THE RELATIONSHIP BETWEEN INTEREST RATES AND THE CREDIT PERFORMANCE OF COMMERCIAL BANKS

A CASE STUDY OF STANBIC BANK UGANDA LIMITED
(MAIN BRANCH)

BY

NAKABBA SSALI SYLVIA

05/U/9278/EXT

2050009472

SUPERVISED BY

MS. NANYANZI MARION

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DECLARATION

I Nakabba Ssali Sylvia, hereby declare that the content of this research report is original and has never at any moment been presented by any other person to a University or Institution of higher learning for any academic award.

Signature: ...................... Date: ..............................

NAKABBA SSALI SYLVIA
05/U/9278/EXT
(STUDENT)
DEDICATION

This work is dedicated to my family especially to the family of the late Mr. Kakyomya whom I have drawn great motivation to complete this course. Thank you so much for supporting me to this level of education.
APPROVAL

This research report was read and approved and is now ready for submission under my supervision as a university supervisor.

Ms. Nanyanzi Marion
Signature: ……………………… Date: ……………………………
(SUPERVISOR)
ACKNOWLEDGEMENT

To the Lord Jesus I give you the glory, work like this is impossible to accomplish single-handedly. Therefore, it is against this that I would like to express my heartfelt thanks and appreciation to the following people.

Firstly, my supervisor Ms. Nanyanzi Marion deserves special thanks for her guidance, support, insights and ideas, encouragement, and willingness to assist me whenever approached throughout this research.

Secondly, my heartfelt thanks and appreciation goes to my parents Mr. and Mrs. Ssali and my aunt Mrs. Noeline Kakyomya and my cousin Edward Ssemata for their priceless love and care. I also express my sincere gratitude to my friends namely; Emma Barigye, namakajjo Rogers, Freddie, Phionah, Irene, karyebala Patrick, kaketto frank, Irene and many more who have given me an opportunity to complete the course with invaluable memories.

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KEY TERMS USED

A variable

It is anything that can take place on differing or varying values. The value can differ at the same time for different objects or persons.

Interest rate

An interest rate is defined as the rate charged by lenders, expressed as a percentage of the principal, to borrowers of the use of assets.

Loan

A loan is an arrangement in which a lender gives money or property to a borrower, and the borrower agrees to return the property or repay the money, usually along with interest, at some future point(s) in time.

Credit performance

Credit performance entails credit standards for borrowers and counterparties, portfolio risk management, attention to changes in economic or other circumstances that can lead to a change in the credit standing of a bank's counterparties.
ABSTRACT

This study sought to establish the relationship between interest rates and the credit performance of Stanbic Bank Uganda Limited, with Stanbic Bank Uganda Limited Main Branch which is located along Kampala road as a case study.

The objectives of this study were; to determine the level of interest rates charged on loans by Stanbic Bank Uganda Limited, to establish the credit performance and loan portfolio of Stanbic Bank Uganda Limited, and to determine the relationship between interest rates and the credit performance of Stanbic Bank Uganda Limited.

The researcher used both primary and secondary sources of data. The researcher was able to distribute 30 questionnaires to respondents, and they were all returned. The researcher was however only able to interview a few respondents from the credit department of Stanbic Bank Uganda Limited because of the busy schedules of the bank employees.

The findings have shown that interest rates are the major factor affecting the credit performance of Stanbic Bank Uganda Limited, where by an increase or decrease in the level of interest rates causes a substantial change in the credit performance of these institutions. The findings also revealed that although interest rates are the major factor influencing the credit performance of Stanbic Bank Uganda Limited, other factors also affect it’s credit performance. Further, interest rates were found to have much impact on credit performance with a Pearson correlation of (r=.823**), sig.=.000), which implies that a reduction in interest rates improves on the credit performance of Stanbic Bank Uganda Limited, and vice versa.

Conclusively, the researcher analyzed the factors that affect credit performance of commercial banks in Uganda and the constraints faced. The researcher established that the market for credit services in Uganda is still very low since it is centered in developed towns, and thus the majority of Ugandans don’t have access to these services. The researcher thus established that for such individuals in rural areas, changes in interest rates and other factors that influence credit performance, do not affect their borrowing levels.

The researcher thus advised the management of Stanbic Bank Uganda Limited to carry out extensive sensitization, and to also employ stringent control measures while awarding credit.
CHAPTER ONE
INTRODUCTION

This chapter introduces the study and includes, background of the study, statement of the problem, research objective, research questions, scope of the study, and the significance of the study.

1.1 Background

An interest rate is defined by Jack Guttentag (2008) as a rate which is charged or paid for the use of money. An interest rate is often expressed as an annual percentage of the principal. Interest rates often change as a result of inflation and Federal Reserve policies. For example, if a lender (such as a bank) charges a customer Shs 90 in a year on a loan of Shs 1000, then the interest rate would be $\frac{90}{1000} \times 100\% = 9\%$. The interest rate charged is determined by; the cost of capital which includes; insurance, labor, rent, and other related costs, plus the profit margin of the lending institution.

An interest rate is also defined as the rate charged by lenders, expressed as a percentage of the principal, to borrowers for the use of assets. Interest rates typically are quoted on an annualized basis known as the annual percentage rate (Lando, 2004)

A loan is an arrangement in which a lender gives money or property to a borrower, and the borrower agrees to return the property or repay the money, usually along with interest, at some future point(s) in time. Usually, there is a predetermined time for repaying a loan, and generally the lender has to bear the risk that the borrower may not repay a loan.

The credit performance of a Commercial Bank largely depends on the level of borrowing of loans and their subsequent repayment. Many authors view borrowing as an activity that involves the taking of a risk by the lending institution, which foregoes other investment options to lend to a customer. Borrowings in Stanbic Bank Uganda are recognized initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between proceeds net of
transaction costs and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

Commercial banks dominate the financial sector in Uganda and account for over 90% of the assets of the banking system. Commercial banks provide banking facilities as well as on lending of deposits. The commercial bank system consists of the indigenous commercial banks which are dominated by Stanbic Bank, Centenary Bank and the foreign banks dominated by Standard Chartered Bank Ltd.

Over the years, commercial banks in Uganda devised means of upgrading their risk management practices. In this upgrade, commercial banks have developed methodologies, introduced more rigorous credit granting control practices to ensure effective credit risk measurement and management. There has been the establishment and launch of the Credit Reference Bureau in the first quarter of financial year 2008/2009 to improve the ability of commercial banks to screen loan applicant thus reducing credit risk. Republic of Uganda Budget Speech (Financial Year 2008/09)

There has been an increase in bank credit in the last 8 years since June 2001, by an average of 8% per year in real terms. As a share of GDP, which is a measure of the value of all activity in the economy, bank credit has doubled from 6% in 2001 to 12% in 2009. Admittedly, this is still low as compared to Kenya where the bank credit to GDP ratio is over 20%, nevertheless Uganda is moving in the right direction. Mutebire (2009)

Stanbic Bank Uganda Limited (“the bank”) is a subsidiary of Stanbic Africa Holdings Limited which is in turn owned by Standard Bank Group Limited, Africa’s leading banking and financial services group. The Standard Bank Group ranks top among South African banking groups by market capitalization and profitability. Stanbic Bank Uganda Limited is incorporated in Uganda and is a licensed commercial bank. The bank is a public limited liability company and is listed on the Main Investment Market Segment (MIMS) of the Uganda Securities Exchange on 25 January 2007. The case study for this research will be the main branch which is located on Cham towers Jinja road, Kampala.
With the growing need for performance, aligned with the drive towards profitability, an effort thus has to be made on the assessment of the factors that affect the credit performance of Commercial banks. A number of factors affect credit performance of Commercial banks, but the most dubious one is the level of interest rates especially in Uganda where sensitization of the loan seeking individuals is very low. Even with a change in the levels of interest on loans, some individuals are never affected, or concerned since the need for funds is high, coupled with the high levels of poverty, ignorance about the effect of interest changes, and also the lack of security which is usually mandatory for borrowing of loans.

