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Interrelationships between credit risk management and financial performance of Microfinance Institutions in Uganda

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Brief Description

Financial performance in financial institutions continue to attract attention of scholars and policy-makers due to the long reputable role they play towards economic growth and poverty alleviation.

A study was conducted to examine the interrelationships between credit risk management and the financial performance of Microfinance Institutions (MFIs) in Uganda.

Specifically, the study assessed how credit risk assessment, estimation and risk appraisal influences the financial performance of Microfinance Institutions in Uganda.

The study adopted a cross-sectional survey design and primary data was collected from 32 microfinance institutions in Uganda in December 2021.

The study obtained responses from 224 staff of MFIs using a questionnaire tool.

Data was analyzed using SPSS software in which descriptive statistics, correlations and multiple linear regression results were produced.

The study findings revealed a statistically significant positive relationship between credit risk management and financial performance (r=.740, p<.01).

In particular, there was a strong positive relationship between credit risk assessment and financial performance (r=.669, p<.01).

Credit risk estimation had a strong positive correlation with financial performance (r=.660, p<.01).

There was a strong positive correlation between risk appraisal and financial performance (r=.755, p<.01).

The regression analysis showed that credit risk management is a significant predictor of financial performance among MFIs (β=.562, t=10.138, p<.05).

In conclusion, it is clear from the study findings that the financial performance of MFIs highly depends on its credit risk management practices such as risk estimation, credit assessment, credit risk control among others.

There is therefore a need for microfinance institutions to embark on credit risk management in order to reduce on the risk of default and non-performing loans.

This will involve loan assessments, controls, loan approvals, credit rating and borrower evaluation.

Lastly, a pre-disbursement training is recommended for all successful loan applicants.

Abstract

Financial performance in financial institutions continue to attract attention of scholars and policy-makers due to the long reputable role they play towards economic growth and poverty alleviation. A study was conducted to examine the interrelationships between credit risk management and the financial performance of Microfinance Institutions (MFIs) in Uganda. Specifically, the study assessed how credit risk assessment, estimation and risk appraisal influences the financial performance of Microfinance Institutions in Uganda. The study adopted a cross-sectional survey design and primary data was collected from 32 microfinance institutions in Uganda in December 2022. The study obtained responses from 224 staff of MFIs using a questionnaire tool. Data was analyzed using SPSS software in which descriptive statistics, correlations and multiple linear regression results computed. The study findings revealed a statistically significant positive relationship between credit risk management and financial performance. In particular, there was a strong positive relationship between credit risk assessment and financial performance ($r=0.669$, $p<.01$). Credit risk estimation had a strong positive correlation with financial performance ($r=0.660$, $p<.01$). There was also a strong positive correlation between risk appraisal and financial performance ($r=0.775$, $p<.01$). The regression analysis showed that credit risk management is a significant predictor of financial performance among MFIs in Uganda ($\beta=0.562$, $t=10.138$, $p<.05$). Credit assessment had a moderate positive relationship with the financial performance of MFIs in Uganda ($\beta=0.302$). Credit risk estimation had a weak positive relationship with the financial performance of MFIs in Uganda ($\beta=0.155$). Lastly, loan portfolio performance had a moderate positive relationship with the financial performance of MFIs in Uganda ($\beta= 0.273$). In conclusion, it is clear from the study findings that the financial performance of MFIs highly depends on its credit risk management practices such as risk estimation, credit assessment, and credit risk control among others. There is therefore a need for microfinance institutions to embark on credit risk management in order to reduce on the risk of default and non-performing loans. This will involve loan assessments, controls, loan approvals, credit rating and borrower evaluation. Lastly, a pre-disbursement training is recommended for all successful loan applicants.