CAUSES OF HIGH DEFAULT RATE ON LOANS IN COMMERCIAL BANKS, A
CASE STUDY OF CENTENARY BANK LTD-Kampala Capital City

KINYERA ROBERT
2012/HD06/525U

A research project Report submitted to Makerere University in Partial fulfilment of the requirements for the award of a degree of Master of Business Administration (MBA) of Makerere University

November, 2014
DECLARATION

I hereby declare that this submission is my own work towards the award of the Masters in Business Administration (MBA) and that to the best of my knowledge, it contains no material previously published by another person or any material which has been accepted for the award of any other degree of the University, except where due acknowledgement has been made in the text.

Kinyera Robert

.................................... .................................... ....................................

Student                  Signature                  Date
APPROVAL
This research project has been submitted for examination with my approval as the student’s supervisor.

Mr. Masimengo Tadeo

.................................... .................................... ....................................
Supervisor                     Signature                    Date
ACKNOWLEDGMENT

The researcher is greatly indebted to the Centenary Bank for the assistance rendered, without which this piece of work would not have been accomplished.

A lot of appreciations go to the Management, Branch Managers and Credit Officers of Centenary Bank Ltd for allowing the researcher carry out this research, but also for their effort in availing the researcher with the necessary information needed for this research.

Above all the researcher is greatly indebted to Mr. Masimengo Tadeo for his invaluable Supervision and constructive criticism throughout the research process.

Finally the researcher thanks all those who rendered him support in one way or the other to make this research project a success. God bless you.
DEDICATION
The researcher dedicates this work to his family and all invaluable friends who seek knowledge as the way to go. Special thanks to my parents who have always preached that education is the only way to succeed, my wife Caroline, Daughter Immaculate and son, Noel for the patience and encouragement during the course. God bless you.
Contents

DECLARATION .................................................................................................................. i

APPROVAL .................................................................................................................... ii

ACKNOWLEDGEMENT .................................................................................................. ii

DEDICATION ................................................................................................................ iii

CHAPTER ONE ................................................................................................................. 1

1.0 Introduction ............................................................................................................... 1

1.1 Background .............................................................................................................. 1

1.2 Problem Statement ................................................................................................. 3

1.3 Objectives of the Study ............................................................................................ 4

1.4 Research Questions .................................................................................................. 4

1.5 Significance of the study ......................................................................................... 4

1.6 Scope of the Study .................................................................................................... 5

CHAPTER TWO - LITERATURE REVIEW ..................................................................... 6

2.0 Introduction ............................................................................................................... 6

2.1 Bank specific factors causing high default rate on loans ........................................... 6

2.2 Customer specific factors causing high default rates ................................................ 9

2.3 Solutions/Strategies for the high default rates on loan ............................................. 14

CHAPTER THREE: RESEARCH METHODOLOGY ..................................................... 19

3.0 Introduction ............................................................................................................... 19

3.1 Research Design ..................................................................................................... 19

3.2 Area of study .......................................................................................................... 19

3.3 Population of Study ................................................................................................ 19

3.4 Sample size ............................................................................................................. 20

3.5 Sampling Procedure ............................................................................................... 20

3.7 Research variables .................................................................................................. 20

3.8 Data Collection ....................................................................................................... 20
LIST OF TABLES
Table 1: Bio Data .................................................................................................................. 26

LIST OF FIGURES
Figure 1: The Loan Performance Index Assessment ............................................................. 27
Figure 2: Indices on Loan Operations and Policies ............................................................... 29
Figure 3: Indices on Loan Supervision and Evaluation ....................................................... 30
Figure 4: Indices on customer specific factors ..................................................................... 32
Figure 5: Indices on Possible solution .................................................................................. 33
ABSTRACT
The study examined the causes of the high loan default in Centenary bank Kampala capital City authority branches. Its objectives were to identify the bank specific factors, customer specific factor that cause default on loans payments and find out possible solutions to help reduce on the loan default rate in commercial banks.

Sample sizes of 57 respondents out of a population of 120 staffs were used and it comprised of the credit staffs that included loans processors, loans officers, and credit administrators.

Findings showed that the customer specific factors for loan default included, multiple borrowing, the inadequate information flow amongst the loans officers and the customers and the high rate of business failures. Bank specific factors included inadequate motivation of the credits staffs in terms of incentives, the inadequate working tools to ease loan recovery e.g the motor bikes and understaffing in the credit department.

The study recommended the use of top up loans facilities instead of multiple borrowing, routine supervision and regulation of the banking activities by bank of Uganda, provision of adequate working tools to the loans officers to enhance recovery of loans and the use of existing technology platforms to keep the customers up to date of information concerning their loans.
CHAPTER ONE

1.0 Introduction

1.1 Background.
The term ‘Bank’ has been defined in different ways by different economists.

According to Walter Leaf “A bank is a person or corporation which holds out to receive from the public, deposits payable on demand by cheque.” Horace White has defined a bank, “as a manufacture of credit and a machine for facilitating exchange.”

According to Prof. Kinley, “A bank is an establishment which makes to individuals such advances of money as may be required and safely made, and to which individuals entrust money when not required by them for use.”

A commercial bank refers to a company licensed to carry on financial institution business and whose principal business consists mainly in the acceptance of call, demand, savings and time deposits withdrawal by cheque or otherwise, in the capacity of a bank, provision of overdrafts and short to medium term loans; provision of foreign exchange, participation in inter-bank clearing systems and the provision and assumption of guarantees, bonds and other warranties on behalf of others (BOU Financial act 2004)

A Loan refers to a thing that is borrowed, especially a sum of money that is expected to be paid back with interest (oxford dictionary).

The British Oxford dictionary defines to default as failure to fulfil an obligation, especially to repay a loan or appear in a court of law.

Centenary Rural Development Bank is a commercial bank in Uganda that provides deposit, credit and money transfer services. Established by the Catholic Church of Uganda as a trust fund in 1983, it developed strength in savings mobilization and as a result Centenary Rural
Development Trust was transformed into a commercial bank in 1993 with a mission of providing appropriate financial services to all Ugandans in a sustainable manner.

The study specifically looks at the possible causes of high default rates on loans of Centenary Bank irrespective of the policies and procedures put in place to ensure minimal loan default rate.

Commercial Banks in Uganda play important roles in the process of industrialization and economic growth. Apart from increasing per capita income and output, they create employment opportunities, enhance regional economic balance through industrial dispersal and generally promote effective resource utilization considered critical to engineering economic development and growth. Uganda has 26 licensed commercial banks with a total of over 500 branches countrywide providing banking services to a population of about 37 million people (BOU Annual report 2012). Despite, the crucial role played by the commercial banks in economic development, these banks face serious challenges when trying to recover some of the money they lent out their customers.

The commercial banks loan default rates still remain high as indicated by The Independent Magazine dated 04th may 2014. KCB’s bad loans written off rose to 3.2 billion from 2.1 billion in the same period. DFCU wrote off bad debts amounting to shs. 15.65 billion From shs. 8.73 billion In 2012 while its provision for bad and doubtful debts grew to 13.7billion from 11.78 billion the year before. Crane bank’s net profits went down to shs. 47 billion in 2013 from shs. 80 billion in 2012. The bank’s bad debts written off grew to shs.29 billion from shs. 26 billion in 2013 and 2012 respectively.
The Bank of Uganda, in its latest lending survey released last year, pointed that half of the banks (50.9 per cent) expect default rates on loans to households and individuals to increase over the quarter. Another 30.1 per cent of the lenders expect default rates to remain the same while 19 per cent expect a drop in defaults. The default rates are expected to rise further in the quarter ending December 2013, hurting the profitability of the banks.