According to the Stanbic Bank Uganda Limited Annual report and financial statements for the year ended 31 December 2007, there was an increase in the level of net interest income of Stanbic Bank Uganda Limited of 20.1% despite the entrance into the market of many competitors especially Micro Finance Institutions which also have the backing of Government. The Bank also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing.

With the increase in net income earned by Stanbic Bank Uganda Limited, there is a similar expectation with the credit performance, but the financial statements show an increase in the number of non performing loans by 59.4%, and an increase in the provision for the impairment of loans by 36%, a fact which calls for a study.

1.2 Statement of the problem

Net interest income (According to the Stanbic Bank Uganda Limited Annual report and financial statements for the year ended 31 December 2007), increased from Shs 88.9 billion in 2006 to Shs 106.8 billion, representing 58.8 percent of operating income. The 20.1% growth in interest income was driven by loans and advances to customers which increased from Shs 340.6 billion to Shs 477.6 billion by the end of 2007.
However, there has been a deviation in the credit performance of Stanbic Bank which is affected by the high levels of interest rates, which amount to default or bad debts as shown in the table below:

<table>
<thead>
<tr>
<th>Years</th>
<th>Interest rates</th>
<th>Loans advanced (shs)</th>
<th>Impaired loans and advances (shs)</th>
<th>Allowance for impairment (shs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>19%</td>
<td>331,021,027,000</td>
<td>1,896,052,000</td>
<td>4,618,418,000</td>
</tr>
<tr>
<td>2005</td>
<td>20%</td>
<td>475,850,507,000</td>
<td>1,549,598,000</td>
<td>6,937,066,000</td>
</tr>
<tr>
<td>2006</td>
<td>20%</td>
<td>340,612,000,000</td>
<td>1,109,197,000</td>
<td>4,965,529,000</td>
</tr>
<tr>
<td>2007</td>
<td>22.5%</td>
<td>477,590,000,000</td>
<td>1,735,583,000</td>
<td>7,741,737,000</td>
</tr>
</tbody>
</table>

The problem as seen in the table, is the increase in the level of impairment of loans by 59.3% from 2006 to 2007, an increase in the allowance for impairment of loans by 36%, and an increase of 50.2% in the level of allowance for impairment of loans in 2004 to 2005, which shows a declining credit performance, despite the increase in net interest income.

1.3 Purpose of the study

The study was focused on establishing the relationship that exists between interest rates and the credit performance in Stanbic Bank (U) Ltd

1.4 Objectives of the study

The objectives of the study included:

i. To determine the level of interest rates charged on loans by Stanbic Bank Uganda Limited.

ii. To establish the credit performance and loan portfolio of Stanbic Bank Uganda Limited.

iii. To determine the relationship between interest rates and the credit performance of Stanbic Bank Uganda Limited.
1.5 Research questions

i. What are the interest rates charged for borrowing loans in Stanbic Bank Uganda Limited?

ii. What is the credit performance and loan portfolio of Stanbic Bank Uganda?

iii. What relationship exists between interest rates and the credit performance of Stanbic Bank Uganda Limited?

1.6 Scope of the study

1.6.1 Study scope

The focus of the study was to assess the effect of changes in interest rates on borrowing levels in Stanbic Bank Uganda Limited. The interest rates were used as the independent variable, and credit performance as the dependent variable.

1.6.2 Geographical scope

The research was limited to Credit department and Business Banking department of Stanbic Bank Uganda Limited (Main Branch) which is located on Cham Towers Jinja Road, Kampala, since this is where the problem exists, and also because the main branch is in a better position to provide information about the subject.

1.6.3 Time scope

The study covered the Annual reports of Stanbic Bank Uganda Limited for the period 2004 – 2008, because it’s during this period that a high level of loan impairment was carried out, thus affecting the credit performance of the Bank.
1.7 Significance of the study

- **Management of Stanbic Bank Uganda Limited**
  Management of Stanbic Bank Uganda limited will be provided with reliable information about the relationship that exists between interest rates and the credit performance of Commercial Banks.
  The management will in addition be availed with information regarding various ways of improving the credit performance of the organization.
  The information provided from this research will enable the management to create more efficient budgets which will be focused on the most vital areas needed to improve credit performance.
  The researcher will further provide management with reliable information about ways of improving sales performance.

- **Researcher**
  The study will enable the researcher to acquire skills on research and will enable her to conduct successful interviews in the future. In addition, this will be a formulation for future research during a professional career, which the researcher is pursuing.
  The research will enable the researcher to fulfill the partial requirement for the award of Bachelor of Commerce.
  The study will help the researcher to gain an insight in credit risk management, practical experience in research which will enable her exploit different opportunities and overcome challenges within the working environment.

- **Future researchers**
  Research students will also be able to use this study for reference both in class and while carrying out research related studies.
1.8 Conceptual Framework

**Independent Variable**
- Interest rates
- Advertising
- Marketing
- Loan Culture
- Security
- Advance period

**Dependent Variable**
- Credit performance
- Sales Performance
- Financial position
- Profitability
- Working Capital

**Intervening Variable**
- Loans advanced
- Loans impaired
- Return on Capital

Source: Adapted from the Financial Structure Database as described by Beck, Demirgüc-Kunt and Levine (2000)

**Interest rates:** It is presumed that a decrease in the level of interest rates required for loan repayment corresponds with an increase in the credit performance of the firm.

**Advertising:** This increases awareness about loan packages/products offered by the firm, and this is in turn causes an increase in the number of people who apply for loans from the bank.

**Marketing:** Increased aggressive marketing for the firm can create awareness about the loan packages/products offered by the firm, and thus leading to an increase in the sale of loan products.

**Loan culture:** The loan culture affects the level of credit performance in a way that; where a favorable loan culture exists, the credit performance will be good.
Security: The security demanded when loans are awarded also affects the firm’s level of credit performance since a large number of people in Uganda and other developing countries lack the assets demanded by banks as security against loans awarded.

Advance period: The advance period simply means the time given to clients to pay back loans. The effect of this period on the credit performance of a firm is that; ‘the longer the advance period, the higher the interest returned’, which directly relates to improved credit performance. A shorter advance period on the other hand mitigates the credit risk faced by such lending firms.

Loans advanced: This is the benchmark for the credit performance of the company. An increase in the loans advanced by the company signifies an improved credit performance and vice versa.

Loans impaired: An increase in the level of loans impaired signifies poor credit performance of the firm.

Credit performance: The independent variable in this study is the credit performance of Stanbic Bank Uganda Limited. This is determined by the number of loans advanced or impaired, and highly depends on the interest levels.

Sales performance: Interest rates may also affect the sales performance of organizations whereby; an increase in the rate of interest impairs the sales performance of these organizations. For instance, if the interest rate charged on mortgages is increased, less people will be able to afford such mortgages, and thus the sales performance of mortgages will be impaired.

Financial position: With a reduction in sales of an organization due to an increase in interest rates, the financial position of this organization will more likely follow the same declining trend. The financial position of a firm usually looks healthy when it can meet its short and long term expenditures, and it is thus dependent on the sales levels.

