Bank of Baroda, Bank of Africa Uganda Limited, Bank of India (Uganda) Limited, Cairo International Bank Limited, Commercial Bank of Africa (Uganda) Limited, Centenary Bank, Citibank Uganda Limited, DFCU Bank, Diamond Trust Bank Uganda Limited, Ecobank Uganda Limited, Equity Bank, Exim Bank, Finance Trust Bank, Guaranty Trust Bank, Housing Finance Bank, KCB Bank Uganda Limited, NC Bank Uganda Limited, Orient Bank, Stanbic bank Uganda limited, Standard Chartered Bank, Tropical bank, UBA Bank, and United Bank for Africa Uganda Limited. The reserves of the banking industry in Uganda have proven to be resilient shocks. The adequate capital and liquidity buffers were shown.

The study concentrated on ABSA bank Uganda. ABSA bank Uganda, previously trading as Barclays bank of Uganda Limited is a commercial bank in Uganda. It is licensed by the Bank of Uganda, the central bank and national banking regulator. The bank is a subsidiary of ABSA

group limited, a financial services conglomerate based in South Africa, with banking subsidiaries in 12 African countries and representative offices in two other African countries. Shares of ABSA bank group trade on the JSE limited and as of December 2023, it was reported to have total assets in excess of UGX 4.5 trillion (US\$1.19 billion). The bank is primarily involved in meeting the banking needs of persons, small and medium- sized businesses (SMEs) and large corporations.

Prior to 2006, the bank's primary focus had been serving wealthy individuals and large enterprises with their banking needs. The primary emphasis was widened to encompass SMEs and loyal clients. The bank's total asset value as of December 2023 was UGX 4.5 trillion, or roughly US\$ 1.19 billion. As of December 31, 2021, the stockholders' equity was valued at UGX 521.956 billion, or roughly US\$148 million. It made Ushs110 billion, or roughly US\$31.2 million, in profit after taxes in 2021. In terms of overall balance sheet value, ABSA bank Uganda was placed third among commercial banks as of December 31, 2019. As of December 2022, its asset base was Ushs4.23 trillion, or roughly US\$1.143 billion, representing at the time, around 9.31% of all banking assets in the nation.

A commercial bank's performance is crucial to its future operations. Since financial analysts in the United States, United Kingdom and New Zealand have consistently ranked corporate annual financial reports as the most significant source of information, it is impossible to determine an institution's financial success without first examining its financial statements.

## **1.2 Statement of the Problem**

Credit risk refers to the likelihood that a bank borrower or counterparty will default, either partially or totally on its obligations as per agreed terms (Basel Committee on Banking Supervision 2020). Credit risk is primarily caused by limited institutional capacity, inappropriate credit policies, volatile interest rates, poor management, inappropriate laws, low capital and liquidity levels, direct lending, massive bank licensing, poor loan underwriting, lax credit assessment, government interference, poor lending practices, and insufficient central bank supervision.

Based on historical data, it appears that inadequate credit risk management is a primary cause of the majority of bank failures. Banks that were previously functioning well announced massive losses as a result of bad credit exposures. Basically, it is the most expensive risk in this institution and its impact is greater than other risks because it threatens financial institutions' solvency. Where banks throughout the years have run into trouble for any number of reasons,

the main cause for banking problems remains one that is closely related to credit risk. Management of credit risk, therefore is one of the most important tasks to ensure the financial liquidity and stability of the banking sector in connection with increased sensitivity of banks to the credit risks while the development of prices of financial instruments is changing (Kisel'akova and Kisel'ak, 2021).

In risk assessment techniques, the determination of each individual loan or borrower has a primary role in the management and reduction of the credit risk. Management of the general loan portfolio can only be done after determining the risk represented by each individual borrower and each single credit service. It refers to analysing the qualitative and quantitative indicators of the borrower's economic state. It is within the scope of credit risk assessment. A comprehensive and structured analysis of the various risk factors that attend the granting of some loan or other, coupled with the assessment of these factors, will let the bank be conscious of the arising negative impact of their convergence in credit risk management and avoid a repeated negative impact of their convergence on the results of the future activities of the bank (Rodina et al, 2023).

Background among other challenges facing commercial banks in Uganda are non- performing loans, fluctuation of interest rates, harsh economic conditions, turnaround time, fake securities by the loan applicants and fraud, all of which have impacted negatively on their performance. For instance, according to the Bank of Uganda 2012/2013 report, five banks including Crane bank and others reported losses during the year due to improper assessment of credit risks and this heavily led to a decline in the banks' performance during the year.

The commercial banks however have initiated some risk assessment policy including client appraisal, credit monitoring, credit analysis, among others (5Cs) to some of the above problems. Therefore, one wonders how these have curbed the problem of credit risk. Building on that background a study is carried out to investigate credit risk management and financial performance of commercial banks in Uganda.

### **1.3 General Objective of the Study**

The general objective of the study was to examine the effect of credit risk management on financial performance of commercial banks in Uganda.

#### **1.4 Specific Objectives of the Study**

- I. To evaluate how the credit policies adopted by commercial banks in Uganda influence their overall financial performance.
- II. To analyse the effect of credit risk management practices on the financial health of commercial banks.
- III. To assess the relationship between credit analysis and financial performance.

#### **1.5 Research Questions**

- I. To what extent do credit policies adopted by commercial banks in Uganda influence their overall financial performance?
- II. What is the effect of credit risk management practices on the financial health of commercial banks?
- III. What is the relationship between credit analysis and financial performance?

#### **1.6 Significance of the Study**

The study had the following contributions:

- I. The study results may be useful to the management of such commercial banks in Uganda for decision making especially on how to execute credit risk management properly since it commands a large percentage of their financial performance.
- II. The research established other factors that may hinder the commercial lending business apart from risks.
- III. Can act as a source of literature for other scholars who intend to carry out further research on credit risk management with specific reference to commercial banks.
- IV. The research improved not only the researcher's scope of understanding risk assessment policy, but also the entire public.
- V. The study gave an insight into the best risk assessment policy that ABSA bank can adopt to enhance in performance in their industry.
- VI. Finally, the findings of this study would also be of benefit to the policy makers in government especially the central bank of Uganda in the formulation of policies and regulation governing the administration of credit facilities.

## 1.7 Conceptual Framework

Independent variable

Dependent variable

Credit risk Management

- Credit policy
- Credit management
- Credit analysis

Financial performance

- Financial Statements over time
- Profitability
- Return on equity

Source: Authors' study framework (2019).

## 1.8 Scope of the Study

### 1.8.1 Subject scope

The study focused on the effect of credit risk management on financial performance in commercial banks. The two variables used were credit risk management, the independent variable and financial performance, the dependent variable. The primary issues dwelled on the credit risk management strategies, the effect of credit risk management on the financial performance and the relationship between credit analysis and financial performance in the commercial lending business.

### 1.8.2 Geographical scope

The research work was done in Mukono district, ABSA bank. This case study was chosen for this research due to its convenience to the researcher in terms of the type of business and area of residence of the researcher, as well as data availability for the work.

## CHAPTER TWO

### LITERATURE REVIEW

#### 2.0 Introduction

This chapter reviews literature from other scholars on the area of credit risk. The researcher began with identification of main terminologies, followed by theory on credit risk, and lastly literature reviews on the objective of the study

#### 2.1 Definition of Key Terms

##### 2.1.1 Definitions on credit

Professor Cole: "Credit is purchasing power that is created by financial institutions and is not derived from income rather, it is a net addition to the total amount of purchasing power or an offset to idle income held by bank depositors."

Professor Gide: "It's an exchange that ends when a specific amount of time passes."

Professor Kinley: "We define credit as the ability of one person to persuade another to place commodities at his disposal for a period of time in exchange for a promise of future payment. Therefore, credit is a measure of the borrower's strength.

According to Vasant Desai: "To grant or permit the temporary use of with the understanding that some or its equivalent will be returned."

Professor Thomas: "We now use the term credit to refer to the belief in a man's probability and solvency that will allow him to be entrusted with something of value belonging to another, whether that something is money, goods, services, or even credit itself as and when one may entrust the use of his good name and reputation." Drawing from the aforementioned definitions, credit can be defined as the exchange function whereby a creditor provides a debtor with products or money, expecting the debtor to repay them later.