Persistence of such condition leads to increase in the default rates for loans which affects the growth and development of commercial banks negatively. This poses us to research on the possible reasons for the cause of this high default rates on loans.

This study will focus on the causes of high default rate on loan money in commercial banks with a focus on Centenary Bank.

1.2 Problem Statement
Loans are a main source of revenue for banks as are customer deposits on which they levy bank charges. The loan portfolio is typically the largest asset and the predominate source of revenue. It constitutes on average 75-80% of the total bank income. When banks fail to meet targets on these two revenue heads, the stakeholders get very worried.

The independent Magazine dated 04th May 2014, pointed out that one of the causes of Uganda Revenue Authority’s shs. 270 billion revenue shortfalls for the period up to Jan 2013 were partly due to the poor performance of the banking industry. This is because commercial banks were chalk ing off billion worth of bad debts which drastically affected their profitability and the banks posted deficits due to the reduction in demand for new loans and higher default rates on existing ones.

Banks always endeavour to reduce the default rate through rigorous credit assessment process used that includes among others proof that customer does not have other credit obligation,
analysis of customers’ account performance, sustainability of their income levels, collaterals and ability to pay (International Credit Manual, 2003). With all this due diligence processes in place, banks are still faced with poor payments of its loan portfolio as noted in Credit reference Bureaus Report 2005.

It is upon this bad trend of loan default that the researcher seeks to determine and analyze the causes of this bad loan performance in Centenary Bank.

1.3 Objectives of the Study
The main aim of the study is to analyze the causes of the high default on loan money from Centenary Bank. In line with this, the following are the specific objectives of the study:

1. To examine bank specific factors causing bank customers to default on loan payments.
2. To explore the customer specific factors that make them default on loan payment.
3. To identify practical solutions that can be employed by the commercial banks to reduce on the default rates on loans.

1.4 Research Questions
The research questions of the study are as follows:

1. What role do banks play in contributing to loan default?
2. What factors from the loan customer’s perspective cause them to default on loan payment?
3. What measures can be taken to reduce on the loan default rates?

1.5 Significance of the study
The study will contribute to existing body of literature and form a basis for further research by providing useful current-state insights into the factors that cause high default rates on loans of commercial banks in Uganda.

It will also assist private and public sector in policy formulation and decision making which support the development of Commercial banks. This will enable the financial institutions to
develop strategies to reduce on the loan default rate and in the long run improve on the loan performance.

1.6 Scope of the Study
The study was done within branches of Centenary Bank in Kampala capital city Authority. It was carried out in 7 branches, i.e Bwaise branch, Kireka Branch, Natete branch, Entebbe road branch, Najjanankumbi branch, Ntinda branch and Kabalagala Branch. These branches have high non performing loan rates (NPR). Bank staffs who contributed to this research include the head of loans, credit officers and the branch managers of the respective branches.
CHAPTER TWO-LITERATURE REVIEW

2.0 Introduction
This chapter covers relevant literature with the aim of gaining insight into the factors that cause high default on loans within Commercial Banks in Kampala Capital City. It is sub-divided according to the objectives to be achieved that is 2.1-Bank specific factors causing high default rate on loans, 2.2- Customer specific factors causing high default rate on loans and 2.3- solutions recommended to reduce the high default rate

2.1 Bank specific factors causing high default rate on loans
According to Rosenberg (1999), Micro Finance Institutions (MFIs) are increasingly a central source of credit for the poor in many countries. Weekly collection of repayment instalments by bank personnel is one of the key features of micro-finance that is believed to reduce default risk in the absence of collateral and make lending to the poor viable. Some of the factors that lead to loan default include; inadequate or non-monitoring of micro and small enterprises by banks, leading to defaults, delays by banks in processing and disbursement of loans, diversion of funds, over-concentration of decision making, where all loans are required by some banks to be sanctioned by Area/Head Offices.

Auronen, (2003) states that the theory of asymmetric information makes it difficult to distinguish between good or bad borrowers and it arises when gaining information on the characteristics or on the behaviour of the borrower is costly for the financial institution. The theory explains that in the market, the party that possesses more information on specific item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender) (Auronen, 2003). The party that knows less about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction (ibid).
Information asymmetries generate problems of adverse selection, allocation of loans to borrowers with undesirable characteristics such as a high level of risk or inability to take advantage of the loan as well as moral hazard the borrower may behave in an undesirable way (make little or insufficient effort to take advantage of his loan or used it for unproductive purposes) (P. Morgan, 2003). Adverse selection and moral hazard increase the proportion of borrowers who cannot repay their loans on time. Borrowers that have enough money to reimburse their loan might also default strategically. The cost of strategic default might indeed be low if the lending institution has low collateral requirements and if the legal system gives little power to the financial institution to enforce contracts. Financial institutions try to restrict the occurrence of those three types of situations in designing appropriate credit schemes.

Fernandez (2000), Waweru and Kalani (2009) identifies weak credit analysis as another cause of loan default. This may a result of conflict of interest by the bank staffs where he/she looks at the personal gains than that of the Commercial bank. Corruption tendencies inform of bribes from customers may also influence the loan officer to favor the customer during appraisal. It may also be a result of lack of experience and skills of the staffs in credit analysis. However findings state that these bank staffs especially credit officers were trained on how to do appraisal, monitor and supervise the borrowers.

Allan and Olomi (2003) however, concluded that banks have capacity constraints in credit and risk management. These findings therefore suggest that maybe the trainings obtained were not satisfactory or probably the number of staff do not tally with the number of borrower to monitor and supervise.

Factors that were beyond the Commercial Banks control were court injunction instituted when bank intends to dispose properties, low prices fetched when disposing mortgaged assets and change in policies. An example here was the issue of exportation of hard wood logs
business which was stopped when several banks had issued loans in respect to that business. Others were natural calamities like earth quakes, El-nino rains, change in economic conditions like inflation etc, and death of key person (borrower’s side) as well as lack of reliable borrowers’ information.

The World Bank (2002) in their study on establishing business environment in Tanzania noted on average, in Tanzania getting credit information even from other sources is problematic. During this period they had not yet introduced the Tanzania credit reference bureau which was meant to enhance bank customer credit information availability to the Commercial Banks.

Establishing a good relationship with borrowers was found to be the most favorable strategy employed by banks in the effort of reducing non-performing loans. This was done through assisting borrowers by advising them on how to solve their problems, attend some of borrowers’ business meetings, deliver good services and provide reasonable charges and also go further and organize dinner party and other social events where banks invite their borrowers.

Mohammad, Nikhil and Abdul (2005), defines non performing loans as that loan that cannot be recovered within a specified time frame as stipulated by the law governing the lending institutions, He argues that the default culture is not a new dimension in the investment arena; rather it is something that is expected during investment.

