The effect of loan defaults on profitability of financial institutions in Uganda: a case study of post bank, Anaka branch, Nwoya district

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Abstract: *The study examined the relationship between borrower behavior and profitability in post bank limited Anaka branch, Nwoya District, established the relationship between borrowers' capacity on sales and profits of the post bank limited, Anaka branch, Nwoya District, and investigated the relationship between borrowers' capacity on cash flow of the post bank limited, Anaka branch, Nwoya District. The study's findings also showed a substantial correlation between borrower behavior and loan repayment performance at Post Bank Anaka, with a significantly higher standardised coefficient of determination of 0.604 than 0.20. This concurs with Nguyen's (2017) Behavioural Primacy Theory, which contends that interactions between an individual and their environment are the primary cause of common behavior. People frequently alter their behavior to adapt with environmental changes. Thus, economic, cultural, social, psychological, personal, and political aspects influence the behavior of bank borrowers: The ability and willingness of borrowers to repay the proposed loans must be thoroughly evaluated, assessed, and checked before borrowers are provided loans. Economics was the initial discipline to develop a specific theory of purchasing behavior. This would give the bank the opportunity to lower bad debts and enhance loan repayment efficiency. Also, Post Banking Anaka should make sure that the rate of interest on the loan is reasonable for the borrower and does not consume a large portion of the borrower's income, since this could encourage repayment avoidance.*

Keywords: **loan defaults and financial institutions**

Background to the Study

By converting specifically deals into loans to governments, companies, and people, financial firms play a significant role in supporting the accumulation and deployment of capital. It is unarguable that Uganda's banking industry contributes to the concentration and distribution of capital. Commercial banks have traditionally been viewed as businesses that accept deposits, extend loans, and generate profit via the discrepancy between both the costs of the former and the revenues from the latter operations (Smith, Staikouras & Wood, 2017).

Because loan repayment is rarely totally guaranteed, lending is a dangerous business. As a result of implicit contracts between lenders and borrowers, according to Brown, Falk, and Fehr (2015), banking ties can encourage diligent work and prompt payback. Also confirming the strength of long-term connections, Fehr & Zehnder (2016).

They posit that in credit markets dominated by short-term interactions, borrowers may only be motivated to repay if they know that, due to credit reporting, their current behaviour is observable by other lenders.

Since 1926, Post Bank has been in operation. It first existed as a post office division. According to the Communication Act of 1997, Post Bank Uganda Limited was established in February 1998 to take over the activities of the previous post office savings department.

On July 30, 2009, Hon. Fred Omach formally launched the Post Bank branch in Anaka. The branch extension aims to increase access to financial services for people with low incomes and those living in remote areas. As a company with limited liability, Post Bank was founded under the Corporations Act in February 1998. The Bank of Uganda oversees bank activities as part of the financial institutions. The government of Uganda owns all of Post bank Uganda. As of 2012, Post bank Uganda maintained a branch network of 33 fixed branches and 17 mobile banking units, totalling 50 branches.

PROBLEM STATEMENT

The loan management team at Post Bank Limited is in place, as are proper and understandable guidelines for managing loans that serve as the industry's top source of information and standards for loan operations. The team's goal is to assist Post Bank Limited in achieving its goals by supplying information and advice that will enable the creation and upkeep of a successful credit portfolio and identify, analyze, and reduce loan defaults that pose a threat to the financial institution's goals of profitability and sales growth (post report, 2020). similar to utilizing collateral as security for a loan, and with appropriate management and supervision.

Due to effective loan management, post bank has registered low level of loan default since loan portfolio has been one of the best performing in the microfinance industry in Uganda (microfinance, center, 2019).

Nonetheless, it is sad that the banking firm continues to encounter some bad debts and deteriorating profitability levels despite all the above steps the post bank has made to prevent loan default. It has been common to see poorly thought out credit products and

partnerships, which is a result of the micro authorised deposit - taking institution's poorly managed loan default system (Barth et al, 2018). Reduced loan default has had a negative impact on the financial institution's profitability due to rises in net loss and loss bad debts (Chijoriga, 2017). Based on this bias, this study used Post Bank as a case study to look at how loan default affects financial institutions' profitability in Uganda.