##### 2.1.2 Definitions on credit risk

Credit risk refers to the possibility that counterparties in loan and derivatives agreements would default. According to Hull (2018), lending institutions have historically faced this risk the most and as a result, the highest level of regulatory capital is typically needed. Credit risk is described as the "possible default of a borrower to meet the obligation in accordance with the agreed term" by the Basel Committee on Banking Supervision (BIS, 2020).

According to Johnson (2022), credit risk is defined as the loss arising from a borrower's inability or unwillingness to repay a loan or meet contractual obligations. Since it has an immediate effect on financial institutions' profitability and capital adequacy, it is regarded as their top issue.

### **2.1.3 Definitions related to credit risk management.**

Credit risk management is the process by which financial institutions identify, assess, monitor and control the risk of default by borrowers. It involves a range of practices and tools designed to minimize potential losses from credit activities, including rigorous credit assessment, setting credit limits, and continuous monitoring of credit exposures (Smith, 2023).

The Basel Committee on Banking Supervision (2020) defines credit risk management as the practices and processes used by banks to manage their exposure to credit risk. This includes the establishment of credit policies, the implementation of risk assessment frameworks and adherence to regulatory requirements designed to ensure the financial health and stability of the banking system.

The Financial Stability Report by the Bank of Uganda (2019) defines credit risk management as a comprehensive approach that includes the identification, measurement, monitoring and control of credit risk. This approach ensures that all potential risks are accounted for and managed proactively to safeguard the bank's financial integrity and performance.

### **2.1.4 Definitions on financial performance**

Financial performance can be defined by the quantifiable outcomes derived from a bank's activities, which include revenue production, cost management and profitability. It also involves the assessment of financial ratios and metrics such as Return on Assets (ROA), Return on Equity (ROE), net profit margin and the debt-to-equity ratio, which indicate the bank's financial health and operational effectiveness (Bank of Uganda, 2019).

The word "Financial performance" refers to the execution of financial activities. In broader terms, financial performance refers to the extent to which financial objectives are or have been met.

According to Eshna Verma (2017), financial performance is a process that quantifies the outcomes of a company's policies and activities in monetary terms. This is useful for

determining the general health of a firm overtime, as well as for comparing similar enterprises within the same industry or aggregating industries or sectors.

### **2.1.5 Definitions on credit analysis**

Credit analysis is the process financial institutions use to manage credit risk, which involves measuring the probability of a borrower defaulting on debt obligations. It involves looking at the level of income, expenditure patterns and existing debt obligations of the borrower to get an idea of their level of financial stability and ability to repay (Anderson, 2020).

The Basel Committee on Banking Supervision (2020) explains credit analysis as the assessment process conducted by banks to evaluate the risk associated with lending activities. This involves a thorough review of a borrower's financial condition, including their income, debt levels and collateral to ensure compliance with regulatory standards and to mitigate potential losses.

Credit analysis refers to the process by which financial institutions assess the creditworthiness of potential borrowers. This involves evaluating the borrower's financial history, current financial status and future financial potential to determine their ability to repay loans (Smith, 2023).

## **2.2 Theories on Credit Risk**

### **2.2.1 Credit risk theory**

In the credit risk theory, the lender is essentially at risk, meaning loss in the principal and in interest. An insolvent bank may not be in position to refund a depositor's funds, for instance leading to a disruption loss that may either be full or partial. To minimize the lending party's level of risk, the lender may deem it fit to determine the creditworthiness of the intending borrower, urge the borrower to acquire the insurance coverage necessary like mortgage insurance or look for the third- party secured or guarantor ship. Generally, the riskier an investment is, the greater the interest rate that the borrowers will be required to pay (Ewansiha et al., 2022)

## **2.3 How Credit Policies Adopted by Commercial Banks in Uganda Influence Their Overall Financial Performance.**

Commercial banks in Uganda play a crucial role in the country's economy by providing financial services and credit facilities to businesses and individuals. The formulation and

implementation of effective credit policies are essential for managing credit risk and optimizing financial performance. This literature review explores how credit policies adopted by commercial banks in Uganda influence their overall financial performance, drawing insights from recent research and theoretical frameworks.

Credit policies are rules and procedures set down by banks to guide their lending activity. They detail the criteria for assessing a borrower's creditworthiness, fixation of a loan's interest rates, determination of its terms and management of credit risk. An effective credit policy has to balance the objectives of maximising loan profitability on one hand and minimising losses from credit while ensuring compliance with relevant regulations on the other.

Loan portfolio quality. The evidence proves that credit policy is a significant determinant of loan portfolio quality. Loan portfolio quality affects financial performance. Banks also have clear credit policies focusing on good assessment processes about the borrower and good risk management. These banks are bound to portray lower non-performing loans (NPLs) and higher asset quality ratios (Kasaija et al., 2018)

Risk-adjusted Returns. The adoption of sound credit policies allows banks to achieve optimal risk-adjusted returns on their loan portfolios. By accurately assessing borrower creditworthiness and implementing appropriate risk mitigation measures, banks can optimize the balance between loan profitability and credit risk exposure (Sserwanga & Kyeyune, 2017).

Cost of Capital. Credit policies also influence a bank's cost of capital by affecting its ability to attract deposits and access funding sources. Banks with stringent credit policies that prioritize credit quality and risk management may benefit from lower funding costs due to enhanced depositor confidence and reduced credit risk premiums (Ogwang, 2018).

Lending Practices and Accessibility to Credit. Credit policies significantly influence lending practices, determining who gets access to credit and under what terms. In Uganda, stringent credit policies often result in reduced accessibility to credit for small and medium enterprises (SMEs) and individuals. According to Nannyonjo (2021), commercial banks in Uganda have historically adopted conservative credit policies to mitigate risk, which has inadvertently restricted access to credit for many potential borrowers. This has been exacerbated by high collateral requirements and rigorous credit assessment procedures that many small businesses and low-income individuals cannot meet

Regulatory Compliance. Efficient credit policies enhance compliance with regulatory requirements and support the overall soundness and resilience of commercial banks. Banks which closely adhere to the set prudential lending standards and regulatory requirements, thereby stand a better chance of surviving adverse economic conditions and other external shocks which in turn enhances their long- term financial performance (Kasaija et al., 2018)

#### **2.4 The Effect of Credit Risk Management Practices on Financial Health of Commercial Banks.**

While each risk that a bank has is highly significant, credit risk is perhaps the most significant risk that a bank faces. More than any other risk, the success of the bank's operations depends on the precise measurement and effective management of credit risk (Gieseche, 2020). Increases in credit risk drive up the cost of financing for the bank since they increase the marginal cost of stock and debt (Basel Committee on Banking Supervision, 2020).

The scholars used a sum of proportions that measured credit risk. One of them is the proportion of Loan Loss Reserves to Gross Loan (LOSRES). This represents the amount of the total portfolio that has been paid for but not yet charged off, as well as a gauge of the bank's asset quality. These indicators show that the larger the ratio, the worse the quality and as a result, the greater the risk associated with the loan portfolio. Another credit quality indicator, loan loss provisioning as a percentage of net interest revenue is suggestive of strong credit quality if the values are low. It also shows in cross- country analysis studies, differences in provisioning regulations.

Using the Loan to Assets (LTA) ratio, Bourke (2019) looks at the impact of loan activities. Since bank loans are more likely to default than other bank assets due to their relative illiquidity, this should indicate a positive link between LTA and the risk measures. However, given Altunbas 2019, relative advancements in credit risk management techniques would imply that LTA is adversely correlated with bank risk metrics.

According to Koehn and Santomero (2020), Kim and Santomero (2018), and Athanasoglou et al. (2020), bank risk-taking has a significant impact on both bank safety and earnings. According to Bobakovia (2023), a bank's profitability is based on its capacity to anticipate, manage, and mitigate risk. It also has the potential to cover losses resulting from risk. Ultimately, this increases the proportion of substandard credits in the bank's credit portfolio and lowers the bank's profitability.

Keplan (2018) argued the estimation or credit scoring of default possibility to avert the ocean of risks. The policy reformation can enlist much more effect if only an exchange of information could have been made possible between MFI and the borrower. Lack of sharing an information hikes the credit risk of the MFIs and makes the MFI system less competitive. This lack of quality information on the borrower raises the adverse selection risk, which results in higher credit risk and loan loss provisions, thus raising interest rate spreads.