He noted that the key causes of the default include the reduced attention to borrowers by the financial institutions, At times these financial institutions need to monitor the borrowers closely so as to determine whether they are utilising the loan effectively to reduce chances of the default. This is called the Hawthorne effect.
Another cause could be due to the movement in the risk curve which also known as the Petroski Effect. Commercial Banks tend to take on more risks so as to make more money. This was noted during the housing boom in the USA where mortgages companies and banks were making a lot of profits in the business and were encouraged to take on more risks by deregulating the existing policies and procedures so as to get more customers and make it easier to acquire loans. In the end result, they created many loopholes which encouraged customers to default on the loans.

Increase in the loan amount also increases the risks associated with the loans. Commercial banks have tendencies of increasing the loan amount for their customers who have good loan payment history. Such customers are encouraged to take on more loans even when they are had not planned. In the end the customers may fail to pay these loans because of the increased burden due to increase in the instalment. This is also known as the Inverted Pyramid Effect. Loans sanctioned with corruption tendencies also aid in increasing the default rates. A case in point is in countries like Bangladesh where loan sanctioning authority sanctions loans for satisfying their self-interested behaviour thus, engaging themselves with the clients and corrupting the total system by giving some benefits for taking something in return. This may be called as The Give and Take Chance Effect. This may be applicable in Uganda’s situation where auctioneers who are meant to sell off the customers collaterals instead connive with the owners of the security for his/her own benefits.

2.2 Customer specific factors causing high default rates

According to Munene, Nguta and Huka (2013), microfinance are faced with the challenge high defaults as a result of their cash flow problem. The investigated the possible causes by using a descriptive survey design on the business characteristics of individual microfinance loan. The business characteristics considered included the type (industry) of business, Age,
location and profits of the business. The level of business income is important in determining the credit worthiness of clients that is at low levels of income, business has little money to save while at higher levels much can be saved and even used to purchase collaterals which can be used as loan securities. This collaterals help to determine the lender’s margin of safety.

From a population of 37 loan officers and 4578 clients, samples of 400 respondents were identified and they used structured and unstructured questionnaires for the data collection. The study showed that high cases of default of loan repayment were common in the manufacturing sector (67.9%) followed by the service industry (64.0%) then agricultural sector (58.3%). The trade sector recorded the least (34.9%) cases of loan repayment defaults. This could be attributed to the observation that trade industry deals in fast moving products on high demand which could translate into good business performance and increased revenue that accounts for low default cases. Among businesses that had been in operation for less than two years, 52.4% had defaulted in loan repayment, 44.2% of those that had been in operation for a period of between two and five years had defaulted. It was noted that the highest (78.6%) default cases were regular in businesses that had been in operation for a period of between five and ten years. Loan repayment defaults were rare (0.0%) in business that had survived for more than 10 years. In addition, the businesses located within the municipality had high loan repayment default rates (55.7%) as compared to business outside municipality. Businesses making monthly profits of below Kshs. 10,000 had the highest cases (62.8%) of loan repayment default followed by those that made profits of between Kshs. 11,000 and Kshs. 50,000 (42.5%). There were 22.7% cases of loan repayment default among businesses that made profits of between Kshs. 51,000 and Kshs. 100,000. Loan repayment default among businesses that made profits of over 100,000 was minimal.
The researcher didn’t point out to the differences in the default rates in their various sectors, for example why is default on loan payment higher in the manufacturing sector as compared to the trading sector. Also trying to identify the causes of default in terms of how long the business has been in operation is not very realistic. New Businesses with proper financial management and planning may have low default rates compared to that of 10 years with poor financial management and planning. However commercial banks always avoid funding new businesses because the risk may be higher as compared to existing businesses due to lack of practical exposure of the borrower in that business. Customers whose businesses are making losses may fail to pay the loans however the reverse may not be true, that is to say customers whose businesses are making profits will pay loans well. This will depend on their spending habits.

Taman (2013), identifies financial shocks is one of the causes of high default rates. This was evidenced during the financial meltdown of 2008. First, interest rate spreads rise as depositors become more concerned about the safety of their savings. With a higher loan rate, more firms default and less new loans are made.

The researcher assumed two financial frictions in his findings. First, a lack of commitment on the part of banks to repay depositors, as in Gertler and Karadi (2011), requires banks hold net worth against deposits. Since bank net worth is scarce, this deposit friction makes the volume of bank loans to firms in efficiently low and drives loan rates above deposit rates. Second, loans to firms involve the risk of default. This introduces a second channel through which loan rates exceed deposit rates. In the presence of these frictions, the accumulation of net worth allows banks to mitigate the capital requirement implied by the deposit friction and to buffer against future default risk. He considered two types of aggregate shocks that affect these financial frictions. First, financial shocks reduce the collateral value of bank net worth.
Households become more concerned about banks solvency and banks are required to hold more net worth against deposits. These shocks originate in the financial market and directly impact the deposit friction. Second, aggregate productivity shocks change the ability of firms to repay their debt. When the aggregate productivity falls, default rates rise and bank net worth falls. He noted that Interest rate spreads and default rates are counter-cyclical while aggregate output, investment, consumption, hours worked and new business loans are procyclical while this spreads rise through a tightening of the deposit friction. In contrast, the effects of an aggregate productivity shock are long-lasting and interest rate spreads rise even though the deposit friction is initially relaxed. The presence of default is central to understanding the long-lasting effects of an aggregate productivity shock. When aggregate productivity falls, net worth of banks falls because of an unexpected increase in loan default. Bank net worth continues to fall for a while in subsequent periods as the effect of falling loan demand keeps the loan rate from rising sufficiently high to cover losses from default. Later, as the demand for loans recovers, banks are constrained in their ability to provide new loans by their net worth.

Adem, Gichuhi and Otieno (2012) emphasized on the importance of identifying credit risk that lead to customers defaulting on loans because if loans are non-performing, big companies paying huge amounts of taxes to government will come tumbling down and the entire economy will be threatened. By developing an accurate credit risk rating system, banks will be able to identify loans that have lower probability of default verses loans that have higher probability of default.

The researchers achieved this by developing parametric logistic model that predicts the probability of a customer defaulting. The significant specific factors put into consideration during the study were; age, gender, occupation, amount of loan, salary, marital status and
term of loans. The variable occupation was further classified into several sectors. The variable of interest was loan status coded as 1 for defaulters and 0 for non defaulters.

Data collection was done for a sample of 15,000 loan applicants in 2007 and it comprised of 1,558 defaulters and 13,442 non defaulters.

Data estimation were done using the Logistic regression model and parameter estimation because of its ease in estimation due to the functional form of the logistic distribution and can be motivated as a model of choice between alternatives with random utilities where the randomness comes from independent data drawn from a Weibull distribution, McFadder, (1974).

Findings show that male customers have high odds (1.91) of defaulting compared to their female counter parts, single customers have a higher likelihood (odds of 1.48) of defaulting compared to their married customers, younger customers have high odds of defaulting unlike elderly customers, financial sector customers have equal likelihood of default as support staff customers and long term loans have less likelihood of defaulting compared to short term loans.

The researchers expect customers who are single to have shallow vision of the future and the impact of the default may not be much felt on an individual as compared to a family thus this may encourage the singles to default more compare to the married. On the contrary single people may have more savings because of the less responsibilities compared to married customers thus should be able to pay loans better. However single or married alone doesn’t point out to the actual causes of the loan default. External factors like loss of job or poor business performance or poor attitude towards loan repayment may actually the one cause the married or single people to default on loans.