RESEARCH OBJECTIVES

The study was guided by the following objectives.
1.   To examine the relationship between borrower Behaviour on profitability in post bank limited Anaka branch, Nwoya District.
2.   To establish the relationship between borrowers' capacity on profitability of the post bank limited, Anaka branch, Nwoya District.
3.   To investigate the relationships between credit terms on profitability in post bank limited Anaka branch, Nwoya District

RESEARCH QUESTIONS

The study was guided by the following questions:
1.   What is the relationship between borrower behaviour on profitability in post bank Limited Anaka branch, Nwoya District?
2.   What is the relationship between borrower's capacities on profitability in post bank limited, Anaka branch, Nwoya District?
3.   What is the relationship between credit terms on profitability in post bank limited Anaka branch, Nwoya District?

RESEARCH METHODOLOGY

Research design
A research design is an approach outlining how the topic of study was approached. This study uses a questionnaire-based descriptive survey design. The purpose of the study is to gather data from respondents regarding the factors that contribute to loan defaults. Descriptive research's objective will be used (Mugenda and Mugenda 2019). The research employs a descriptive and correlative survey with an ex-post facto design that uses interviews and questionnaires that were given to a variety of people, as well as both quantitative and qualitative techniques of data collecting. This type of survey—a descriptive survey—is useful when a study was gathering first-hand information from respondents through interviews or questionnaires.

Study population
The study would concentrate on the employees of post bank Anaka branch. According to the human Resource records, there were 45 employees at post bank Anaka branch.

The study was carried out in Anaka town. The choice of the town is influenced by the presence of branch of Post bank limited within the town hence respondents were reached easily.

Sample size and sampling procedure
A sample size refers to the number of subjects in the sample (symbolized by n) or a subset of a population (Creswell, 2017). Based on the Krecjie and Morgan (1970) sampling table, the sample size will be 45 respondents.
 Formula for determining sample size under Krecjie and Morgan (1970)

Table 1: Krecjie and Morgan table

N	S	N	S	N	S
10	10	220	140	1200	291
15	14	230	144	1300	297
20	19	240	148	1400	302
25	24	250	152	1500	306
30	28	260	155	1600	310
35	32	270	159	1700	313
40	36	280	162	1800	317
45	40	290	165	1900	320
50	44	300	168	2000	322

Data collection method
Quantitative data
Quantitative data was collected using questionnaire survey method.
Questionnaire survey method

The questionnaire survey approach involves asking a lot of people a series of questions to gather data for a particular research (Amin, 2019). The following benefits make the questionnaire a useful tool for gathering data: It is uniform since the same phrase is used every time it is administered, and confidentiality is guaranteed by the use of a prompted system. As a result, it may address uncomfortable, immoral, or unlawful subjects. Since they are involved directly in the operations, the method was utilized to gather data from middle level personnel and other lower tier staff at the bank.

Interview method

An interview is a method of gathering data that entails asking respondents spoken questions, either one-on-one or in a group (Chaleunvong, 2019). Throughout the interview, the answers to the questions will be noted down and captured on tape.

Key informants, such as the owners and top management employees, who would be purposefully chosen because of the knowledge they contain, were gathered through in-depth interviews. The ability to construct a report with respondent during an interview gives the interviewer the following benefits: ask a follow-up question to elicit more information from the respondent, clarify their meaning, look for details they missed, and go beyond the gist of their statement; make sure the reply responds to all of the questions; deliver more difficult instructions and ensure their comprehension; among other things, change the questions' order (barker, etal,2017)

Data Collection Instruments

Questionnaires

Self-Administered Questionnaires (SAQ) were used to collect structured data from the study components. A five-point Likert scale trying to measure from Strongly Disagree as response 1, Take issue as response 2, Not sure as response 3, Agree as response 4, and Strongly Agree as response 5 was used to test perception in the SAQs. One incredibly vague issue per section was designed for SME employees to give additional or express their thoughts (Jackson, 2019).

Interview Guide

When referring to a method of gathering data, an interview is any discussion between the investigator and the received prior) over the phone, in person, or in a focus group (Creswell, 2017). Unstructured and typically open-ended questions were used in the guide to elicit detailed information from participants. Given that these individuals have extensive knowledge of taxation regulations and bank performance, this guidance made it possible to collect information from the bank and other top leadership officials in these businesses.