Profitability: Profitability simply refers to a situation where a firm’s revenues are greater than it’s expenditures. When interest rates are reduced, sales revenues increase due to the increase in demand of credit facilities. This on the other hand has a positive impact on the profitability of the firm.
1.9 Relationship between interest rates and the credit performance

An increase in the level of interest rates is presumed to cause a reduction in the level of loans advanced and thus leading to poor credit performance, while a reduction in interest rate levels improves the credit performance of banks. Kyagulanyi d (2008), Several empirical studies including, Kyagulanyi d (2008), bank portfolio management in commercial banks, Kakuru Julius (2000) Financial decisions and the business, Lando, David (2004) Credit Risk Modeling, and Kellison, Stephen G (1970) The Theory of Interest have found that there is a strong relationship between interest rates and the credit performance of commercial banks.
CHAPTER TWO
LITERATURE REVIEW

Introduction

In this chapter, review of literature is done in accordance with the study variables. This chapter thus entails the theory of different scholars in relation to interest rates and borrowing levels in commercial banks.

2.1 Level of interest rate charged by Stanbic Bank (U) Ltd

2.1.1 Interest rates

Interest is a fee paid on borrowed assets. It is the price paid for the use of borrowed money or, money earned by deposited funds. Assets that are sometimes lent with interest include money, shares, consumer goods through hire purchase, major assets such as aircraft, and even entire factories in finance lease arrangements. (Lando, 2004)

David (2004) asserts that the interest is calculated upon the value of the assets in the same manner as upon money. Interest can be thought of as "rent of money". When money is deposited in a bank, interest is typically paid to the depositor as a percentage of the amount deposited; when money is borrowed, interest is typically paid to the lender as a percentage of the amount owed. The percentage of the principal that is paid as a fee over a certain period of time (typically one month or year), is called the interest rate.

Interest is compensation to the lender, and for forgoing other useful investments that could have been made with the loaned asset. These forgone investments are known as the opportunity cost. Instead of the lender using the assets directly, they are advanced to the borrower. The borrower then enjoys the benefit of using the assets ahead of the effort required to obtain them, while the lender enjoys the benefit of the fee paid by the borrower for the privilege. The amount lent, or the value of the assets lent, is called the principal. This principal value is held by the borrower on credit. Interest is therefore the price of credit, not the price of money as it is commonly believed. (Kakuru, 2000)
2.1.2 Types of interest

Simple interest

Simple interest according Donald (2003), is calculated only on the principal amount, or on that portion of the principal amount which remains unpaid. The amount of simple interest is calculated according to the following formula:

\[ I_{\text{simp}} = (r \cdot B_0) \cdot m \]

Where;
- \( r \) - Is the period interest rate (\( I/m \)),
- \( B_0 \) - the initial balance and \( m \) the number of time periods elapsed.

A bank account offering only simple interest and from which money can freely be withdrawn is unlikely, since withdrawing money and immediately depositing it again would be advantageous. (Kyagulanyi, 2008)

Compound interest

According to Kyagulanyi (2008), compound interest is very similar to simple interest; however, with time, the difference becomes considerably larger. This difference is because unpaid interest is added to the balance due. Put another way, the borrower is charged interest on previous interest. Assuming that no part of the principal or subsequent interest has been paid, the debt is calculated by the following formulas:

\[ I_{\text{comp}} = B_0 \cdot \left[ (1 + r)^m - 1 \right] \]
\[ B_m = B_0 + I_{\text{comp}} \]

Where;
- \( I_{\text{comp}} \) - Is the compound interest, \( B_0 \) the initial balance,
- \( B_m \) - Is the balance after \( m \) periods (where \( m \) is not necessarily an integer)
- \( r \) – This represents the period rate

A problem with compound interest is that the resulting obligation can be difficult to interpret. To simplify this problem, a common convention in economics is to disclose the interest rate as
though the term were one year, with annual compounding, yielding the effective interest rate. However, interest rates in lending are often quoted as nominal interest rates. (Donald, 2003)

**Fixed and floating rates**

Commercial loans generally use simple interest, but they may not always have a single interest rate over the life of the loan. Loans for which the interest rate does not change are referred to as fixed rate loans. Loans may also have a changeable rate over the life of the loan based on some reference rate. (Pandey, 1995)

Combinations of fixed-rate and floating-rate loans are possible and frequently used. Loans may also have different interest rates applied over the life of the loan, where the changes to the interest rate are governed by specific criteria other than an underlying interest rate. An example would be a loan that uses specific periods of time to dictate specific changes in the rate, such as a rate of 5% in the first year, 6% in the second, and 7% in the third. (Lando, 2004)

**Cumulative interest (return)**

The calculation for cumulative interest is (FV/PV)-1. It ignores the 'per year' convention and assumes compounding at every payment date. It is usually used to compare two long term opportunities. (Donald, 2003)

**2.1.3 Composition of interest rates**

Gregory (2009) noted that, in economics, interest is considered the price of credit, therefore, it is also subject to distortions due to inflation. The nominal interest rate, which refers to the price before adjustment to inflation, is the one visible to the consumer. He further added that Nominal interest is composed of the real interest rate plus inflation, among other factors. A simple formula for the nominal interest is:

\[ i = r + \pi \]
Where;

\(i\) - Is the nominal interest

\(r\) - Is the real interest and \(\pi\) is inflation

This formula attempts to measure the value of the interest in units of stable purchasing power. However, if this statement were true, it would imply at least two misconceptions. First, that all interest rates within an area that shares the same inflation (that is, the same country) should be the same. (Donald et al, 2003)

Lando (2004) asserts that the reason behind the difference between the interest that yields a treasury bond and the interest that yields a mortgage loan is the risk that the lender takes from lending money to an economic agent. In this particular case, a government is more likely to pay than a private citizen. Therefore, the interest rate charged to a private citizen is larger than the rate charged to the government.

To take into account the information asymmetry aforementioned, both the value of inflation and the real price of money are changed to their expected values resulting in the following equation:

\[ i_t = r_{(t+1)} + \pi_{(t+1)} + \sigma \]

Here,

\(i_t\) - Is the nominal interest at the time of the loan

\(r_{(t+1)}\) - Is the real interest expected over the period of the loan

\(\pi_{(t+1)}\) - Is the inflation expected over the period of the loan and \(\sigma\) is the representative value for the risk engaged in the operation.
2.1.4 Determinants of interest rates

Opportunity cost

This encompasses any other use to which the money could be put, including lending to others, investing elsewhere, holding cash, and simply spending the funds. (Pandey, 1995)

Inflation

Since the lender is deferring his consumption, he will at a bare minimum, want to recover enough to pay the increased cost of goods due to inflation. Because future inflation is unknown, there are three tactics. (Pandey, 1995)

Charge X% interest 'plus inflation'. Many governments issue 'real-return' or 'inflation indexed' bonds. The principal amount or the interest payments are continually increased by the rate of inflation. See the discussion at real interest rate.

Decide on the 'expected' inflation rate. This still leaves both parties exposed to the risk of 'unexpected' inflation.

Allow the interest rate to be periodically changed. While a 'fixed interest rate' remains the same throughout the life of the debt, 'variable' or 'floating' rates can be reset.