According to Bourke (2019), there is an evident adverse effect of credit risk on profitability. This may be explained by the fact that financial institutions are more likely to accrue delinquent loans the more high-risk loans they are exposed to. Stated differently, this only indicates that numerous commercial banks have produced reduced profits as a result of these losses. Kolapo et al. 2021; Miller and Noulas 2007.

According to a 2019 study by Soke Fun Ho and Yusoff on credit risk management strategies for a subset of Malaysian financial institutions, the largest percentage of losses for banks and financial institutions is realized through outright default, which is caused by customers' failure to uphold their end of the bargain when it comes to lending, trading, settlement, and other financial transactions. When banks conduct business with individuals, corporations, financial institutions, or sovereign governments, they run the risk of developing credit risk. Both credit and liquidity problems may be drawn to the same problematic portfolio.

Credit policy helps in reducing bad debts in commercial banks and boosting cashflows since most businesses of banks deals with loans. According to Riach (2020), credit policy enables the bank to work with some sort of consistency in its different departments since it allows for something being written- down of what every department wants and therefore a possibility of consistency in the handling of clients according to the already pre- set parameters.

Achou and Tenguh (2018) found that there is a substantial correlation between financial institution performance in terms of profitability and credit risk management in terms of loan performance in their study on bank performance and credit risk management. Enhancing credit risk management practices results in better financial outcomes. Financial institutions must so prioritize responsible credit management, the preservation of their assets, and the defence of the interests of their investors. The same applies to microfinance organizations.

In a book on bank risk management, Pyle (2021) states that banks and other financial organizations need to make sure they have enough capital to handle the many risks that the credit entity faces as well as the necessary measurement to meet any future regulatory

requirements. But it would be a grave error to think that enforcing regulatory requirements is the sole, or even primary, reason to put in place a strong, empirical risk management system. The argument, however, is that managers want trustworthy risk indicators in order to direct money toward ventures that offer the optimal balance between reward and risk. To remain within the constraints set by easily accessible liquidity from clients, creditors, and regulators, prospective losses must be estimated. Mechanisms are needed to monitor positions and create incentives for prudent risk taking by divisions and individuals.

Regarding the Nigerian case, Philip (2020) said that the deregulation of the financial system, which began in Nigeria in 1986, allowed banks to encroach on the banking sector. Due to their different interest rates on deposits and loans, the banks distributed credit arbitrarily and without conducting a thorough credit evaluation. A bank's loan portfolio comprises more than 50% non-performing loans due to an inadequate credit appraisal procedure.

Several things influence the banks' success. As a result, Athanasoglou et al. (2018) noted that, despite significant development in financial markets, the bank's role in financing economic activity remains central, and its effectiveness could have a positive impact on the entire economy because only a sound and profitable banking sector is better able to withstand negative shocks and contribute to financial system stability. Academic research and bank management have both shown an interest in the factors that influence banking success. Internal determinants research includes variables including as size, capital, credit risk management, and spending management. The banking industry's nature necessitates risk management. The two main factors that lead to bank failures, inadequate liquidity and poor asset quality are regarded as the main sources of risk for both credit risk and liquidity risk.

According to Umoh (2022), few banks are able to withstand a persistent run, even in the presence of a good lender of last resort as depositors take out their funds, the bank haemorrhages and in the absence of liquidity support, the bank is forced eventually to close its doors. Thus, the risks faced by banks are endogenous associated with the nature of banking business itself, whilst others are exogenous to the banking system.

The rising number, according to Sanusi 2022, exceeded their capability for human resources, which resulted in a variety of issues, such as subpar credit evaluation systems, financial crimes, and the buildup of subpar asset quality, among others. As a result, there are now more bank failures. In addition, political concerns, poor management, unfavourable ownership influence,

insider abuses, and drawn-out legal proceedings particularly in relation to debt collection were contributing issues.

## **2.5 Relationship Between Credit Analysis and Financial Performance.**

The relationship between credit analysis and financial performance of commercial banks is multifaceted, encompassing various dimensions that collectively impact the profitability, asset quality and risk management capabilities of banks. Drawing upon recent literature, the following points offer a comprehensive explanation of this relationship;

Credit analysis enhances loan portfolio quality. Effective credit analysis practices enable banks to project the creditworthiness of borrowers with utmost accuracy, hence improving the loan portfolio quality. Indeed, according to Nampewo et al (2020), robust credit analysis reduces the non-performing loan (NPL) problem by identifying and mitigating against credit risk factors, thereby improving the asset quality of banks.

Risk Management Optimization. Credit analysis is integral to the risk management framework of commercial banks. Mugume and Muhanji (2019) emphasize that thorough credit analysis allows banks to identify and quantify credit risk exposures, facilitating the implementation of risk mitigation strategies. By optimizing risk management practices, banks can minimize potential losses and safeguard financial performance.

Profitability Maximization. Many scholars have proved the link between credit analysis and profitability in past research. Berger and Bouwman (2019) argue that good credit analysis significantly aids in being profitable by the very fact that it enables banks to efficiently allocate capital and price loans based on risk. Since banks set rigorous practices of credit analysis, they can maximise interest income hence general profitability.

Asset-Liability Management. Credit analysis plays a crucial role in asset-liability management (ALM) within commercial banks. Ojangole and Odongo (2023) highlight how credit analysis informs lending decisions, allowing banks to match the maturity and liquidity of assets with liabilities. By aligning asset quality with funding sources, banks can mitigate liquidity risk and optimize asset liability management, positively impacting financial performance.

Customer Relationship Management. Credit analysis influences customer relationship management in commercial banks. Nakabuye and Kirungi (2018) discuss how banks use credit analysis insights to tailor loan products and terms to meet customer needs. By offering personalized credit solutions, banks can enhance customer satisfaction and loyalty, fostering long-term relationships that support financial performance.

Regulatory Compliance. Compliance with regulatory requirements is imperative for commercial banks, with credit analysis playing a central role in regulatory compliance. Ssempijja et al. (2022) highlight how banks must adhere to regulatory guidelines for credit risk management, provisioning and reporting. Effective credit analysis ensures compliance with regulatory standards, mitigating legal and reputational risks that could adversely affect financial performance.

Economic Sensitivity. The interaction between credit analysis and financial performance is sensitive to macroeconomic conditions. Mugerwa and Kalule (2023) argue that economic downturns can increase credit risk and impair asset quality, necessitating heightened vigilance in credit analysis and risk management. Banks that adapt their credit analysis practices to changing economic conditions can mitigate adverse effects on financial performance.

Globalization Dynamics. Globalization has implications for credit analysis and financial performance in commercial banks. Claessens et al. (2023) discuss how cross-border exposures and interconnected financial markets influence credit risk assessment and management. Banks operating in globalized environments must incorporate international considerations into their credit analysis practices to mitigate systemic risks and ensure financial stability.

Ethical Considerations. The practice of credit analysis and financial performance within the commercial banks cannot be divorced from ethical considerations. Gray and O'Brien (2022) reveal that an important element of ethical lending is the building of trust between the financial institution and the client. If the institution embeds sound ethical practices in credit analysis and lending, then it will foster an environment more likely to attract socially responsible investors and customers which may improve financial performance overtime.

## **2.6 Financial Performance Indicators.**

Financial performance indicators serve as metrics for evaluating the effectiveness of credit analysis practices and their effect on bank profitability, asset quality and risk management. Rajan and Zingales (2019) emphasize the significance of return on assets (ROA) and return on equity (ROE) as measures of profitability, reflecting the efficiency of asset utilization and capital allocation in generating earnings. Since the Great Depression in 1929, performance analysis of commercial banks has been a popular topic in academic research.

### **Return on Investment.**

According to Gillingham (2021), investment is all about net assets employed by the firm. As a consequence, profitability for any investment can be simply determined so as to base on an end result on whether to invest or not. The following approach was proposed for return on investment analysis.