Data Collection Procedures

An introductory letter from Metropolitan International University research directorate was obtained after submitting the research proposal to enable the researcher to collect data from the field. Upon establishing the validity and reliability of instruments to be used, the researcher would gather raw information from the field. Data collection, processing, and analysis was undertaken by the researcher herself.

Data Analysis

Organizing, structuring, and giving meaning to the vast amount of unstructured data that was acquired in order to assess reliability and test the research questions is what this procedure entails (Sekaran, 2018). The statistical program SPSS version 23 was used to import the data for analysis. Descriptive statistics and inferential statistics were involved in quantitative data analysis. Analysis employing frequencies, percentages, means, charts, and standard deviation was included in descriptive statistics. Based on a 5-point Likert scale with strong agree to strong disagree as the extremes, the analysis of central tendency and dispersion is performed. Similar to this, inferential statistics were conducted using linear regression analysis and the Pearson's correlation coefficient. In order to assess quantitative data, summary findings were reported in numerical terms and displayed using a percent distribution technique while upholding a predetermined degree.

RESULTS

Table 1 Response Rate

	Frequency	Percentage
Response	45	93.75%
None response	03	6.25%
Total	**48**	**100**

Source: Primary data, 2021

From table 1 above, 93.75% of the respondents willingly accepted to participate in the study and 6.25% of them never involved in the study due to their known reasons. The response rate was large enough to justify the study since most of the respondents were positive and willing to give out information required. According to Mugenda and Mugenda (2018), a response rate of 70% is appropriate for the research.

BIO DATA OF THE RESPONDENTS

The respondents were asked about their important demographic characteristics which included

their gender, positions, how interest rate affect the customers of post Bank Anaka, size of the post Bank Anaka ,membership for Post Bank Anaka, age group, and the finding are presented below.

Gender of the Respondents.

Table 2: Gender respondents

Gender	Frequency	Percentage
Male	35	55.66%
Female	10	44.3%
Total	45	100

Source: Primary data, 2021

From table 2 above, 55.66% of the respondents were males and 44.3% of them were females.

The results indicate that both males and females were represented and this enabled the researcher to views from all categories of the respondents about internal control systems and financial

Table 3: Duration of the Post Bank Anaka Branch (PBAB)

Duration	Frequency	Percentage
Less than 5 years	06	13%
5-10 year	09	27%
11-15 year	18	40%
Over 15 years	12	20%
Total	45	100

Source: primary data, 2021

From table 3, the respondents were requested to indicate the period that the institution has been in the operation, from the findings, majority of the respondents pointed out that Post Bank Anaka Branch has been in operation between 11-15 years with 40% however other argued that its 5-10

Table 4: composite reliability

Latent variable	Original sample (o)	Sample mean(M)	Standard Error (STEER)	T-statistics	P-value
Borrower behaviour	0.894	0.894	0.015	59.236	0.000
Borrower commitment	1.000	1.000	0.000		
Credit administration	0.928	0.928	0.010	97.350	0.000
Credit repayment performance	0.903	0.903	0.017	53.351	0.000

Source: primary data

The results in the table 4 above indicated that all of the indicators (Borrower behaviour with 0.894, customer commitment with 1.000, credit repayment performance with 0.903 and credit administration with 0.928) have got individual indicator reliability values that are shown to be larger than 0.6 as the performed so high level of internal consistency reliability have been demonstrated in all the variable

Table 5: average variance

Latent variable	Original sample (o)	Sample mean (M)	Standard Error (STEER)	T-statistics
Borrower behaviour	0.740	0.741	0.030	24.450
Borrower commitment	1.000	1.000	0.000	
Credit administration	0.813	0.814	0.021	38.349
Credit repayment performance	0.757	0.785	0.035	21.751

Source: primary data

The results in table 4.5 above indicated square roots of AVE of each latent variable that is greater than the correlations among the latent variables Borrower Behaviour, credit administration, Borrower Commitment and Credit Repayment Performance with original samples of 0.740, 1.000, 0.813 and 0.757 respectively. Therefore the results indicate that there is a relationship between Borrower Behaviour, Credit Administration, Borrower Commitment and Credit Repayment Performance and they influence the Credit repayment performance of Post bank Anaka