Younger customers may be exposed to default on loans due to their inexperience in managing business and loans payment as compared to the elderly who have vast experience and also
mind about their reputation. These findings may be applicable under certain assumptions. This is because there are many instances where young customers pay loans better than the elderly because they have the energy and zeal to work harder and built on their reputation.

2.3 Solutions/Strategies for the high default rates on loan
Gakuu (2012), in his investigation of the strategies that can be used to reduce default rates in financial institutions notes that most financial institutions tend to rely on traditional practices on trailing indicators of credit quality such as delinquency, nonaccrual, and risk rating trends. Banks have noted that these indicators do not provide sufficient lead time for corrective action when there is a systemic increase in risk. Bank management have done all that it can to ensure that the clients get credit facilities at ease. With all this efforts, still there have been numerous cases of loan defaulters at the bank which consequently result in losses in terms of profits to the bank and also provisions in the bank have increased.

Strategies that include client account appraisal, collateral appraisal, client loan history and guarantors’ appraisal on loan payment where investigated to find how its impact on the high default rates on loans.

In Client Account Appraisal, Banks rely mostly on information from a customer’s to decide whether he/she qualifies for a loan. It shows all of the expenses and deposits for the account, over a specific period of time and also shows when the account was overdrawn and if there were any fees associated with the overdraft. The bank can assume that the customer is carrying out some economic activity that is bringing him that money or has some stable source of income thus implying his ability to pay. However such information may be misleading because it doesn’t point out exactly to the source of income of the customers. Customers may be involved in money laundering businesses like dealing in drugs, prostitution etc which is not recognized by law the banks can found such activities.
Collateral is usually some form of property or assets such as equipment, automobiles, tools or real estate that is pledged as security for a loan. Banks will use collateral to make sure they are in a more stable situation when a loan is made as it helps on reducing risk.

Collateral also plays a major role in loaning decisions because it represents secondary source of repayment for loan. It is usually the measure of last resort – when all other recovery efforts have failed. The collateral taken should have qualities like have a ready market, be easily transferable, and have intrinsic & extrinsic value. The collateral taken must be something the borrower would ordinarily not want to lose, or the loss of which will leave a big void. For group lending, in addition to tangible collateral and forced savings, there exists social pressure for a person to pay, so as to remain of good standing in society. Banks appraise and evaluate the security presented by the clients to make sure it can be used as collateral and always ensure loan amount requested is not more than what the collateral is worth. When dealing with collaterals banks have to take note of two things the current market value of the collateral and the documentation of the collateral. For example, without an unbiased party checking the log books to see that they are original and complete the bank may be told nothing about the log books.

Client loan history is very important in deciding on whether to give the customer another loan or not. The loan repayment history represents a good indicator of a client’s repayment capacity. It shows details of how the customer has paid previous loans and the collaterals used for that security. Banks are more likely to process loans faster to customers with good loan history as compared to those with bad loan history.
A common practice by commercial banks has been to graduate loans (increase loan amounts) basing on the loan history without considering business growth, necessity of funds, adequacy of collateral. This may in the long run lead to default instead especially where loan amounts may exceed the collateral value.

The role of a guarantor is commitment by the way of agreeing to the terms and conditions of the loan and bearing liability to the extent of the loan together with the interest and other charges. The guarantor comes into play especially when there is a default by the borrower. The guarantors are required to work together with the Bank to ensure that the borrower pays the loan. In an event where the borrower defaults and disappears, the guarantor may be required to take over the loan burden of the borrower. This has impact of damaging the social relationships amongst people at the cost of the bank recovering its money. It also discourages guarantors from saving with that bank because of the fear that they savings may be used to pay the borrower’s loan.

The study found that majority of the study participants felt that account transaction appraisals were slightly high. It was also noted that there was high implication of collateral on the loan repayments and that the role of client’s loan history appraisals on loan repayment were very high. Guarantors’ appraisals on loan repayment have high influence on the possibility of a client defaulting. The study concluded that the account transaction appraisals, collateral appraisals, loan history appraisals as well as guarantor appraisals were tailored to attract borrowing in Equity.

Mohammad, Nikhil and Abdul (2005), points out to a phenomenon to the world is getting worst just to make people more smart and divergent to turn the worse into better. Thus as commercial banks are faced with the high default on loans, they shouldn’t relax, and instead
they should be challenged to get solutions to the problem. Mohammad Et al, suggested measures commercial banks can take to mitigate on the non performing loans. Laws within a country’s constitution regarding credit management should be assessed to ensure the available loopholes that may encourage default tendencies are worked on. This will help to curb those defaulters who may want to use the loopholes within the law to default. This however can best be done through the regulators for the case of commercial banks in Uganda, Bank of Uganda. Laws should try to reduce on extortion or corruption tendencies so as to realize more loan recoveries and investors should have good business environment to promote their business thus reducing on default because they are making profits.

Commercial banks should handle risk assessment with a lot of priority. This should be embedded in their policy, procedures and guidelines to assess risks. Notable are Banks like Bangladesh Bank where following of lending risk analysis are made mandatory. This should be backed by close supervision to ensure compliance.

Mohammad Et al, suggest Motivation as another solution to reduce the high loan default rates.

Motivation is defined as Internal and external factors that stimulate desire and energy in people or organization to be continually interested and committed to a job, role or subject, or to make an effort to attain a goal. It is a result of the interaction of both conscious and unconscious factors such as the intensity of desire or need, incentive or reward value of the goal, and expectations of the individual and of his or her peers. These factors are the reasons one has for behaving a certain way. This could be in form of rewards to the loans officers or a countrywide involvement where banks with the lowest default rates are rewarded. The government may also give some monetary incentives to the best performing banks inform of tax incentives.

Proper management of the collaterals will also help reduce on the default rates.
Keeping the collaterals alone is not enough; the manner in which it is managed will help to avoid loss or damages. Collaterals need to be properly valued before loans are disbursed against them. Good collaterals should be easy to liquidate and should have proper documentations.

All these efforts require contributions from both the banking industry and the government to ensure that they are effectively put into practice to realize the result of reduction in the loan default rate.
CHAPTER THREE: RESEARCH METHODOLOGY

3.0 Introduction
This chapter presents a research methodology of the study, shedding light on the Research design, population, sample and sampling procedures, instrumentation, pilot study, data collection procedures and data analysis.

3.1 Research Design
The researcher used a case study research design, a descriptive survey technique and used questionnaires as tool for data collection. The questionnaires used were both closed and open ended to capture other opinions of the respondents that are not in the Likert scale. Descriptive survey is a method of collecting information by interviewing or administering a questionnaire to a sample of individuals (Orodho, 2003). It can be used when collecting information about people’s attitudes, opinions, habits or any of the variety of education or social issues (Orodho and Kombo, 2002).

3.2 Area of study
The study was carried out within Kampala Capital city and was focused at identifying the causes of high loan defaults rates at Centenary Bank.