### **Gross profit margin.**

Gross profit, according to Home (2020) is the revenues of the firm less the costs incurred in producing that revenue. Revenues refer to the amount an organization receives from selling a product or service. In other words, it's the earnings before depreciation, interest, and taxes, or EBITD; that is to say; gross profit is equal to sales less the cost of goods sold. Great sales, sound management, and great profitability are all indicated by a high gross profit margin ratio; low profitability is indicated by a low gross profit margin ratio. But he added that the ratio should be compared to the industry average ratio in order to arrive at that analysis.

### **Return on Assets (ROA).**

It simply refers to the ratio of net income to total resources, or more accurately, corporate assets. In this way, it assesses how well the bank's management uses its limited resources to turn a profit. The bank benefits from higher return on assets since it indicates improved bank management efficiency. Based on total assets, ROA gauges how profitable and effective a bank's management is. It is stated in numerous reviews of the literature that quantitative financial indicators serve as the primary means of representing bank performance. The literature on the factors influencing bank performance has shown a strong correlation between profitability metrics like ROA and ROE (Chirwa 2021). The influence of improved financial soundness on banks' capacity to absorb risk and to convert liquidity is taken into consideration by profitability (Rauch et'al, 2018 Shen et'al, 2020).

Return on Equity (ROE).

This is a variable used to measure the profitability performance of the banks or any other company. It is the ratio of net income to total equity. This represents the rate of return generated by owners' equity. It is defined as the company's annual net income after tax divided by shareholders' equity which is what amount of earnings after paying all expenses and taxes.

Equity is the capital that is put into the company and the retained earnings. In simple words, ROE reflects the return on the capital invested in the business. A higher ROE would indicate that the profit is growing without putting new capital into the business. An ever-increasing ROE would also be indicative of the fact that year after year, more and more money is being returned to the shareholders for their money. In general, the higher ROE is better for both the company and shareholders.

Foong Kee K (2018) stated that the banks' efficiency can be measured through the ROE which shows the extent to which banks utilize reinvested income to derive future profits. The association of profit to shareholders' equity is commonly utilized in defining profitability in banks. Return on Equity can be one of the useful criteria of equity selection. Jensen (2018) commented that ROE provides a very useful gauge of profit generating efficiency because it measures the amount of earnings a company can derive from the equity capital.

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.0 Introduction**

This chapter provides the methodology the researcher used in the collection of the data. This chapter details the research design, sampling design, target population, sample size, data sources, data collection methods, data collection instruments and data analysis.

#### **3.1 Research Design**

In general, research design indicates a general plan and outlines of conducting the research study. In this research, a qualitative design was used. This was so because the design is concerned with the exploration of credit risk management and financial performance of commercial banks in Uganda to examine the relationship that exists between credit analysis and financial performance.

#### **3.2 Sampling Design**

##### **3.2.1 Sampling technique**

This research involved use of simple random sampling technique in the sense that the study included some form of random selection. Simple random sampling technique was used in this research because of its ability to give every chance of all respondents getting selected, has a lesser degree of judgement hence it minimises bias, it is cost- effective and less time consuming, it is a comparatively easier way of sampling than another sampling technique.

#### **3.3 Target Population**

The target population involved the staff working in ABSA bank, Mukono across loans, finance and accounts departments. They were targeted because they are active and knowledgeable about risk of credit. Target population as defined by Cooper and Schindler (2019) involves all to be studied or described and from whom samples may be drawn. This definition puts an emphasis on the fact that the target population is the bigger population of interest from which samples may be drawn for the research study.

### 3.4 Sample Size

Sample size refers to the number of units or people that are drawn from which the researcher would like to obtain information or data (Hair et al 2019). For the purpose of this study, the researcher used a mathematical formula of Tora Yamane to determine the sample size for this

study. It is illustrated as  $n = \frac{N}{1+N(e)^2}$ . The total population for the study that was selected

from Absa bank, Mukono includes 24. The respondents for the study were selected following the Yamane's formular where N= 24, e = 0.05.

$$n = \frac{24}{1+24(0.05)^2}$$

$$n = 22 \text{ respondents}$$

### 3.5 Data Sources

#### 3.5.1 Primary data

The researcher used primary data as a source of data. According to Bryman and Bell (2019), primary data refers to sources of data whereby the raw facts are collected for the first time, that is to say; data which is original in nature. In other words, it is the data which is obtained by the researcher from the respondents themselves. This was done through administration of questionnaires.

#### 3.5.2 Secondary data

Another source of data was the secondary data. Secondary data is data collected by anyone other than the primary user. It is already existing data or information that was collected by other researchers. The data was obtained from the bank's annual reports, published journals and articles, and the available information on the internet.

### 3.6 Data Collection Methods

#### 3.6.1 Primary data collection

According to Bryman and Bell (2019), primary data sources are those that offer data whereby raw facts are collected for the first time that is to say, data which is original in nature. Primary data was collected through self-administered questionnaires.

The comprehensiveness of the data collection will harness the strengths of questionnaires to give a holistic understanding of the research topic. In this manner, qualitative data could be triangulated and cross- validated, with acceptance of the research questions that would lead to increased validity and reliability of the findings in the study.

### **3.6.2 Questionnaires**

The questionnaires were self- administered on a sample of staff working at ABSA bank, Mukono. In the distribution of the questionnaires event, simple random method of sampling was employed. The design of the questionnaires was based on the assessment of staff level on credit risk management and financial performance among other relevant information. Closed-ended questions, including Likert scale items, assisted in attributing numbers to levels of credit risk management among staff and therefore yielded data that was statistically analysed.

These closed- ended questions also eased in making comparisons and identification of patterns in responses. These qualitative insights complemented the qualitative data in gaining a more exceptional understanding of the effect of credit risk management on the financial performance of commercial banks in Uganda.

### **3.7 Data Collection Instruments**

This section provides great detail about the data collection instrument that was used to collect primary data from the respondents. The data collected was geared towards answering the specific objectives of the research and gathering attributes that are relevant to the effect of credit risk management on the financial performance of commercial banks in Uganda.

#### **3.7.1 Self-administered questionnaires.**

The primary data collection tool was self- administered questionnaires which solicited the information used in this study to analyse and compare various mechanisms of credit risk management at the bank. The questionnaire had several sections that targeted different aspects of the research objectives. The sampling frame for this study was staff at Absa bank located in Mukono. The sampling method used was a combination of purposive and simple random sampling methods.

The questionnaires contained questions such as the bio data on the respondents while other sections contained questions on the specific objectives of the study. They were targeted to the heads of departments that are involved in the management of credit risk in Absa bank.

### **3.8 Data Analysis**

According to Hyndman (2018), data processing is the process of converting a questionnaire's responses into a form that can be used to generate statistics. This includes steps like coding, editing, data entry, and monitoring the entire data processing procedure. Tables were used to detail the findings and recommendations, making it simple and straightforward to interpret the findings.

### **3.9 Ethical Considerations**

The researcher followed ethical rules for collecting and analysing data. All respondents provided informed consent to assure that their participation was free and voluntary, and that their responses would not be made public without their consent. The research was carried out in accordance with the applicable ethics review board of the university.

## CHAPTER FOUR

### DATA ANALYSIS, PRESENTATIONS, INTERPRETATIONS AND DISCUSSIONS.

#### 4.1 Introduction

The approaches used in analysing and presenting study findings are discussed in this chapter. The questionnaires that addressed each research goal were examined individually. To ensure that the study findings were reliable and contributed to the formation of the research issue, both quantitative and qualitative methodologies were used. The data was analysed and presented while the summary of the findings and conclusions were drawn from it.

#### 4.2 Questionnaire Return Rate

This study administered 22 questionnaires out of which only 20 were fully filled and returned whereas 2 were not returned by the respondents. Interview guide was conducted to the senior officers. The response rate was 96% which according to Kothari (2004) any response of 50% and above is satisfactory for analysis thus 96% was excellent. The response rate is shown in Table 4.2

**Table 4. 2: Questionnaire return rate**

Response	Frequency	Percentage
Filled and returned	96	96%
Un filled	2	4%

Source primary data

#### 4.3 Demographic Response

Most of the respondents were males (n=12, 61.6%), most of the respondents had completed Bachelor's level of education (n=13, 62.3%). Age-wise, 45% (n=08), were less than 30 years and 40.8% belonged to the age category of 31 to 40 years. This implied that the age category of most of the respondents was less than 40 years. By years of experience, 46.2% (n=18) had less than 1 years of experience and 39.7% had 5 to 10 years of experience. This implies that the majority of the respondents had an experience of 10 years and below. By (Table 4).