Default

According to Ward (2009), there is always the risk the borrower will become bankrupt, abscond or otherwise default on the loan. The risk premium attempts to measure the integrity of the borrower, the risk of his enterprise succeeding and the security of any collateral pledged. For example, loans to developing countries have higher risk premiums than those to the US government due to the difference in creditworthiness. The creditworthiness of businesses is measured by bond rating services and individual's credit scores by credit bureaus. (Hommer, 1996)
The risks of an individual debt may have a large standard deviation of possibilities. The lender may want to cover his maximum risk, but lenders with portfolios of debt can lower the risk premium to cover just the most probable outcome. (Pandey, 1995)

**Deferred consumption**

Charging interest equal only to inflation will leave the lender with the same purchasing power, but he would prefer his own consumption sooner rather than later. There will be an interest premium of the delay. He may not want to consume, but instead would invest in another product. The possible return he could realize in competing investments will determine what interest he charges. (Willem, 2009)

**Length of time**

Shorter terms have less risk of default and inflation because the near future is easier to predict. Broadly speaking, if interest rates increase, then investment decreases due to the higher cost of borrowing. (Donald, 2003)

**Government intervention**

According to Pandey (1995), interest rates are generally determined by the market, but government intervention - usually by a central bank - may strongly influence short-term interest rates, and is used as the main tool of monetary policy. The central bank offers to buy or sell money at the desired rate and, due to their control of certain tools they are able to influence overall market interest rates.

*The Federal Reserve (Fed)* implements monetary policy largely by targeting the federal funds rate. This is the rate that banks charge each other for overnight loans of federal funds. Federal funds are the reserves held by banks at the Fed. (Pandey, 1995)

*Open market operations* are one tool within monetary policy implemented by the Federal Reserve to steer short-term interest rates. For instance; using the power to buy and sell treasury securities, the Open Market Desk at the Federal Reserve Bank of New York can supply the market with dollars by purchasing T-notes, hence increasing the nation's money supply.
By increasing the money supply or Aggregate Supply of Funding (ASF), interest rates will fall due to the excess of dollars banks will end up with in their reserves. Excess reserves may be lent in the Fed funds market to other banks, thus driving down rates. (Kakuru, 2001)

The researcher generally concurs with the findings of previous authors regarding the determinants of interest rates which include; opportunity cost, length of time, inflation, default, government intervention, and deferred consumption. The authors however ignore the effect of other social economic factors on the level interest rates, and these may include; the political stability of the country, the number of competitors in the market, the perception towards credit in a country, the level of sensitization of the population about credit, corruption levels, and the level of economic stability.

2.1.5 Interest rates and credit risk

It is increasingly recognized that the business cycle, interest rates and credit risk are tightly interrelated. The Jarrow-Turnbull model was the first model of credit risk which explicitly had random interest rates at its core. Lando (2004), Darrell Duffie and Singleton (2003), and van Deventer and Imai (2003) discuss interest rates when the issuer of the interest-bearing instrument can default.

2.2 Credit performance and Loan Portfolio of Stanbic Bank (U) Ltd

The Credit performance of banking organizations entails a number of activities and is thus influenced by a wide range of factors ranging from interest rates, poor credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic and other circumstances. A large number of authors have written in support of the assertion that interest rates affect the credit performance of commercial banks, an assertion which the researcher intends to critically study.

A loan portfolio generally refers to the clientele base/ structure of borrowers especially of loans. The researcher seeks to establish the loan portfolio of Stanbic Bank Uganda Limited in order to ascertain the clientele base of the firm, and in this way determine the factors that lead such
groups to the bank. A particular emphasis is however to be placed on the influence of interest rates on such decisions.

### 2.2.1 Credit performance

While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties. (David, 2004)

### 2.2.2 Loan

Like all debt instruments according to Kellison (1970), a loan entails the redistribution of financial assets over time, between the lender and the borrower. In a loan, the borrower initially receives or borrows an amount of money, called the principal, from the lender, and is obligated to pay back or repay an equal amount of money to the lender at a later time.

Donald (2003) notes that, typically, the money is paid back in regular installments, or partial repayments; in an annuity, each installment is the same amount. Acting as a provider of loans is one of the principal tasks for financial institutions. For other institutions, issuing of debt contracts such as bonds is a typical source of funding.

### 2.2.3 Types of loans

**Secured**

A secured loan is a loan in which the borrower pledges some asset as collateral for the loan. (Kakuru, 2001)

*A mortgage loan* is a very common type of debt instrument, used by many individuals to purchase housing. In this arrangement, the money is used to purchase the property. The financial institution, however, is given security a lien on the title to the house until the mortgage is paid off.
in full. If the borrower defaults on the loan, the bank would have the legal right to repossess the house and sell it, to recover sums owing to it. (Kakuru, 2001)

_A stock hedge loan_ is a special type of securities lending whereby the stock of a borrower is hedged by the lender against loss, using options or other hedging strategies to reduce lender risk. (Kakuru, 2001)

_A pre-settlement loan_ is a non-recourse debt; this is when a monetary loan is given based on the merit and awardable amount in a lawsuit case. Only certain types of lawsuit cases are eligible for a pre-settlement loan. This is considered a secured non-recourse debt due to the fact that if the case reaches a verdict in favor of the defendant the loan is forgiven. (Kakuru, 2001)

**Unsecured**

Unsecured loans are monetary loans that are not secured against the borrower's assets. These may be available from financial institutions under many different guises or marketing packages: Credit card debt, Personal loans, Bank overdrafts, Credit facilities or lines of credit, corporate bonds. (Donald, 2003)

**Demand**

Demand loans are short term loans that are atypical in that they do not have fixed dates for repayment and carry a floating interest rate which varies according to the prime rate. They can be "called" for repayment by the lending institution at any time. Demand loans may be unsecured or secured. (Donald, 2003)

**2.2.4 Loan payment**

The most typical loan payment type is the fully amortizing payment in which each monthly rate has the same value overtime. (Kakuru, 2001)
2.2.5 Credit risk management

Buiter (2009) defines credit risk as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization.

Kakuru (2000) states that, credit management policy is a framework formulated by an organization as a guide to credit decisions. He further adds that, credit policies are actions designed to minimize costs associated with credit. It thus involves guidelines on the analysis of the credit worthiness of a customer, terms and conditions of credit and assessment of the ability to monitor.

Glover (1999) also said that an effective credit policy begins with an understanding of the financial exposure that an individual or their business can endure, and the amount of working capital that one is willing to risk.

2.2.6 Factors considered before credit is given

Kakuru (2001) states that in order to estimate the probability of default, the financial manager should consider the following aspects usually referred to as the 4C’s;

Character: this relates to the willingness of the customer to settle his obligation. In making analysis about the customer’s character the following aspects are considered, namely; bank reference, marital status, attachment to government agencies, level of education, stability of employment, and historical background. (Kakuru, 2001)
Capacity: this is the ability of the customer to pay the credit advanced to him. When analyzing the capacity, the manager should look at financial statements, previous experience with the client, trade references, and the amount and purpose of the credit. (Willem, 2009)

Capital: this is the contribution or interest of the customer in his business and is shown by the formula; capital= assets-liabilities. It therefore refers to the financial resources that a company may have in order to deal with its own debt. (Kyagulanyi, 2008),

Capacity: this includes the assessment of prevailing economic conditions and other factors like social and political, which may affect the customer’s ability to pay. It therefore refers to the external conditions surrounding the business that you are analyzing. (Kakuru, 2001)

Collateral: this is security against failure to pay, the person seeking credit offers this security before credit is granted, and security should be safe and easily marketable.