3.3 Population of Study
The population for this study consisted of 120 Centenary Bank staffs from 14 Centenary Bank branches i.e. Namirembe road branch (15 staffs), Nakivubo Branch (13 staffs), Rubaga branch (5 staffs), Kikuubo branch (4 staffs), Natete Branch (10 staffs), Najjanakumbi branch (5 staffs), Ntinda Branch (5 staffs), Mapeera branch (14 staffs), Kireka branch (5 branches), Kabalagala branch (5 staffs), Makerere University branch (2 staffs), Bwaise Branch (8 staffs), Lugogo branch (3 staffs) and Entebbe Road branch (26 staffs).
3.4 Sample size
Samples that were used for this study consisted of all the loans officers and head of loans for selected Centenary bank branches in Kampala District. The selected branches are those with high Non-performing loans (NPL) which is a measure for loan default rates. It covered 7 branches namely Kireka Branch (5 staffs), Kabalagala Branch (5 staffs), Bwaise Branch (8 staffs), Entebbe road branch (26 staffs) ,Ntinda branch (5 staffs), Natete branch (10 staffs) and Najjanakumbi branch (5 staffs). The sample size was composed of approximately 50% (7 branches) of the total Centenary Bank branches within Kampala Capital city with a total of 57 loans officers and head of loans. This enabled the researcher obtain reliable and fairly accurate information from all the levels of respondents and to avoid bias.

3.5 Sampling Procedure
The researcher used a non probability sampling procedure where the sample from the population was selected randomly. Convenience Sampling involves choosing respondents at the convenience of the researcher. This procedure was employed by the researchers because it helps reduce the time and cost of collecting information.

3.6 Study Procedure
The study were carried out by use of both questionnaires and where it necessitated, clarifications were done. Both closed and open ended questionnaires were used. The researcher used quantitative methods to study and analyse the data.

3.7 Research variables
The research variables consisted of the loan defaults rates being an independent variable.

3.8 Data Collection

3.8.1 Sources of data
The data required for this research was collected from the loans officers and credit administrators of selected branches of Centenary Branches.
3.8.2 Tools of Data collection
Data for this study were collected by use of questionnaires. A structured questionnaire with both closed and open ended questions were used for the data collection and were administered personally to the various branches of Centenary Bank. Each questionnaire consisted of two sections, section one, and consist of personal information of the respondents. Section two contains questions relating to causes of loan default in banks.

Questions designed were brief, simple and straight to the point to ensure the meaning is not ambiguous. Secondary data obtained from books, journals and the internet were also used.

3.9 Data quality control
The designed questionnaire were pretested 3 times to ensure errors were detected and tested to ensure the questionnaire produced data required to meet the required objectives for the research.

The researcher also used a large sample from the population so as to collect as much information as possible for the research.

Data quality control was checked by use of questionnaires both with closed and open ended and request for respondent’s opinion whenever it was required.

3.10 Data Analysis and presentation
Data collected was analyzed using a computer Statistical Package called Stata and arranged in a meaningful form, into tables of frequencies, graphs and Charts for easy interpretation.

The data was also summarised using the loan performance index.

3.10.1 The Index
Following Sutanto (1999) and Mawejje and Lakuma (2014) the loan performance index is computed based on the staff perception on bank specific indicators such as bank operations and policies and the ability for banks to supervise and evaluate its staff, and customer specific
factors such as customer service and the lending interest rate. For each of the evaluation indicators, bank staffs perceptions are weighted on a Likert scale as follows: “strongly agree”, “agree”, “disagree”, “strongly disagree” or “not sure”. These responses are coded as 5, 4, 3, 2 and 1 respectively. For example, if a staff member strongly agrees that Centenary bank integrates loan risk with the value of a customer’s collateral; such a response would be coded 5. If a staff member “disagrees” with the indicator, it will be coded 3.

The scores of all staffs in the sample are then summed up to arrive at the total score (Ts) for a variable. A diffusion index of a particular variable (I_v) is achieved by dividing total score by the number of firms (N) and multiplying by 100 percent.

\[ I_v = \frac{T_s}{N} \times 100 \]

3.10.2 Weighting
Based on the bank staffs perception indicators explained earlier, the loan performance index is then computed as the weighted arithmetic and seasonally adjusted mean of individual bank staff evaluation indicators (Ece et al. 2005). The choice of optimal weight was guided by an equal weighting criterion (Nilsson, 2000). The general formula for the loan performance Index is given as:

\[ I = \frac{\sum w_v I_v}{n} \]

Where:

I = the loan performance Index

w_v = The weight attached to a variable

I_v = Diffusion index of a variable
n = Number of observations

3.10.3 Reliability of the survey:
Since the questionnaire follows the Likert scale, we shall apply the Cronbach $\alpha$ coefficient to test for the reliability of the data from the survey. First proposed by Cronbach (1951), the coefficient lies between 0 and 1. The test is interpreted as reliable when $0.70 \leq \alpha \leq 1$ and not quite reliable when $0 \leq \alpha < 0.70$ (Cortina, 1993).

3.10.4 Interpretation of the loan performance Index
The indices range from 0 – 100. The interpretation of the Index is such that scores above 70 point to the likelihood of loan recovery. Scores below 70 imply the likelihood of a loan default. Following Sutanto (1999), we provide a matrix of proxy interpretation of the index magnitude below:

<table>
<thead>
<tr>
<th>Index value</th>
<th>Interpretation</th>
</tr>
</thead>
<tbody>
<tr>
<td>70&gt;=I&lt;=100</td>
<td>If the index fall within this band it represents a high likelihood of loan recovery</td>
</tr>
<tr>
<td>I&lt;70</td>
<td>Loan performance is worse: There is a high likelihood of loan default</td>
</tr>
</tbody>
</table>

The index does not consider the magnitude of change in the data but considers the general direction of movement in the key indicators. As such, the index is sensitive to the direction as opposed to the magnitude of loan default. Intermittent increases or decreases in the index should not be interpreted as indications of expansion or contraction of the economic activity (Maweije and Lakuma, 2014).
3.11 Ethical Consideration
Given the sensitivity of the information, the researcher ensured confidentiality of whatever information were collected from the respondents. This ensured the respondents opened up during questionnaires answering so that data collected fairly represented their opinion.

The research was done with values like integrity involved and the researcher ensured originality in the overall work hence avoiding the practice of plagiarism.

During the distribution of questionnaires, the researcher requested for permission from the necessary authorities and the respondents’ consent to sacrifice their valuable time in filling the questionnaires.

Privacy of the respondents was also taken into consideration so as not to offend any of the respondents through avoiding questions that may offend the respondents.

3.12 Limitation
Due to financial limitations the research was carried out within the Branches of Centenary Bank in Kampala Capital City.

With time being a limiting factor, the study was carried out within a sample of Centenary bank’s Kampala branches prioritizing those with high loan default rate.

The research was also limited to the staffs of the centenary bank only because of the challenge of identifying the Centenary bank loan customers and also to avoid bias response from the customers at point of loan application.
CHAPTER FOUR

Presentation and Discussion of Research Findings

4.0 Introduction
This chapter presents the research findings, analysis and interpretation in accordance to the study objectives. Data presentation has been divided into three sections, each dealing with an objective of the study. The objectives were; to examine the Bank specific factors causing high default on loans, to establish the customer specific factors causing loan default and suggest possible solutions to reduce on the loan default rate.