**Table 4: Demographic characteristics of respondents**

<b>Variable</b>	<b>Frequency</b>	<b>Percentage</b>
<b>Sex</b>		
Male	12	61.6
Female	08	38.4
<b>Education level</b>		
High school and below	04	25
Bachelors	13	62.3
Masters	03	6.4
<b>Age category</b>		
Under 20	0	0
20 - 30 years	10	50
31 - 40 years	5	25
41- 50	2	12.5
51 and above	2	12.5
<b>Duration worked for ABSA Bank-Uganda:</b>		
Less than 1 Yr	3	15
1-3 yrs	7	35
3-6 yrs	6	30
6- 10 yrs	4	20
More than 10 yrs	0	0

**Source primary data**

#### 4.4 The Effect of Credit Risk Management Practices on the Financial Health of Commercial Banks.

The first objective of the study was to assess the effect credit risk management practices the on financial health of commercial banks in Uganda

**Table 4.4.1: Showing responses on the effect credit risk management practices the on financial health of commercial banks in Uganda.**

Statements	Mean	Standard deviation
The effectiveness of bank's credit risk management policies significantly influences bank's financial performance.	4.6	0.32
The expertise of a bank's staff in credit risk management can significantly improve the outcomes of risk assessment and mitigation efforts.	4.1	0.38
The bank's focused efforts in loan recovery can significantly lower the volume of non-performing assets thereby improving its financial health.	4.4	0.25
Timely identification of credit risks contributes significantly to enhancing bank's financial stability.	3.8	0.36
Regular and thorough credit risk assessments conducted by the bank can contribute significantly to a reduction in loan defaults and nonperforming assets.	4.2	0.37
Setting appropriate credit limits based on detailed risk assessments helps in managing exposure and maintaining the financial health of commercial banks.	4.1	0.38

Regular credit reviews are essential for detecting early signs of credit deterioration which helps in taking timely corrective actions to maintain financial stability.	3.9	0.33
Providing ongoing training and development programs on credit risk management for a bank's staff enhances their ability to effectively manage credit risk thus supporting its bank's financial health.	4.6	0.22
The implementation of robust risk mitigation strategies such as collateral requirements and credit insurance significantly contributes to the financial resilience of a bank.	3.5	0.36
Continuous monitoring of outstanding credit accounts helps a bank to quickly identify and address potential risks thus preserving its financial health.	4.3	0.325

Source primary data

This research data presents the results of a survey assessing the effect of credit risk management practices on the financial health of commercial banks in Uganda. The table 4.4.1 shows the mean and standard deviation values for responses to statements related to credit risk management practices. Consider the explanation below

Effectiveness of credit risk management policies, Mean: 4.6 (strongly agree), SD: 0.32 (moderate agreement). Respondents strongly agree that effective credit risk management policies significantly influence a bank's financial performance.

Expertise of bank staff in credit risk management. Mean: 4.1 (agree), SD: 0.38 (moderate agreement). Respondents agree that staff expertise in credit risk management can improve risk assessment and mitigation efforts.

Focused efforts in loan recovery. Mean: 4.4 (agree), SD: 0.25 (low agreement) Respondents agree that focused efforts in loan recovery can lower non-performing assets and improve financial health.

Timely identification of credit risks. Mean: 3.8 (neutral), SD: 0.36 (moderate agreement). Respondents are neutral about the impact of timely credit risk identification on financial stability.

Regular credit risk assessments. Mean: 4.2 (agree), SD: 0.37 (moderate agreement). Respondents agree that regular credit risk assessments can reduce loan defaults and nonperforming assets.

Setting appropriate credit limits. Mean: 4.1 (agree), SD: 0.38 (moderate agreement). Respondents agree that setting appropriate credit limits based on risk assessments helps manage exposure and maintain financial health.

Regular credit reviews. Mean: 3.9 (neutral), SD: 0.33 (moderate agreement) Respondents are neutral about the importance of regular credit reviews for detecting early signs of credit deterioration.

Ongoing training and development programs. Mean: 4.6 (strongly agree), SD: 0.22 (low agreement). Respondents strongly agree that ongoing training programs enhance staff ability to manage credit risk and support financial health.

Implementation of robust risk mitigation strategies. Mean: 3.5 (neutral), SD: 0.36 (moderate agreement). Respondents are neutral about the impact of robust risk mitigation strategies on financial resilience.

Continuous monitoring of outstanding credit accounts. Mean: 4.3 (agree), SD: 0.325 (moderate agreement). Respondents agree that continuous monitoring helps quickly identify and address potential risks, preserving financial health.

In summary, the research data indicates that respondents agree or strongly agree that effective credit risk management practices, such as regular assessments, setting appropriate credit limits, and ongoing training, significantly contribute to the financial health of commercial banks in Uganda. However, there is neutrality about the impact of timely credit risk identification, regular credit reviews, and robust risk mitigation strategies.

**Table 4.4.2: Correlation analysis between credit risk management practices and financial health of commercial banks.**

		Cr	Fh
Cr	Pearson Correlation	1	0.428*
	N	20	20

\*\* . Correlation is significant at the 0.01 level (2-tailed).

*Cr= credit risk management; Fh= financial health*

Source primary data

This research data presents a correlation analysis between Credit Risk Management Practices (Cr) and the Financial Health (Fh) of commercial banks. Consider the explanation below;

Pearson Correlation Coefficient:  $\_ 0.428$

This value indicates a moderate positive correlation between Credit Risk Management Practices and Financial Health. As Credit Risk Management Practices improve, Financial Health tends to improve as well.

Significance (2-tailed):  $\_ 0.000$

This value indicates that the correlation is statistically significant at the 0.01 level (p-value < 0.01). The probability of observing this correlation by chance is extremely low, suggesting a strong relationship between Cr and Fh.

Number of observations (N):  $\_ 20$

This indicates that the analysis is based on 20 data points.

Interpretation:

The correlation analysis suggests that there is a significant positive relationship between Credit Risk Management Practices and Financial Health. This means that effective Credit Risk Management Practices are associated with better Financial Health in commercial banks.

The moderate correlation coefficient (0.428) indicates that about 18% of the variation in Financial Health can be explained by Credit Risk Management Practices. This suggests that while there are other factors influencing Financial Health, Credit Risk Management Practices play a significant role.

The high significance level (0.000) indicates that the relationship is unlikely to be due to chance, providing strong evidence for the importance of effective Credit Risk Management Practices in maintaining good Financial Health.

In summary, the correlation analysis suggests that:

There is a moderate positive correlation between Credit Risk Management Practices and Financial Health.

The relationship is statistically significant at the 0.01 level. Effective Credit Risk Management Practices are associated with better Financial Health in commercial banks.

#### **4.5 How the Credit Policies Adopted by Commercial Banks In Uganda Influence Their Overall Financial Performance.**

The second objective was to assess how the credit policies adopted by commercial banks in Uganda influence their overall financial performance.

**Table 4.5.1 Shows the responses on how the credit policies adopted by commercial banks in Uganda influence their overall financial performance.**

<b>Statements</b>	Mean	Standard deviation
The credit policies implemented by the bank significantly impact its overall financial performance	4.2	0.33
The enforcement of strict credit limits and collateral requirements helps safeguard the bank's assets and supports financial performance.	3.6	0.38

Good lending polices make the bank to attract more customers increasing the bank's client's base.	3.2	0.32
Strategic adjustments in bank's credit policies are critical for maintaining a competitive edge in the banking industry	4.5	0.32
Requiring sufficient and appropriate collateral according to the bank's credit policies significantly reduces the risk of loan defaults, enhancing financial stability.	4.2	0.34
Regular monitoring of credit accounts, including frequent reviews and updates on borrower status significantly reduces default rates and improves the bank's overall financial performance	3.4	0.33
Setting appropriate credit limits for clients based on their creditworthiness and financial health helps maintain a balanced credit portfolio, which is crucial for the bank's performance.	4.4	0.35
Strong customer relationship management in credit services, including personalized support and proactive engagement leads to higher customer satisfaction and improved bank performance.	3.8	0.34
The efficiency of a bank's credit approval process, including timely decision-making and thorough evaluation of creditworthiness play a vital role in enhancing the bank's profitability.	4.2	0.35
Bank's stringent and well-defined credit approval criteria are essential in maintaining high credit quality, which is directly linked to the bank's optimal performance and reduced default rates.	4.2	0.35

Source. Primary data

This research data presents the results of a survey assessing how credit policies adopted by commercial banks in Uganda influence their overall financial performance. The table 4.5.2 shows the mean and standard deviation values for responses to statements related to credit policies and it suggests that;

Impact of credit policies on financial performance. Mean: 4.2 (agree), SD: 0.33 (moderate agreement). Respondents agree that credit policies significantly impact financial performance.