The researcher concurs with Kakuru (2001) and Kyagulanyi (2008) regarding the criteria considered before credit is given to borrowers. For credit to be given, an individual must have some collateral, have the capacity to pay (which is attained through bank reference, marital status, attachment to government agencies, level of education, stability of employment, and historical background), Capacity to pay, and Capital. All these requirements enable the bank to highly mitigate credit risk.

However, due to the increasing level of competition, other factors not mentioned by the above authors have of recently been considered before credit is given. These may include; reference from the Credit reference bureau, duration of work and salary, reputation of the firm, and borrowing history.

2.3 Relationship between interest rates and the credit performance of commercial banks

The study of the relationship between interest rates and the credit performance of commercial bank and other financial institutions has been the central issue in relationship marketing and financial analysis as well as business-to-business marketing literature.
The debate that interest rates influence the credit performance of Commercial Banks has been raging on since the financial and economic crisis period of the 1970s and early 1980s, and the period of economic reforms. There are a variety of interest rates namely; lending/borrowing, deposit rate, bank rates among others. This study however focuses on lending rates.

One of the provocative questions in the banking sector is on its relatively high interest rates. Albeit microfinance commendation of mitigating wide interest rate variation of about 50 per cent between formal financial institutions and moneylenders, (Armendariz de Aghion and Morduch 2005), spatial differences within the sector have incited concerns. Rosenberg et al. (2009) estimate an average interest rate yield of 30 per cent and based on some benchmarking analysis conclude that microfinance lending rates are not usurious.

In a related argument, Paranjape (2008) questions the interest rate rigidity of microfinance institutions in an era of low and changing lending rates. While repayment rates in the banking sector provide an indication of the customer response to changes in interest rates, examining the joint effect of the latter and income levels of entrepreneurs on demand for loan size and thus credit performance will yield detailed information.

The pricing of loan amount theoretically depends on the cost of funds, transaction cost, Investment income, and mark-up. However, there are two issues which make a distinct difference in microfinance. The first tries to disentangle the role of subsidies that is very much present in microfinance operations.

Microfinance practitioners, aware of the effect of subsidies, have either discounted subsidies at the outset or mitigate its effect through an exit approach over time. Either of these approaches is not a familiar practice in traditional banking and evidence of adverse consequences in the microfinance market abound. (Morduch, 1999)

Empirical studies indicate that high loan repayment occurs more in Asia than in Africa. High loan repayment performance of 80% - 98.6% was reported in four finance institutions in Asia. The Bank for Agriculture and Agriculture operatives in Thailand, The Badan Kredit, and Bank Rakyat in Indonesia, and the Gramoan Bank in Bangladesh. According to Yarca (2004), three factors attributed this namely; the awarding of loans done much faster, the use of existing social
structures and peer groups to ensure prompt repayment, and the rigid structure of loan awarding and repayment.

The prescription of the McKinnon Shaw shows that a low real interest rate is a disincentive to savings, thereby reducing availability of credit. The Mackinnon-Shaw hypothesis was criticized by Stiglitz and Weis (1981) and Besley (1994) who are of the view that interest rates cannot function as an allocator of credit because borrowers with higher risk are may be considered rather than those who are good for business with lower risk.

According to Stiglitz and Weis (1981), high interest rates lead to adverse selection of loan seekers and this in the end affects loan repayment, and thus credit performance of the firm. Besley and Coase (1995) further asserted that the borrowing and repayment rate cannot be 100% even when interest rates are very favorable. This they attributed to be due to the existence of other factors affecting credit performance of banks like; the political situation of countries, inflationary conditions, economic conditions, and others.


Kakuru Julius (2000) further notes that, interest rates can be reliably used as competitive tool in the financial industry.

Areas for further work point to the use of extensive datasets to explore bi-causality between loan amount and its price in the case repeated loans. Also issues of effective interest rate and higher-order interactive terms, which include repayment rate, loan schedules, and economic activity will offer in-depth policy direction for practitioners of client responsiveness to a blend of strategies. (Morduch, 1999)
2.4 Conclusion

From the above literature review, the majority of authors/writers assert that changes in interest rates largely affect the credit performance of commercial banks. This in theory concurs with the researcher’s opinion, and thus means that an increase in the interest rate charged for borrowing loans will definitely lower the credit performance of the firm, whereas a decrease in the interest rates will lead to an improvement in the credit performance of the firm, since more people will borrow at lower interest rates.

However, much as the writers have analyzed interest rates and the credit performance of commercial banks, very few have paid attention to the relationship that actually exists between the two variables. In addition, the aspect of credit performance is not well defined by the majority of researchers, and this made it difficult for the researcher to get an overall view of credit performance in commercial banks, especially in Africa since the majority of researchers are based in Europe and America. The researcher also believes that even though interest rates a big role in credit performance of commercial banks, they may not entirely affect the credit performance of the firm since there are also a large number of other factors that are important.

Consequently, the researcher is to venture more into establishing the relationship between interest rates and the credit performance of commercial banks, and in addition attempt to devise solutions to poor credit performance of commercial banks in this study.
CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter puts an emphasis on the data collection methods the researcher used and the nature of the data analysis. It specifically presents the study design, area of study, population, sample size and selection method, sources of data, data collection techniques, data processing and analysis. It also looked at the problems encountered in the study.

3.2 Research Design and Strategy

The study was focused on the relationship between interest rates and the credit performance of commercial banks, with Stanbic Bank Uganda as a case study. The researcher used descriptive and analytical research tools basing on the findings of the questionnaires and interview guide which were used in collecting data. The descriptive research design is a research tool where a phenomenon is critically described the way it is, while analytical research design involves in-depth analysis of a research phenomenon.

3.3 Study Area

The study was focused on the relationship between the interest rates charged by Stanbic Bank Uganda Limited and credit performance.

3.4 Study Population

This involved the Head of Credit, credit evaluation managers, and administrators, who were directly involved in the credit process.
3.5 **Sampling procedure and techniques**

The sample size was selected according to the number of respondents found in the department of interest in the firm. A random sample of 30 people was selected on the basis of respondents who were directly involved in the variables of the research topic. Simple random sampling was employed in instances where all the respondents in a certain department proved to be key to the study. Simple random sampling involves the selection of a predetermined number of respondents using random selection. This method was used since it mitigates the possibility of bias regarding the response to questions.

3.6 **Sample Size**

A random sample of 30 people was in the end be selected on the basis of respondents who were directly involved in the variables of the research topic.

**Table 1: Sample Size**

<table>
<thead>
<tr>
<th>Respondents</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Heads of Departments</td>
<td>10</td>
</tr>
<tr>
<td>Loan Officers</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>30</strong></td>
</tr>
</tbody>
</table>

Source: Primary data

3.7 **Data Sources**

Information was obtained from two sources of data namely; primary data sources and secondary data sources.

3.7.1 **Primary sources**

This is the kind of data that was collected directly from the field of study, and had never been published anywhere else. The most important component here were interview, observation and questionnaires.
3.7.2 Secondary sources

Secondary data is the kind of data that is sourced from the works of other researcher's who have previously extensively studied the same or similar topic as the researcher. The important sources were publications about credit performance, and various libraries like the one at Makerere University, British council Library, newspapers and other journals. Important information was also obtained from the internet, especially from online journals and news papers.

3.8 Data collection Methods and Tools

- **Interviews**

  An interview is a method of data collection which involves verbal interaction between the researcher and respondents. An interview can either be carried out face to face with the respondent or through telephone calls. The researcher used both face to face interviews and telephone interviews in collecting data, and this was the main source of primary data. In addition to this informal discussions held helped to produce information to supplement that, got from the formal methods.