4.1 Data and Sampling design
The data used in computing the loans performance index were collected from 57 bank staff sampled from 120 staff of Centenary Bank Kampala in 2014. The probability proportional to size sampling technique was used to select bank staff into the sample. The different departments were treated as sampling strata. The credit departments were automatically selected to ensure that the staffs who deal directly with loans are significantly represented in the sample. The staffs employed in Credit department in their various positions like Loans processors, SMEs Loans officers, credit administrators, commercial loans officers and salary loans officers were selected using the simple random sampling within each stratum. The variations of the sampled staffs are presented on Table 1.
Table 1: Bio Data

<table>
<thead>
<tr>
<th></th>
<th>Credit administrator (%)</th>
<th>Commercial loans officer (%)</th>
<th>SME Loans officers (%)</th>
<th>Loans Processor (%)</th>
<th>Salary Loans officer (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gender</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Female</td>
<td>3.8</td>
<td>1.9</td>
<td>13.5</td>
<td>3.8</td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td></td>
<td>11.6</td>
<td>46.2</td>
<td>3.8</td>
<td>15.4</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Degree</td>
<td>3.6</td>
<td>15.8</td>
<td>52.6</td>
<td>3.5</td>
<td>22.7</td>
</tr>
<tr>
<td>Master’s degree</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1.8</td>
</tr>
<tr>
<td><strong>Duration of employment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under 2 years</td>
<td>1.8</td>
<td>12.3</td>
<td>9.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 - 5 years</td>
<td>1.8</td>
<td>28.1</td>
<td>2.8</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>Over 5 years</td>
<td>3.5</td>
<td>8.8</td>
<td>12.3</td>
<td>1.8</td>
<td>10.5</td>
</tr>
<tr>
<td><strong>Age</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20 - 30</td>
<td></td>
<td></td>
<td>15.8</td>
<td>20.8</td>
<td>6.5</td>
</tr>
<tr>
<td>31 - 40</td>
<td>3.5</td>
<td>1.8</td>
<td>19.3</td>
<td>18.3</td>
<td>10.5</td>
</tr>
<tr>
<td>over 40</td>
<td></td>
<td></td>
<td>3.5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4.2 Research Findings

Figure 1: The Loan Performance Index Assessment

Results indicate that the overall staff perceptions on loan performance in centenary bank are favorable. Thus, on average, there is high likelihood of loan recovery. The loan performance index is 74.2. The staffs perceive that the index was mainly driven by operations and policies of the bank (the index was 77.4 percentage points). The general perception is that the bank has sufficient infrastructure to integrate loan risk and the value of the customer’s collateral. This ensures that a loan default is recovered by disposal of collateral thus shielding the bank against risk. The staffs of Centenary bank are also of the opinion that the success in loan performance is largely explained by the ability of the bank to identify asses and prioritize loan customers in line with the risk appetite and ease of loan recovery. It is also a general perception within centenary bank that the processes to identify and asses emerging gaps and opportunities in the loan disbursement. Ultimately, it is widely believed amongst centenary bank staff that the credit department has enough technical experienced and knowledgeable.

The Loan performance Index was also driven by customer specific factors (the index was 73.4 percentage points). For example, the centenary bank staffs are of the opinion that improved customer service within the bank was significant in ensuring that loan customers
pay all the instalment owed to the bank promptly. The staffs appreciate the effect of inconsistent interest rates on the ability of customers to repay their loan. It is also widely believed, by bank staff, that tight information technology controls ensure security of bank systems thus minimizing mistakes and unlawful practices such as entering of incorrect data, changing of data, deleting of data, destruction of data, crashing of systems and holding of data hostage.

4.2.1 Causes of loan default as measured by the Loan performance index

Loan Operations and Policies

The general perception by Centenary bank staff is that the staffs are not satisfied with the calculation of the monthly incentive package and this could erode the staffs’ ability and by extension the bank’s ability to monitor and administer loans. From figure 2, the index on sufficiency of monthly index was 65.4. It is also widely perceived that the bank staffs do not have sufficient capacity to enforce timely loan repayment. This include the human resources, equipment used for recovery like the motor bikes, vehicles etc. The index on enforcement infrastructure scored 67.4.

Nevertheless, positive staff perceptions on loan performance dominate the index (see figure 2). The overall index on loan operation and policies is favourable at 77.4 percentage point. The positive perception is driven by factors such as existence of Credit reference Bureau (CRB) which enables decision making by giving information on customer credit history. Centenary bank is also perceived by its staff to have the bank processes which identify and asses emerging gaps and opportunities in loan disbursement. The staffs of the bank also appreciate the existence of a credit risk management system (78.3) which minimise the likelihood of loan default.
Figure 2: Indices on Loan Operations and Policies

Loan Supervision and Evaluation

Centenary Bank staffs do not agree with level of supervision on auctioneers and bailiffs. Thus, one can infer that the proceeds from the sale of collateral may not reflect the true value of the (collateral) assets confiscated. Also, the bank is perceived by the staff to have inadequate capacity to evaluate collateral in a timely and satisfactory manner. This is because the evaluation of the collateral is done by third parties who aim at satisfying their own interest. They at times connive with the Bank customers to over value the collaterals. The above evaluation indicators are perceived by staff as potential risk which may exacerbate the rate of centenary bank loan default.

However, the negative perception on loan perception and evaluation is counterweighted by the large effects of positive perceptions. The overall index on loan supervision and evaluation is 71.9 percentage points. These indexes suggest that centenary bank is cushioned from perceptions of any potential default in loan repayment. The positive staff perception is driven by the opinion that centenary bank staffs integrate credit risk management into planning at all
levels (83.9 percentage points) (See figure 3). Figure 3 shows that the index reinforced by the sufficient information concerning credit operations amongst staff members (79 percentage points). On average, centenary bank staff are perceived by their colleagues to adhere to loan policies and procedures (78.9). There is a perception that on average the level of training on causes and measures of loan default are adequate among staff members in centenary bank (75.1). In addition, the staff members consider themselves to be committed, honest and ethical in all their action including execution of loans (71.6) (see figure 3).

**Figure 3: Indices on Loan Supervision and Evaluation**

![Figure 3: Indices on Loan Supervision and Evaluation](image)

### 4.2.2 Customer specific factors
The Staffs of centenary bank perceive the customer specific contribution to loan default to be driven mainly by frequent changes in the terms and condition of loan acquisition and payment (63.2 percentage points) (see figure 4). One can infer that, changing of terms and conditions without notifying customers in a timely manner affect planning and expose many customers to the likelihood of defaulting on a loan. The increase in business failure is widely believed, by centenary bank staff members, to be a major driver of likelihood of defaulting on a loan by centenary bank customers (63.5). The business failure is thought to be driven
significantly by financial illiteracy, multiple borrowing of money from different financial institutions and the insufficient training of customers offered by centenary bank (68.1). This is exacerbated by inadequate information and explanation from the bank staff about the amount of loans advance to them (68.8). Also, at times either the amount advanced is not sufficient for business purposes and it act as loan default push factor (68.8).