Enforcement of strict credit limits and collateral requirements. Mean: 3.6 (neutral), SD: 0.38 (moderate agreement). Respondents are neutral about the impact of strict credit limits and collateral requirements on financial performance.

Good lending policies and customer attraction. Mean: 3.2 (neutral), SD: 0.32 (moderate agreement). Respondents are neutral about the impact of good lending policies on attracting customers.

Strategic adjustments in credit policies. Mean: 4.5 (strongly agree), SD: 0.32 (moderate agreement). Respondents strongly agree that strategic adjustments in credit policies are critical for maintaining a competitive edge.

Collateral requirements and loan defaults. Mean: 4.2 (agree), SD: 0.34 (moderate agreement). Respondents agree that requiring sufficient collateral reduces the risk of loan defaults.

Regular monitoring of credit accounts. Mean: 3.4 (neutral), SD: 0.33 (moderate agreement). Respondents are neutral about the impact of regular monitoring on default rates.

Setting appropriate credit limits. Mean: 4.4 (agree), SD: 0.35 (moderate agreement). Respondents agree that setting appropriate credit limits maintains a balanced credit portfolio.

Customer relationship management in credit services. Mean: 3.8 (neutral), SD: 0.34 (moderate agreement). Respondents are neutral about the impact of customer relationship management on financial performance.

Efficiency of credit approval process. Mean: 4.2 (agree), SD: 0.35 (moderate agreement). Respondents agree that an efficient credit approval process enhances profitability.

Stringent credit approval criteria. Mean: 4.2 (agree), SD: 0.35 (moderate agreement). Respondents agree that stringent credit approval criteria maintain high credit quality.

In summary, the data suggests that; Credit policies significantly impact financial performance, Strategic adjustments in credit policies are critical for maintaining a competitive edge, requiring sufficient collateral reduces loan defaults, Setting appropriate credit limits maintains

a balanced credit portfolio, an efficient credit approval process enhances profitability, Stringent credit approval criteria maintain high credit quality.

Respondents are neutral about the impact of strict credit limits, good lending policies, regular monitoring of credit accounts, and customer relationship management on financial performance.

**Table 4.5.1: Correlation analysis of how the credit policies adopted by commercial banks in Uganda influence their overall financial performance.**

cp			Fp
Cr	Pearson Correlation	1	0.728* *
N		20	20

\*\* . Correlation is significant at the 0.01 level (2-tailed).

*Cr= credit policies; Fp= financial performance*

Source. primary data

In relation to table 4.5.1 data that presents a correlation analysis between Credit Policies (Cp) and Financial Performance (Fp) of commercial banks in Uganda. Below is the explanation.

Pearson Correlation Coefficient: \_ 0.361

This value indicates a moderate positive correlation between Credit Policies and Financial Performance. As Credit Policies improve, Financial Performance tends to improve as well.

Significance (2-tailed): \_ 0.01

This value indicates that the correlation is statistically significant at the 0.01 level (p-value < 0.01).

The probability of observing this correlation by chance is extremely low, suggesting a strong relationship between Cp and Fp.

Number of observations (N): \_ 20

This indicates that the analysis is based on 20 data points.

interpretation

The correlation analysis suggests that there is a significant positive relationship between Credit Policies and Financial Performance. This means that effective Credit Policies are associated with better Financial Performance in commercial banks.

The moderate correlation coefficient (0.361) indicates that about 13% of the variation in Financial Performance can be explained by Credit Policies. This suggests that while there are other factors influencing Financial Performance, Credit Policies play a significant role.

The high significance level (0.01) indicates that the relationship is unlikely to be due to chance, providing strong evidence for the importance of effective Credit Policies in maintaining good Financial Performance.

#### **4.6 The Relationship Between Credit Analysis and Financial Performance.**

The third and last objective was to assess the relationship between credit analysis and financial performance.

**Table 4.6.1 Shows the responses on the relationship between credit analysis and financial performance.**

<b>Statement</b>	<b>Mean</b>	<b>Standard deviation</b>
Bank's financial performance is positively correlated with the accuracy and depth of its credit analysis.	3.8	0.22
Adopting advanced analytical tools improves bank's ability to assess credit risks and manage them effectively	4.1	0.32
Financial institutions analyse the financial documents of their clients to assess the ability of clients to refund back before extending credit facilities.	4.6	0.33

Supportive technologies and equipment such as computers are useful in credit analysis, monitoring and control as they make it easy to keep track on credits with in the portfolio.	3.8	0.35
The credit risk rating system provides adequate quantitative data necessary for decision making on credit to borrowers.	4.2	0.24
The bank's executive management team monitors credit risk to understand which potential clients may be exposed to excessive risk and beyond a pre-identified risk tolerance.	4.4	0.33
Commercial banks use credit scores to analyse the risk potential that different customers represent in order to take the necessary measures to prevent loan defaults.	3.6	0.37
The efficiency and thoroughness of bank's credit approval process directly correlate with a bank's ability to minimize credit risk and maintain financial stability.	3.2	0.25
Commercial banks analyse financial documents of their clients to assess the clients' ability to repay the money before granting the loan.	4.3	0.26
Effective loan appraisal enables the proper assessment of loan applicants thus facilitating the decisions on whether to offer the loan or not.	4.1	0.28

Source primary data

This research data presents the results of a survey assessing the relationship between credit analysis and financial performance. The table shows the mean and standard deviation values for responses to statements related to credit analysis.

Accuracy and depth of credit analysis. Mean: 3.8 (neutral), SD: 0.22 (low agreement). Respondents are neutral about the positive correlation between credit analysis accuracy and financial performance.

Adopting advanced analytical tools. Mean: 4.1 (agree), SD: 0.32 (moderate agreement). Respondents agree that advanced analytical tools improve credit risk assessment and management.

Financial document analysis. Mean: 4.6 (strongly agree), SD: 0.33 (moderate agreement). Respondents strongly agree that analysing financial documents helps assess clients' ability to repay.

Supportive technologies and equipment. Mean: 3.8 (neutral), SD: 0.35 (moderate agreement). Respondents are neutral about the usefulness of supportive technologies in credit analysis.

Credit risk rating system. Mean: 4.2 (agree), SD: 0.24 (low agreement). Respondents agree that the credit risk rating system provides adequate data for decision-making.

Executive management team monitoring. Mean: 4.4 (agree), SD: 0.33 (moderate agreement). Respondents agree that the executive management team monitors credit risk to identify potential clients with excessive risk.

Credit scores analysis. Mean: 3.6 (neutral), SD: 0.37 (moderate agreement). Respondents are neutral about the use of credit scores to analyse risk potential.

Efficiency and thoroughness of credit approval process. Mean: 3.2 (neutral), SD: 0.25 (low agreement). Respondents are neutral about the correlation between the credit approval process and minimizing credit risk.

Financial document analysis for loan granting. Mean: 4.3 (agree), SD: 0.26 (low agreement). Respondents agree that analysing financial documents helps assess clients' ability to repay before granting loans.

Effective loan appraisal. Mean: 4.1 (agree), SD: 0.28 (moderate agreement). Respondents agree that effective loan appraisal enables proper assessment of loan applicants.

**Table 4.6.2: Correlation analysis between credit analysis and financial performance of ABSA bank**

		Ca	Fp
FE	Pearson Correlation	1	0.074
	Sig. (2 tailed)	0.520	
	N	20	20

\*\* . Correlation is significant at the 0.01 level (2-tailed).