- **Questionnaire**

  The use of questionnaires is a method of data collection which entails the use if structured direct and indirect questions which are formulated and printed on a piece of paper or sent through email to respondents who then answer the questions with or without the presence of the researcher. This method of data collection was to be selected since it avails extensive amounts of data since it is filled at the discretion of the respondents. Primary data was thus collected using self-administered, structured questionnaires both open and closed ended. Detailed questionnaires concerning various aspects of the study were in addition issued to the respondents selected for the study.

3.9 Investigation procedure
The researcher initially got a letter of introduction from the Faculty, then presented it to the management of Stanbic Bank Uganda Limited. Then she got permission from the management of the to carry out research on their premises. Questionnaires were used to a selected sample of 30 respondents, and interviews scheduled. The researcher then collected the questionnaires from the respondents and data was proceeded and analysis.

3.10 Data Processing, presentation and analysis

- **Data Processing:** The data was processed through using statistical software (SPSS), calculators, and graphical methods. Prior to processing, the data was sorted, edited, coded and tabulated.

- **Data Presentation:** The data was then summarized and presented in simple statistical diagrammatical, tabular and graphical representations, from which conclusions were made at the end of the study.

- **Data Analysis:** Data analysis was done using both qualitative and quantitative methods, and this took the form of tabulation and summarization of data. Due to the nature of the study, quantitative data was analyzed using computer packages like SPSS, while qualitative data was analyzed manually. In addition, other methods of analysis like Pearson’s Correlation were also applied especially when it came to determining the relationship between the variables.

3.11 Limitations of the study

- Respondents were at times not cooperative hence it was hard to get the needed information out of them. Members of Stanbic bank staffs were not easy to meet especially due to their busy schedules; appointments had to be made, coupled with waiting for long hours for them on days of these appointments. The researcher attempt to solve this limitation by; The researcher designed indirect questionnaires, which the respondents filled without a lot of hesitation, appointments were also scheduled with members of staff as early as possible to give room for any unexpected changes in schedule, flexible ways of interviewing the respondents were also adopted for instance; through email, telephone, and off the working
premises, the researcher also availed the respondents with questionnaires at least two weeks before physically meeting them for an interview in order to give them ample time to study the topic, the researcher also fully elaborated to the Managers and staff the benefits to be availed to the company through this research in order to draw their support for it.

- Time: the time within which the study was to be completed was short brought about by the semester system used by Makerere University. The problem was that a lot of time was devoted to the completion of the study leaving other academic deeds with very little time devoted to them.

  The researcher attempted to solve this limitation by; The researcher was cautious about time management and proper planning, the researcher also availed the respondents with questionnaires at least two weeks before physically meeting them for an interview in order to give them ample time to study the topic, the researcher also scheduled appointments with the respondents at least three weeks before physically visiting the company premises.

- Financial constraints were also faced by researchers, who needed to gather information, print, photocopy, and also commute to the research venue almost daily. The researcher solved this limitation by; Using the funds available sparingly, and more funds sought to overcome this vice, telephone interviews were also adopted which enabled the researcher to reduce on the costs associated with transportation to and from the company premises, a variety of information bases were utilized in order to reduce on the cost involved in collecting secondary information (for instance, the Makerere University Main Library was fully utilized, also the various computer laboratories around the University), the researcher also attempted to solve this problem by designing precise and well designed questionnaires, which reduced on the printing costs.
CHAPTER FOUR

PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS

4.1 Introduction

The purpose of this study was to establish the relationship between interest rates and the credit performance in Stanbic Bank (U) Ltd. The study was carried out at the Head Quarters of Stanbic Bank Uganda Limited located on Kampala Road, Kampala District in Uganda. The study was guided by the following objectives:

i. To determine the level of interest rates charged on loans by Stanbic Bank Uganda Limited.

ii. To establish the credit performance and loan portfolio of Stanbic Bank Uganda Limited.

iii. To determine the relationship between interest rates and the credit performance of Stanbic Bank Uganda Limited.

4.2 PERSONAL DETAILS OF RESPONDENTS

This section shows the age of respondents, their gender, and level of education.

4.2.1 Age distribution of employees

Respondents were asked to state their age and the following data was obtained.

Table 2: Age distribution

<table>
<thead>
<tr>
<th>Age</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>11 – 20</td>
<td>11</td>
<td>37</td>
<td>37</td>
<td>37</td>
</tr>
<tr>
<td>21 – 30</td>
<td>15</td>
<td>50</td>
<td>50</td>
<td>87</td>
</tr>
<tr>
<td>31 – 40</td>
<td>4</td>
<td>13</td>
<td>13</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary data
From table 2 above, it is seen that 50% of the respondents who work in the credit department of Stanbic Bank Uganda Limited are within the age group 31 – 40 which is related to the employment policy of Stanbic Bank Uganda Limited which requires that all staff recruited should be at least holders of a Bachelors degree coupled with a working experience of not less than two years, followed by those in age group 21 – 30 at 37% and 13% of the respondents were above 41 years.

4.2.2 Gender of respondents

Respondents were asked to state their gender and the following information was obtained.

<table>
<thead>
<tr>
<th>Table 3: Gender</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender</td>
</tr>
<tr>
<td>--------</td>
</tr>
<tr>
<td>Valid</td>
</tr>
<tr>
<td>Male</td>
</tr>
<tr>
<td>Female</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

*Source: Primary data*

From table 3, it can be noted that the Stanbic Bank Uganda Limited employs both male and female employees, although the majority are male being represented by 60%, while the female are represented by 40%. The researcher established that reason for the high number of male respondents is mainly due to the fact that business related professions for have for a long time been associated to the males, although the number of women taking them up is steadily rising.
4.2.3 Level of education

Respondents were asked to identify their education levels and below are the responses.

**Table 4: Level of education**

<table>
<thead>
<tr>
<th>Education Level</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Secondary</td>
<td>5</td>
<td>17</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Tertiary</td>
<td>25</td>
<td>83</td>
<td>83</td>
<td>100</td>
</tr>
<tr>
<td>University</td>
<td>17</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>30</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>30</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
<td></td>
</tr>
</tbody>
</table>

*Source: Primary data*

Table 4 shows that 83% of the respondents are university graduates, followed by 17% from tertiary institutions. The possible reason for the majority of the respondents having degrees is due to the strict company policy of hiring graduates, which means that Stanbic Bank Uganda Limited considers education and experience highly when selecting its employees.

4.3 Interest rate charged by stanbic bank uganda

4.3.1 Changes in interest rates

Respondents were asked to indicate whether there are changes in the interest rates charged by Stanbic Bank Uganda Limited and the following data was obtained.
Table 5: Changes in interest rates

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Yes</td>
<td>26</td>
<td>87</td>
<td>87</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>4</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>30</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Primary data

Table 5 above shows that 87% of the respondents agree that there were changes in the level of interest rates over the last three years, while 13% do not agree. This shows that data used within this period is relevant to the study since the changes in interest rates can be compared to the credit performance of Stanbic Bank Uganda Limited.

4.3.2 Determinants of interest rates

Respondents were asked whether Interest rates are mainly determined by the market conditions and below are the responses.