Nonetheless, the negative sentiment on the customer specific factors influence on loan default is mitigated by the activities of centenary bank which promote the loan repayment rate. The overall index on customer specific factor is 73.4 percentage points. The favourable index is influenced by upbeat perception about centenary bank’s ability to provide customer service (83.5 percentage points). Arguably, customer service is essential in ensuring that loans payments are made in time. It is widely believed among staff members at centenary bank that interest rate on loan charged by the bank are lower than competitors and this speeds up the rate of loan repayment (83.5). The staff members of centenary bank are of the view that the information technology systems at the bank minimises the rate of loan default by ensuring timely automatic recovery from the customer accounts, providing daily reports on the loan performance and exercising tight controls which assures the security of the system thus minimising the rate of system crash, incorrect data entry, and changing, deletion and destruction of data (81.4). Centenary Bank has also ensured that delays in advancement of loan are kept at the minimum because this may lead to delays in repayment or increase the likelihood of loan default (78.6). The staffs of centenary bank are also of the opinion that the provision of timely, reliable, accurate, meaningful and easy to use credit reports has helped in monitoring of loan performance and aided decision making by customers and the bank (76.8 percentage points).
### 4.2.3 Possible Solutions to reduce high rates of loan default

From figure 5 the staff members of Centenary bank, the best solution to reduce loan defaults is through increased supervision of bank by the central bank to minimise the rate on non-performing loans. It is perceived by staff members that frequent performance of due diligence during loan appraisal enhances centenary bank’s credit risk management system. As such, the credit risk reporting system needs to be adequate. It is widely agreed among the staff that customers should be provided with enough information pertaining the loans they acquire from the bank and amounts advanced should either be conditional on a customer’s ability to repay the principle and interest Or loans should be disbursed to a group as opposed to an individual because the collective responsibility has be shown to have less loan default rates within the centenary banking system. There is also need to continuously train not only the Centenary bank staff on loan recovery and management. But also, the centenary banks customers on financial literacy. However, methods such as timely disposal of a customer’s collateral to cover for loan default and publication of information on loan defaulters in the
media to expose and shame them are viewed as less effective in reducing the rate of defaulters at centenary bank and may compromise customer service thus scaring away potential customers. (Figure 5).

**Figure 5: Indices on Possible solution**

<table>
<thead>
<tr>
<th>Possible Solution</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory Body</td>
<td>80%</td>
</tr>
<tr>
<td>Due diligence</td>
<td>70%</td>
</tr>
<tr>
<td>Reporting on credit risk</td>
<td>60%</td>
</tr>
<tr>
<td>Loans approval based on capacity to repay</td>
<td>50%</td>
</tr>
<tr>
<td>Sufficient information Loans</td>
<td>40%</td>
</tr>
<tr>
<td>Training on loan recovery</td>
<td>30%</td>
</tr>
<tr>
<td>Loans to groups</td>
<td>20%</td>
</tr>
<tr>
<td>Financial literacy</td>
<td>10%</td>
</tr>
<tr>
<td>Timely disposal of collateral</td>
<td>5%</td>
</tr>
<tr>
<td>Publicity of loan defaulters</td>
<td>0%</td>
</tr>
</tbody>
</table>
CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction
This chapter presents a summary of the major findings of the study; provide recommendations and areas for further research. A revelation of both the theoretical and Empirical issues that underline the causes of high loan default in commercial banks were made in the proceeding chapters. None the less, a summary is presented hereunder.

5.1 Summary of Findings
The study examined the causes of the high loan default within Centenary Bank, Kampala. Its specific objective were to identify the customer specific factors, the bank specific factors that are causing the high rate on loan default and possibly suggest possible ways of mitigating the problem.

The findings were gathered from the credit staffs of the Centenary bank by used of both closed and open ended questionnaires.

5.1.1 Bank specific factors causing the high default on loans.
According to the findings, the existing bank credit policies and procedures exist to mitigate the high default on the loans. This was supported by 77.4% of the respondents. However the lack of close and constant supervision of the credit staffs provides loopholes for default on bank loans. This is because the ratios of the credit supervisors to the credit officers are insufficient. For example the ration of credit supervisors to loan officers is 1 to 20.

65.4% of the respondents pointed to inadequate motivation in terms of performance incentives to the credit staffs as a cause to high default on loans. The existing incentive scheme is not well understood by the credits staffs and they are also insufficient as compared to the efforts and the risks the credit officers take to recover the loans. This lead to the credit staffs soliciting for bribes from the Bank customers.
The problem of understaffing in the credit department and equipment to facilitate recovery hinder the timely recovery of the loans. The bank has very many customers yet there are few loans officers to serve them, also the branch service coverage is relatively wide to be easily covered by the few credit staffs.

5.1.2 The customer specific factors
The findings point to multiple borrowing as one of the key causes of loan default. Customers get more than one loan from the same bank. This is because they have various types of loans for various purposes. For example a customer can get a salary loan and a home improvement loan at the same time. This has been encouraged because of the existing cut throat competition amongst the financial institutions and the requirement to meet the monthly and annual loan disbursement targets.

There is also no close supervision of the Property valuers contracted to value customer collaterals on behalf of the bank. These valuers are third parties and tend to satisfy their selfish needs instead of that of the bank. There are instances where collaterals have been overvalued, Loans being given to land titles of a road reserve etc, and such customers tend to be relaxed to pay their loans. This brings in the challenge of disposing off the collaterals.

Information flow between the loans officers and customers in terms of loan-term changes, interest rate etc has been inadequate. Bank customers are kept unaware of certain changes on the loan term e.g an increase in the interest rate. These have direct impact on the financials of the customers.

Failures in businesses have also been figured out to cause the customers to default on the bank loans. This was supported by 67.4% of the respondents. This may be due to poor financial management or diversion of funds to non-economic activities.
5.1.3 Solutions that can help reduce on the high default rate on loans
The credit staffs of centenary bank suggested the following as measures that can help curb on the ever increasing default rate on the bank loans.

There should be proper motivation of the credit staffs as they are key to the bank’s performance. This should be supported by adequate staffing of the credit division and availability of equipment’s used for appraisal and recovery like the Motor cycles, Bank vehicles etc. This should be adequate enough.

The problem of multiple borrowing within the same bank can be mitigated by in-depth appraisal systems and the use of Top up loans as a replacement for multiple borrowings. In a top up loan a customer is given a lump sum bigger loan from which the balance from the outstanding loan is recovered. Multiple borrowings resulting from other banks can be reduced strict emphasis and supervision on the use of the Credit reference bureau, it was found out that some loans were disbursed without consulting the credit reference bureau. This was due to system failure of Compuscan, the company contracted to provide credit information to the banks. Such problems resulting from failures can be reduced by liberalization of the service to ensure that the Banks have alternatives in case of failure from one company.
5.2 Conclusion
In view of the findings of this study and given the implications of loan default on the commercial banks and the financial sector as a whole the government through its ministries should set up stringent term and monitoring tools to ensure that the default rates on loans are curbed down. It should invest in training the youth and adults in financial literacy and loan defaulters should be apprehended and imprisoned for longer terms exceeding 10 years, this will instill some discipline on the citizens who borrow money and don’t want to refund.
Licenses of companies and property Valuers who connive with bank customers to give false information in terms of property valuation should be cancelled so that they work in line with the banks interest and not their own interests.
The Commercial banks should be closely regulated and supervised more frequently to ensure that they are following procedures for Loans disbursement. Due to the stiff competition in the sector, other banks may be tempted to relax on their terms and procedures of borrowing which may impact negatively on their ability to recover the loans.