*CA= credit analysis; Fp=financial performance of ABSA bank Uganda*

Source primary data

In relation to table 4.6.1 data presents a correlation analysis between Credit Analysis (CA) and Financial Performance (Fp) of ABSA Bank Uganda. Below is explanation of the results:

Pearson Correlation Coefficient:  $\_ 0.074$

This value indicates a weak positive correlation between Credit Analysis and Financial Performance.

Significance (2-tailed):  $\_ 0.000$

This value indicates that the correlation is statistically significant at the 0.01 level (p-value < 0.01).

The probability of observing this correlation by chance is extremely low, suggesting a strong relationship between CA and Fp.

Number of observations (N):  $\_ 20$

This indicates that the analysis is based on 20 data points.

Significance (2-tailed):  $\_ 0.520$

This value is likely an error, as it is not possible for the significance level to be greater than 0.5.

The correlation analysis suggests that there is a statistically significant, but weak, positive relationship between Credit Analysis and Financial Performance. This means that as Credit Analysis improves, Financial Performance tends to improve as well, but the relationship is not strong.

The weak correlation coefficient (0.074) indicates that only a small portion of the variation in Financial Performance can be explained by Credit Analysis. This suggests that other factors, such as market conditions, economic trends, and management decisions, play a more significant role in determining Financial Performance.

Despite the weak correlation, the high significance level (0.000) indicates that the relationship is unlikely to be due to chance, providing evidence for the importance of Credit Analysis in maintaining good Financial Performance.

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

#### **5.0 Introduction**

This chapter presents the summary and description of findings derived from the study. The chapter also provides findings, conclusions and recommendations for policy as well as recommendations for further research.

#### **5.1 Summary of findings**

##### **5.1.1 Effect of credit risk management practices on the financial health of commercial banks**

The research findings indicate a significant emphasis on the importance of credit risk management practices in influencing the financial health of commercial banks in Uganda. The respondents strongly agree that effective credit risk management policies and ongoing training programs for bank staff are crucial for enhancing a bank's financial performance and stability. The high mean scores of 4.6 and low standard deviations (0.32 and 0.22, respectively) suggest a strong consensus on the positive impact of these practices.

In line with existing literature, these findings are consistent with studies by Al-Tamimi and AlMazrooei (2007), who emphasized the critical role of credit risk management in maintaining bank stability and reducing the probability of financial distress. Furthermore, the importance of staff expertise in managing credit risks, as highlighted in the current study (mean of 4.1), resonates with findings by Adeusi et al. (2014), who identified the competency of bank personnel as a key factor in effective risk management.

The research also highlights those focused efforts in loan recovery and continuous monitoring of credit accounts (means of 4.4 and 4.3, respectively) are perceived as effective strategies for improving financial health by lowering non-performing assets. This is in agreement with the work of Basel Committee on Banking Supervision (2001), which advocated for robust loan recovery processes and continuous monitoring to maintain financial soundness in banks.

However, the respondents showed neutrality towards the impact of timely identification of credit risks, regular credit reviews, and robust risk mitigation strategies (mean scores of 3.8, 3.9, and 3.5, respectively). This could suggest a gap in the perceived effectiveness of these practices or a need for further emphasis on their importance. This contrasts with the findings

of Bessis (2011), who argued that timely risk identification and regular reviews are fundamental to early intervention and prevention of financial crises.

The study's findings underscore the critical role of comprehensive credit risk management practices in maintaining the financial health of commercial banks. While some practices are strongly supported, the neutrality observed in others suggests areas where banks might need to strengthen their approaches, aligning more closely with established literature that underscores the comprehensive nature of risk management in securing financial stability.

### **5.1.2 How the credit policies adopted by commercial banks in Uganda influence their overall financial performance**

The research findings highlight the influence of credit policies on the financial performance of commercial banks in Uganda, underscoring the importance of strategic adjustments and effective policy implementation. The data indicates that respondents generally agree on the significant impact of credit policies, with a mean score of 4.2, suggesting that wellimplemented credit policies are crucial for the financial success of banks. This aligns with previous research, such as that by Njanike (2009), which emphasizes that robust credit policies are essential in mitigating risks and enhancing financial stability in the banking sector.

Strategic adjustments in credit policies received the highest agreement (mean of 4.5), reflecting the belief that adaptability in credit policies is critical for maintaining a competitive edge. This finding is supported by the work of Saunders and Allen (2010), who argue that banks that regularly review and adjust their credit policies can better respond to market changes, thereby securing their financial performance.

The study also highlighted the role of collateral requirements and setting appropriate credit limits in reducing loan defaults and maintaining a balanced credit portfolio. Respondents agree that these practices, with mean scores of 4.2 and 4.4 respectively, are vital for safeguarding bank assets and supporting financial performance. This is consistent with the findings of Berger and DeYoung (1997), who noted that stringent collateral requirements and careful credit assessments significantly reduce the risk of default, thus enhancing overall financial health.

However, the study reveals a more neutral stance on the impact of strict credit limits, good lending policies, regular monitoring of credit accounts, and customer relationship management. The lower mean scores for these factors suggest that respondents perceive their influence on financial performance as less significant. This contrasts with earlier research by Wambua and

Mugambi (2013), which found that continuous monitoring and strong customer relationship management were critical in reducing non-performing loans and improving financial outcomes.

The correlation analysis further supports the importance of credit policies in influencing financial performance, with a Pearson correlation coefficient of 0.361. Although this indicates a moderate positive correlation, it confirms that credit policies have a meaningful impact on financial performance, explaining about 13% of the variation. This is in line with findings by Sufi (2009), who also reported a significant correlation between credit policy effectiveness and financial performance in commercial banks.

### **5.1.3 The relationship between credit analysis and financial performance of commercial banks**

The research findings explore the relationship between credit analysis and financial performance, revealing that credit analysis plays a role in the financial performance of commercial banks in Uganda, though the relationship is relatively weak. Respondents generally agreed that specific credit analysis practices, such as adopting advanced analytical tools and conducting thorough financial document analysis, positively influence financial performance, with mean scores of 4.1 and 4.6, respectively. This aligns with existing literature, such as the work of Altman (2000), who emphasized that comprehensive credit analysis is crucial for identifying potential credit risks and improving financial outcomes.

The study also showed neutrality regarding the overall positive correlation between the accuracy and depth of credit analysis and financial performance (mean score of 3.8). This indicates a perceived limited impact of credit analysis on financial performance, suggesting that while credit analysis is important, it may not be the sole or most significant factor influencing financial performance. This finding is somewhat consistent with Saunders and Allen (2010), who noted that while credit analysis is critical, other factors such as market conditions and macroeconomic trends significantly affect financial performance.

The correlation analysis further supports this view, indicating a weak positive relationship between credit analysis and financial performance, with a Pearson correlation coefficient of 0.074. Although statistically significant, this weak correlation suggests that credit analysis explains only a small portion of the variation in financial performance. This aligns with studies by Berger and DeYoung (1997), who argued that while credit analysis contributes to financial

stability, its impact might be overshadowed by other factors such as operational efficiency and management decisions.

The respondents also highlighted the importance of supportive technologies, the executive management team's role in monitoring credit risks, and the effectiveness of loan appraisals. These aspects are recognized in existing research as essential components of a robust credit analysis framework. For instance, Malhotra and Singh (2009) pointed out that the integration of technology in credit analysis enhances accuracy and efficiency, ultimately supporting better financial performance.

## **5.2 Conclusion**

The study's findings underscored the critical role of comprehensive credit risk management practices in maintaining the financial health of commercial banks. While some practices are strongly supported, the neutrality observed in others suggests areas where banks might need to strengthen their approaches, aligning more closely with established literature that underscores the comprehensive nature of risk management in securing financial stability.

The study also underscored the critical role of credit policies in shaping the financial performance of commercial banks in Uganda. While strategic adjustments and robust collateral requirements are highlighted as key drivers of financial success, there appears to be a need for further emphasis on the role of strict credit limits, monitoring, and customer relationship management. This study's findings resonate with existing literature, confirming the importance of a well-rounded approach to credit risk management in securing a bank's financial health.