Table 6: Determinants of interest rates

<table>
<thead>
<tr>
<th>Interest determination</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>15</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Agree</td>
<td>5</td>
<td>17</td>
<td>17</td>
<td>67</td>
</tr>
<tr>
<td>Disagree</td>
<td>3</td>
<td>10</td>
<td>10</td>
<td>77</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>5</td>
<td>17</td>
<td>17</td>
<td>94</td>
</tr>
<tr>
<td>Others</td>
<td>2</td>
<td>6</td>
<td>6</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary data

Table 6 indicates that 50% of the respondents strongly agree that market conditions determine interest levels charged by Stanbic Bank Uganda Limited, followed by 17% who also agree that market conditions determine interest rate levels. However, 17% of the respondents strongly
disagree that market conditions determine interest rate levels, while 10% similarly disagree. 6% of the respondents were not sure. This implies that even though market conditions are forwarded by the majority of respondents as the major determinant of interest rates, other factors are also highly influential as shown by the respondents who disagree.

4.3.3 Uniformity of interest rates

Respondents were asked whether Interest rates charged for different loan types are uniform and the following responses were obtained.

Table 7: Uniformity of interest rates

<table>
<thead>
<tr>
<th>Uniformity of interest rates</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly Agree</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agree</td>
<td>10</td>
<td>33</td>
<td>33</td>
<td>33</td>
</tr>
<tr>
<td>Disagree</td>
<td>20</td>
<td>67</td>
<td>67</td>
<td>100</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>30</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary data

Table 7 shows that 67% of the respondents strongly disagree that interest rates charged for different loans are uniform, whereas 33% disagree. This implies that different interest levels are charged for different loan types, which may be due to the fact that different loan types are custom designed for different clientele.
4.4 Loan portfolio and credit performance of Stanbic Bank Uganda Limited

4.4.1 Type of Clients

Respondents asked to indicate the main category of clients that they deal with and the following data was obtained.

Table 8: Type of Clients

<table>
<thead>
<tr>
<th>Client</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individuals</td>
<td>5</td>
<td>17</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Small Firms</td>
<td>13</td>
<td>43</td>
<td>43</td>
<td>60</td>
</tr>
<tr>
<td>Large Firms</td>
<td>8</td>
<td>27</td>
<td>27</td>
<td>87</td>
</tr>
<tr>
<td>Others</td>
<td>4</td>
<td>13</td>
<td>13</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary data

Table 8 above shows that the majority of clients Stanbic Bank Uganda Limited deals with are small firms with 43%, followed by large firms with 27%, 17% for individuals, and the rest were not sure. This implies that the small and large firms are the biggest contributors to the credit performance of Stanbic Bank Uganda Limited and should thus be given special attention. Other clients should however be sought to increase their contribution.

4.4.2 Frequency of loans awarded

Respondents were asked whether Stanbic Bank Uganda Limited frequently gives loans to clients and the following data was obtained.
Table 9: Frequency of loans awarded

<table>
<thead>
<tr>
<th>Loans awarded</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>20</td>
<td>67</td>
<td>67</td>
<td>67</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agree</td>
<td>5</td>
<td>16</td>
<td>16</td>
<td>83</td>
</tr>
<tr>
<td>Disagree</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>5</td>
<td>17</td>
<td>17</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Primary data*

Table 9 shows that 67% of the respondents strongly agree that loans are frequently awarded by Stanbic Bank Uganda Limited, followed by 16% who agree. However, 17% of the respondents were indicated others. This shows that the credit performance of Stanbic Bank Uganda Limited is favorable since a high number of loans are awarded.

4.4.3 Repayment of loans

Respondents were asked whether most of the clients of Stanbic Bank Uganda Limited are able to repay loans in time and the following responses were obtained.
The findings in Table 10 indicate that 60% of the respondents strongly agree that clients are able to repay loans in time, followed with 33% of the respondents who agree. 7% of the respondents strongly disagree that clients are able to repay loans on time. Even though the level of timely loan repayment is high, the management of Stanbic Bank Uganda Limited should employ more stringent measures to ensure that clients pay up in time.

### 4.4.4 Credit performance of Stanbic Bank Uganda

Respondents were asked whether the credit performance of Stanbic Bank Uganda Limited is Excellent, Good, Poor, or Very poor, and the following responses were obtained.

<table>
<thead>
<tr>
<th>Credit performance</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>30</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Excellent</td>
<td>5</td>
<td>16</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>Good</td>
<td>20</td>
<td>68</td>
<td>68</td>
<td>84</td>
</tr>
<tr>
<td>Poor</td>
<td>5</td>
<td>16</td>
<td>16</td>
<td>100</td>
</tr>
<tr>
<td>Very poor</td>
<td>5</td>
<td>16</td>
<td>16</td>
<td>100</td>
</tr>
<tr>
<td>Others</td>
<td>5</td>
<td>16</td>
<td>16</td>
<td>100</td>
</tr>
</tbody>
</table>
From the response in table 11, the researcher deduced that the credit performance of Stanbic bank Uganda is good with 68%, 16% of the respondents agree that the credit performance is excellent, while 16% are not sure. This was explained to be due to effective credit control and effective debt collection methods by the majority of respondents. The respondent who indicated that the performance was poor gave a recommendation that, more customer screening should be done by external sources.

4.5 Relationship between interest rates and the credit performance of stanbic bank uganda limited

4.5.1 How Interest rates affect borrowing and repayment levels for loans in Stanbic Bank Uganda

Respondents were asked whether interest rates affect the repayment levels for loans in Stanbic Bank Uganda Limited, and the following responses were obtained.

Table 12: How Interest rates affect borrowing and repayment levels for loans

<table>
<thead>
<tr>
<th>Interest rates</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>25</td>
<td>84</td>
<td>84</td>
<td>84</td>
</tr>
<tr>
<td>Agree</td>
<td>5</td>
<td>16</td>
<td>16</td>
<td>100</td>
</tr>
<tr>
<td>Disagree</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary data

From the table above, 84% of the respondents believe strongly agree that interest rates influence the credit performance of Stanbic Bank Uganda Limited, while the rest agree with the notion. This means that a change in the level interest rates strongly influences the level of credit performance in Stanbic Bank Uganda Limited, and thus changes to these should be made with caution.
4.5.2 Inferential statistics

This part shows the relationship between interest rates and the credit performance of Stanbic Bank Uganda Limited, and basing on the 30 respondents who answered the questionnaires, the researcher used Pearson correlation to establish the relationship between interest rates and the credit performance of Stanbic Bank Uganda Limited as shown in the table below;

Table 13: Correlation of interest rates and credit performance of Stanbic Bank Uganda Limited

<table>
<thead>
<tr>
<th></th>
<th>Interest rates</th>
<th>Credit performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rates</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>30</td>
</tr>
<tr>
<td>Credit performance</td>
<td>Pearson Correlation</td>
<td>.823**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>30</td>
</tr>
</tbody>
</table>

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

Results revealed that significant positive response relations between interest rates and credit performance ($r=.823**$, sig.=.000). This implies that interest rates influence the credit performance of Stanbic Bank Uganda Limited. Although the majority of respondents concurred that changes in interest rates affect the credit performance of the bank in a high way, the views of the minority who indicated others were also considered, and they stipulated that interest rates alone do not affect the performance of loans, especially due to the ignorance that still exists among the clients about the interest rate changes.
CHAPTER FIVE

DISCUSSIONS, SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of findings, conclusion and recommendations based on the researcher’s views on how the study was carried out and the results obtained from the study.

5.2 Summary and discussion of findings

5.2.1 Interest rates charged by Stanbic bank Uganda

The researcher determined from the findings that the bank charges a uniform interest rate for its clients when credit is awarded, although the rate changes with the different type of loans awarded. The researcher was informed by the majority of respondents that the interest rate levels had slight changes over the previous three years. The researcher was informed by the majority of respondents that the level of interest rates charged by Stanbic bank Uganda Limited is determined by market factors, although the central bank regulates the minimum and maximum rates that are set for lending.