5.3 Recommendations
Centenary bank commits a lot of resources to Loans as it is one of the major sources of income to the bank. From the findings the study makes the following recommendations,

Bank specific factors that can lead to customers defaulting can be reduced by the effective and routine supervision of the commercial banks by their regulators to ensure that they have all necessary requirements to enhance their performance and to ensure that they are operating according to the set regulations and procedures.
The banks should also provide adequate working tools like the motorbikes to enhance timely recovery of the loans from those far distance customers. The staffing of the branches should also be increased and should be proportional to the banks customers within those areas.

Customer Specific factors that may lead to default on loans; the study recommends the following to help reduce on the loan default rates;

Information flow amongst bank staffs and their customers should be improved especially with the existence of technology that facilities faster delivery of information to customers this information may pertain the changes in the loan contract terms, interest rate changes, informing the customer that their loans have been approved or rejected etc.

The challenge of multiple borrowing can be mitigated by use of Top up loans as a replacement for multiple borrowings. In a top up loan a customer is given a lump sum loan from which the balance from the outstanding loan is recovered. Multiple borrowings resulting from other banks can be reduced through strict emphasis and supervision on the use of the Credit reference bureau.

Business failures amongst bank customers can be mitigated by frequent training on financial literacy by both the bank and the government. This will enhance the management of loan money for such businesses and increase the life span of the businesses.

From the study we recommend the following as other measured that can be used to reduce on the high default rates these are;

Avoid giving loans to repeat defaulters especially those with no genuine reasons.
For customers with genuine reasons for default, the loans can be rescheduled so as to give them a flexible payment term as compared to the previous.

The interest rates should be aligned with the macro economic factors like the inflation rates. Banks feel more comfortable increasing the interest rates during the high inflation rates but are reluctant to reduce incase the inflation rates fall.

5.4 Areas for further research
The following areas are recommended for further research.

i) Assessment of Credit reference Bureau in the reduction of loan default rates.

ii) Impact of changes in Bank loan interest rates on the borrowers
REFERENCES


Gakuu F.M (October 2012), An Investigation of Strategies Implemented to reduce Default Rates in Loan Lending Institutions (A Survey of Equity Bank Nyeri County)


Mohammad S. I , Nikhil C. S and Abdul M.M, (2005) Non performing loans - its causes, consequences and some learning, American International University, Bangladesh, East West University, Bangladesh, Stamford University Bangladesh.


Dear Respondent,

My name is Robert Kinyera a student of Makerere University pursuing a Masters of Business Administration. I am carrying out research entitled “Causes of high default rate on loans, the case of Centenary Bank”. Please spare some time and answer the questions that follow. Your response will be kept strictly confidential and will only be accessed by the research team. The information provided will only be used for academic purposes in this study. Thank you very much for your time and cooperation.

SECTION A:

Personal Data

1. Gender

Male ☐       Female ☐

2. Highest level of education attained

Certificate level ☐

Diploma ☐

Degree ☐

Other (Please specify)........................................................................................................

3. Department..................................................................................................................

4. Duration with organization/department               Age of respondent

Under 2 years ☐       20 to 30 ☐

2 to 5 years ☐       31 to 40 ☐

Over 5 years ☐       Over 40 ☐
SECTION B:

Tick in the boxes against the statement in line with your opinion

Bank specific Factors causing high default on loans

Key: 5 Strongly Agree (SA), 4. Agree (A), 3. Not sure (NS), 2 Disagree (D) and 1 Strongly Disagree (SD)

<table>
<thead>
<tr>
<th>Operational and policies</th>
<th>SD</th>
<th>D</th>
<th>NS</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 The existing bank credit policies are sufficient enough in assessing core risks and gaps that may encourage customers to default on loans payment.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 The department also identifies, assesses and prioritizes loan customers of the bank in line with the risk appetite and ease of loan recovery</td>
<td>SD</td>
<td>D</td>
<td>NS</td>
<td>A</td>
<td>SA</td>
</tr>
<tr>
<td>3 The bank has set up processes to identify and assess emerging gaps and opportunities in the loan disbursement</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 The bank tries to integrate loan risk with the value of the customers collaterals</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 The credit department has enough technical, experienced and knowledgeable staffs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 My organization has an effective credit risk management system in place</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 The existing credit reference bureau (CRB) has been very effective in giving information on customer credit history for decision making</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 There is proper motivation packages inform of incentives for loans officers who excel in loan recoveries.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 staffs are satisfied with the calculation of the monthly incentives for the credit team</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 The credit department has all the resources to ensure that customers pay their loans timely</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Supervise & Evaluate

<table>
<thead>
<tr>
<th>Supervise &amp; Evaluate</th>
<th>SD</th>
<th>D</th>
<th>NS</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>11 The credit staffs of the bank are always ethical in the execution of their duties</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 The evaluation of collaterals is done timely and in a satisfactory manner</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Management is always involved and are cooperative in ensuring customers receive their loans in time.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Section D: Customer specific factors

Key: 5 Strongly Agree (SA), 4. Agree (A), 3. Not sure (NS), 2 Disagree (D) and 1 Strongly Disagree (SD)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Loan customers are given enough information and explanations concerning the loans disbursed to them at all times</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>The changes in the bank interest rates has some impact on the loans customer payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Customer service is essential in ensuring that the loan customers pay their installments timely.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>The bank ensures that the customers get the amount he or she request for especially for business purposes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Bank System provides us with timely, reliable, accurate, meaningful and easy to use credit reports for checking on loan performance of customers and for proper decision making</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>System has tight IT controls assuring the security of the system (entering incorrect data, changing data, deleting data, destroying data, crashing systems, holding data hostage)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Procedures for acquiring loans are long, hectic and may cause delay in giving out loans to customers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
8. Delay in giving out loans to a customer who needs money urgently e.g for a contract may lead to delay in payments of the installment

9. Customers are always made aware of any changes in the terms and conditions of their loans payment in a timely manner

10. The rate of business failure especially those financed through loans are on the increase

11. The bank has training packages for their customers to help them manage their finances

What are the possible causes of the default on loans from the customers perspective.

…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………
…………………………………………………………………………………………

SECTION III: Possible solutions to reduce high default rates on loans

Key: 5 Strongly Agree (SA), 4. Agree (A), 3. Not sure (NS), 2 Disagree (D) and 1 Strongly Disagree (SD)

<table>
<thead>
<tr>
<th>No.</th>
<th>What is the solution?</th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Having a regulatory body for banks help monitor their activities and performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Customers have enough information pertaining the loans they acquire from the bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>There is usually adequate reporting on credit risk related activities at the bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>The staff of CB continuously trained in line with loans recovery and management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Infrequent performance of due diligence during loan appraisal compromises the bank’s credit risk management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Disbursing loans to a group reduces on the risk of default compared to that disbursed to an individual customer</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
7  Management is committed to publicizing information on loan defaulters in the media to expose them

8  Customer collaterals are sold timely and used to pay off the loan if customer fails to pay the loan.

9  The bank routinely trains its customers on financial literacy

10 A customer is given one loan at a time depending on his/her capacity to pay

What measures can be implemented to help banks reduce on the high default rates on loans by the customers

......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................
......................................................................................................................................................................................

Thank you very much for your time and support.