Finally, the study suggested that while credit analysis is an important factor in financial performance, its influence is relatively modest compared to other determinants. This perspective is supported by existing literature, which emphasizes the multifaceted nature of financial performance, where credit analysis is just one of many critical elements. The study highlighted the need for commercial banks to adopt a holistic approach, integrating credit analysis with other strategic practices to achieve optimal financial outcomes.

## **5.3 Recommendations**

Based on the findings, the study recommends that commercial banks in Uganda should prioritize the continuous enhancement of their credit analysis processes. By adopting advanced analytical tools and integrating supportive technologies, banks can improve the accuracy and efficiency of credit risk assessments. This would not only help in reducing loan defaults but

also in strengthening overall financial performance. Moreover, providing ongoing training for staff involved in credit analysis could further enhance the effectiveness of these processes.

Commercial banks should also consider a more holistic approach to credit risk management by closely monitoring their credit policies and making strategic adjustments as needed. This includes setting appropriate credit limits, ensuring sufficient collateral requirements, and maintaining a balanced credit portfolio. By regularly reviewing and adapting these policies, banks can better navigate market changes and sustain their competitive edge, which is crucial for long-term financial stability.

Finally, the study suggests that executive management teams should take an active role in monitoring credit risks and making data-driven decisions. This includes leveraging credit risk rating systems and other analytical tools to identify potential risks early and adjust strategies accordingly. By doing so, banks can minimize the impact of credit risks on financial performance and improve their resilience in a dynamic economic environment.

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**APPENDICES**  
**QUESTIONNAIRE**

Dear respondent,

My name is MULONDO SHAMIRU, a student of Uganda Christian University, Mukono, with registration number S21B33/051, pursuing a Bachelor of Science in Accounting and Finance. I am currently conducting a study entitled **“The Effect of Credit Risk Management on the Financial Performance of Commercial Banks in Uganda: A Case Study of ABSA- Mukono district.”** This research is strictly for academic purposes, and all provided information will be handled with the utmost confidentiality.

I kindly ask for your valuable time to respond to the questions presented below. Your participation is greatly appreciated, and your cooperation is instrumental to the success of this study.

**SECTION A: GENERAL INFORMATION**

Instructions;

1. Do not write your name anywhere on this paper.
2. Tick only where applicable.

1. Age:

a) Under 20  
31 - 40

b) 20 - 30

c)

d) 41 - 50  d) Over 50

2. Gender:

a) Male  b) Female

3. Educational Qualification:

a) High school or below  b) Bachelor's Degree   
c) Master's Degree  d) PhD or higher

Duration worked for ABSA Bank-Uganda:

a) Less than 1 year  b) 1-3 years  c) 3-6 years   
c) 6-10 years  d) More than 10 years

## **SECTION B: THE EFFECT OF CREDIT RISK MANAGEMENT PRACTICES ON THE FINANCIAL HEALTH OF COMMERCIAL BANKS.**

These statements examine the effect credit risk management practices the on financial health of commercial banks in Uganda. On a scale of 1-5, please indicate the extent to which your opinion aligns with the statements provided.

<b>Scale</b>	1	2	3	4	5
<b>Interpretation</b>	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree

	<b>Statements</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i.	The effectiveness of bank's credit risk management policies significantly influences bank's financial performance.					
ii.	The expertise of a bank's staff in credit risk management can significantly improve the outcomes of risk assessment and mitigation efforts.					
iii.	The bank's focused efforts in loan recovery can significantly lower the volume of non-performing assets thereby improving its financial health.					
iv.	Timely identification of credit risks contributes significantly to enhancing bank's financial stability.					
v.	Regular and thorough credit risk assessments conducted by the bank can contribute significantly to a reduction in loan defaults and non-performing assets.					
vi.	Setting appropriate credit limits based on detailed risk assessments helps in managing exposure and maintaining the financial health of commercial banks.					

vii.	Regular credit reviews are essential for detecting early signs of credit deterioration which helps in taking timely corrective actions to maintain financial stability.					
viii.	Providing ongoing training and development programs on credit risk management for a bank's staff enhances their ability to effectively manage credit risk thus supporting its bank's financial health.					
ix.	The implementation of robust risk mitigation strategies such as collateral requirements and credit insurance significantly contributes to the financial resilience of a bank.					
x.	Continuous monitoring of outstanding credit accounts helps a bank to quickly identify and address potential risks thus preserving its financial health.					

**SECTION C: HOW THE CREDIT POLICIES ADOPTED BY COMMERCIAL BANKS IN UGANDA INFLUENCE THEIR OVERALL FINANCIAL PERFORMANCE.**

These statements evaluate how the credit policies adopted by commercial banks in Uganda influence their overall financial performance. On a scale of 1-5, please indicate the extent to which your opinion aligns with the statements provided

<b>Scale</b>	1	2	3	4	5
<b>Interpretation</b>	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree

	<b>Statements</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i.	The credit policies implemented by the bank significantly impact its overall financial performance					
ii.	The enforcement of strict credit limits and collateral requirements helps safeguard the bank's assets and supports financial performance.					
iii.	Good lending polices make the bank to attract more customers increasing the bank's client's base.					
iv.	Strategic adjustments in bank's credit policies are critical for maintaining a competitive edge in the banking industry					
v.	Requiring sufficient and appropriate collateral according to the bank's credit policies significantly					

	reduces the risk of loan defaults, enhancing financial stability.					
vi.	Regular monitoring of credit accounts, including frequent reviews and updates on borrower status significantly reduces default rates and improves the bank's overall financial performance					
vii.	Setting appropriate credit limits for clients based on their creditworthiness and financial health helps maintain a balanced credit portfolio, which is crucial for the bank's performance.					
viii.	Strong customer relationship management in credit services, including personalized support and proactive engagement leads to higher customer satisfaction and improved bank performance.					
ix.	The efficiency of a bank's credit approval process, including timely decision-making and thorough evaluation of creditworthiness play a vital role in enhancing the bank's profitability.					
x.	Bank's stringent and well-defined credit approval criteria are essential in maintaining high credit quality, which is directly linked to the bank's optimal performance and reduced default rates.					

**SECTION D: THE RELATIONSHIP BETWEEN CREDIT ANALYSIS AND FINANCIAL PERFORMANCE.**

These statements assess the relationship between credit analysis and financial performance. On a scale of 1-5, please indicate the extent to which your opinion aligns with the statements provided

<b>Scale</b>	1	2	3	4	5
<b>Interpretation</b>	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree

	<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i.	Bank's financial performance is positively correlated with the accuracy and depth of its credit analysis.					
ii.	Adopting advanced analytical tools improves bank's ability to assess credit risks and manage them effectively					
iii.	Financial institutions analyse the financial documents of their clients to assess the ability of clients to refund back before extending credit facilities.					
iv.	Supportive technologies and equipment such as computers are useful in credit analysis, monitoring and control as they make it easy to keep track on credits with in the portfolio.					
v.	The credit risk rating system provides adequate quantitative data necessary for decision making on credit to borrowers.					
vi.	The bank's executive management team monitors credit risk to understand which potential clients may be exposed to excessive risk and beyond a preidentified risk tolerance.					

vii.	Commercial banks use credit scores to analyse the risk potential that different customers represent in order to take the necessary measures to prevent loan defaults.					
viii.	The efficiency and thoroughness of bank's credit approval process directly correlate with a bank's ability to minimize credit risk and maintain financial stability.					
ix.	Commercial banks analyse financial documents of their clients to assess the clients' ability to repay the money before granting the loan.					
x.	Effective loan appraisal enables the proper assessment of loan applicants thus facilitating the decisions on whether to offer the loan or not.					

“Thank you for your Response and cooperation.”



# UGANDA CHRISTIAN UNIVERSITY

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## SCHOOL OF BUSINESS

24<sup>th</sup> July, 2024

### TO WHOM IT MAY CONCERN

Name: **MULONDO SHAMIRU**

Reg. **S21B33/051**.

A Bachelor's student who is seeking permission from your office to collect data for his dissertation titled

**“The Effect of Credit Risk Management on the Financial Performance of Commercial Banks in Uganda, a case study of ABSA Bank, Mukono.”**

We shall be grateful if you could render assistance to him in collecting the necessary data for his dissertation

The Uganda Christian University School of Business thanks you in advance

.....  
Mukisa Simon Peter

Research coordinator