Table 6: path coefficient

Latent variable	Original sample (o)	Sample mean (M)	Standard Error (STEER)	T-statistics
Borrower behaviour Borrower commitment	0.390	0.386	0.040	9.788
Borrower behaviour Credit repayment performance	0.604	**0.608**	**0.042**	**14.243**
Borrower commitment Credit repayment performance	**0.236**	**0.237**	**0.041**	**5.809**
Credit administration Borrower commitment	**0.487**	**0.491**	**0.026**	**18.961**
Credit administration **Credit repayment performance**	**0.144**	**0.140**	**0.056**	**2.584**

Source: primary data

At path coefficient, results in the table 6 indicate that there is a relationship between borrower behaviour with borrower commitment with the original sample of about 0.390, at mean of 0.386 and P-value of 0. 000>0.The results in the table also shows that there is a correlation between borrower behaviour and credit repayment performance with 0.604 and P-value of 0.000>0.5 meaning that credits repayment is highly influenced by borrower's behaviour.

Table 7: total effects of loan default

Latent variable	Original sample (0)	Sample mean (M)	Standard Error (STEER)	T-statistics
Borrower behaviour Borrower commitment	0.390	0.386	0.040	9.788
Borrower behaviour Credit repayment performance	0.697	0.700	0.033	21.158

Credit administration Borrower commitment	0.236	0.237	0.041	5.809
Credit administration **Credit repayment performance**	0.259	0.256	0.053	4.860

Source: primary data

The results in the above table indicates significant between borrower behaviour and borrower commitment with about 0.390 and a sample mean of 0.386 and P-value of 0.000>0.5.

The results also indicate between borrower behaviour and credit repayment performance with about a 0.697. With a sample mean of 0.700 and P-value 0.000>0.5. Credit administration and borrower commitment also showed the relationship with credit repayment performance with about 0.236with 0.237 sample mean and P-value of 0.000>0.5. Credit administration and borrower commitment with 0.487 with sample mean of 0.491 and P-value of 0.000>0.5. Finally, credit administration and credit repayment performance with 0.259, with a sample mean of 0.256 and P- value of

Conclusions

The researcher came to the following conclusions based on the study data, which are detailed in fourth chapter of this paper: Borrowers' behavior is rarely the consequence of a single motive. Common behavior is primarily the product of interactions between a person and their surroundings, although the borrowers' personalities are always important. Due to their perception that defaulting on loans could damage their reputation, borrowers typically avoid doing so. In order to avoid not being able to repay the loan if they do not organize and plan for it, borrowers are typically more driven to employ loan money for income-generating activities.

Customer commitment to repaying the loan is a key factor in determining loan default and payback. The level of dedication that borrowers have to meet their deadlines as stated in repayment plans has a significant impact on how well they have repaid their debt. The performance of student loan is negatively impacted by the borrowers' lack of commitment. The borrowers must be closely monitored in order to ensure successful credit payback. This entails identifying the problematic borrowers and evaluating the effectiveness of their loan use, or if the loan was actually put to the intended use. Loan repayment performance is closely correlated with the rate at which borrowers adhere to their repayment plans; the higher the engagement, the better the repayment performance, and the lower the dedication, the worse the repayment performance.

Recommendations

According to Post Bank Anaka, before granting borrowers loans, the bank must successfully evaluate, appraise, and check their ability and readiness to repay the borrowed funds. This would give the bank the opportunity to lower bad debts and enhance loan repayment efficiency. Also, Post Bank Anaka should make sure that the interest rate on the loan is reasonable for the borrower and does not consume a large portion of the borrower's income, since this could encourage repayment avoidance.

To avoid using the borrowed funds for purposes other than what they were intended, borrowers should make a strategy before borrowing. This will help them in meeting the loan repayment schedules and avoid bad debts.   More so, as a borrower, you should first understand the loaning rates, the burden and the opportunity cost of repayment of the loan, how much they will pay as interest during loan repayment as well as evaluating the performance of the business before the loan. This will act as a basis for decision making on whether to borrow or not.

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