5.2.2 Credit performance and loan portfolio of Stanbic Bank Uganda Limited

The findings revealed that the clientele base of Stanbic Bank Uganda Limited is mainly composed of small businesses and large firms. The researcher also determined that the majority of clients of the credit department of Stanbic bank Uganda are granted commercial loans, which was because of the bank policy and low interest rates charged. The researcher in addition ascertained that Stanbic Bank Uganda Limited frequently gives out loans to customers, and that the level of repayment of loans is both high and timely which show a favorable credit performance level. The researcher also established from the responses of respondents that the credit performance of Stanbic Bank is good. A further view was however brought forward by respondents that there are loan defaults in certain cases which occur mainly due to poor debt
collection methods, and a lack of a standard body that carries out customer screening on behalf of banks.

5.2.3 Relationship between interest rates and the credit performance of Stanbic Bank Uganda

The findings on the relationship revealed that there is a strong relationship between interest rates and the credit performance of Stanbic Bank Uganda Limited as evidenced by the Pearson correlation of \( r = 0.823^{**} \), sig.=.000. This means that there is a high relationship between interest rates and the credit performance of the bank, whereby, a rise in the interest rates reduces the level of loan borrowing substantially, and vice versa.

5.3 Conclusion

The findings obtained from the study do agree with earlier researchers who argued that interest rates highly affect the credit performance of commercial banks internationally. The objective evidence from this study therefore suggests that there is strong relationship between changes in interest rates and the credit performance of Stanbic Bank Uganda, where by an increase in interest rates leads to a reduction in the borrowing levels of loans. The essence of this study was to determine the relationship between interest rates and the credit performance of Stanbic Bank Uganda Limited, and this was thus achieved.

5.4 Recommendations

From the research done, the researcher established that there are many flaws in the management of credit by Stanbic Bank Uganda Limited, and also a shortage of information about credit services provided by commercial banks. The researcher thus recommends the following:

The company adopts more stringent credit control procedures, and to also seek assistance from the various loan assessment bodies, in order to reduce on the risk associated with lending. In the management’s front, it is important that the staff handling transactions is continuously trained so as to improve on accuracy and speed in posting, and to also keep up with the changes in technology, and economic conditions.
Stanbic Bank Uganda Limited, the Government of Uganda and other stakeholders should participate in sensitization of people about the importance of taking up credit services from banks. This will in turn improve on the credit performance of Stanbic Bank Uganda Limited and other banks since more people will be made aware of existing credit services.

The researcher also recommends that Stanbic Bank Uganda Limited creates a wider range of credit services which can be added to the already available offers as this will greatly increase on its credit performance since there is diversification of the market leading to an increase in the clientele base.

5.5 Areas of further research

The researcher recommends the following areas for future investigations which were not researched about satisfactorily.

The researcher believes that this topic of study has been sparsely researched about by previous researchers, and although a lot of data was obtained through primary sources, alto more studies should be done regarding the relationship between interest rates and the credit performance of commercial banks, and a comparison be made between the different conditions in developed countries and the developing countries.

Further studies should be carried out regarding the measures of credit performance of commercial banks. The researcher noted that this is a lowly researched area especially in the less developed countries. Further studies should thus be made in less developed countries, since most of the research studies were found to be foreign based.

The researcher recommends that further studies be made on the ways commercial banks can increase on there credit performance in the rural areas which are still largely untapped in Uganda.

The impact of changes of interest rates on the rural population. The researcher was not able to extensively go deep into the rural areas to assess the consumer behavior towards changes in the level of interest rates.
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18. Ward, Andrew; Oakley, David (2009-08-27), Bankers watch as Sweden goes negative, Financial Times, New York
APPENDICES

APPENDIX 1: QUESTIONNAIRE

TOPIC: THE RELATIONSHIP BETWEEN INTEREST RATES AND THE CREDIT PERFORMANCE OF COMMERCIAL BANKS
(TO BE FILLED BY THE EMPLOYEES OF STANBIC BANK UGANDA LIMITED)

Dear Sir/Madam,

I am a fourth year student of Makerere University carrying out a study with the topic “The relationship between interest rates and the credit performance of commercial banks”, with a Stanbic Bank Uganda Limited, your company as a case study. You are kindly requested to fill in this questionnaire. The information provided in this questionnaire is to be treated with utmost confidentiality, and is for strictly academic purposes. Your contribution towards this study will be highly appreciated. **Instructions:** Please tick the most applicable option, where all options are not applicable, fill in the others option and elaborate more on this response.

**SECTION A: EMPLOYEE’S PERSONAL DETAILS**

1. **AGE**
   
   a) 11-20
   b) 21-30
   c) 41-40
   d) 41+

2. **SEX**
   
   a) Male
   b) Female

3. **LEVEL OF EDUCATION**
   
   a) Secondary
   b) Tertiary
   c) University
   Others
   (specify)
SECTION B: INTEREST RATE CHARGED BY STANBIC BANK UGANDA

1. Has the interest charged by Stanbic Bank changed over the last 3 years?
   a) Yes [□]
   b) No [□]

2. Interest rates are mainly determined by the market conditions.
   a) Strongly Agree [□]
   b) Agree [□]
   c) Disagree [□]
   d) Strongly Disagree [□]

3. The interest rate charged for different loans is uniform.
   a) Strongly Agree [□]
   b) Agree [□]
   c) Disagree [□]
   d) Strongly Disagree [□]
   Others [□]
   (specify) [□]

SECTION C: LOAN PORTFOLIO AND CREDIT PERFORMANCE OF STANBIC BANK UGANDA LIMITED

I) Loan portfolio

1. Borrowers mainly dealt with at Stanbic Bank are?
   a) Individuals [□]
   b) Small businesses [□]
   c) Large firms [□]
   Others [□]
   (specify) [□]
II) Credit performance

1. Stanbic Bank Uganda frequently gives loans to clients.
   a) Strongly Agree
   b) Agree
   c) Disagree
   d) Strongly Disagree
   Others
   (specify)

2. Most of time clients are able to repay loans in time.
   a) Strongly Agree
   b) Agree
   c) Disagree
   d) Strongly Disagree
   Others
   (specify)

4. The credit performance of Stanbic Bank Uganda Limited is?
   Excellent
   Good
   Poor
   Very poor

SECTION D: RELATIONSHIP BETWEEN INTEREST RATES AND THE CREDIT PERFORMANCE OF STANBIC BANK UGANDA LIMITED

1. a) Interest rates affect borrowing and repayment levels for loans in Stanbic Bank Uganda.
   a) Strongly Agree
   b) Agree
   c) Disagree
d) Strongly Disagree
Others
(specify)

b) An increase in interest levels causes a decline in credit performance.
   a) Strongly Agree
   b) Agree
   c) Disagree
   d) Strongly Disagree
Others
(specify)

2. a) Interest rates highly affect the credit performance of Stanbic Bank Uganda Limited.
   a) Strongly Agree
   b) Agree
   c) Disagree
   d) Strongly Disagree
Others
(specify)
APPENDIX II : INTERVIEW GUIDE

(Interview questions for the staff of Stanbic Bank Uganda Limited)

The research questions for this topic include the following;

- What are the interest rates charged for borrowing loans in Stanbic Bank Uganda Limited?
- What is the credit performance and loan portfolio of Stanbic Bank Uganda?
- What relationship exists between interest rates and the credit performance of Stanbic Bank Uganda Limited?