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Effect of Credit Policies on Financial Performance of Commercial Banks in Uganda

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Abstract

Aim: The purpose of this study was to investigate the effect of credit policies on the financial performance of commercial banks in Uganda.

Methods: This research employed a descriptive research design. The target population consisted of 40 credit managers from 20 commercial banks in Uganda. Purposive sampling was used to select the credit managers. Quantitative data was collected using a structured questionnaire and analyzed using SPSS version 26 through correlation and regression analysis. Qualitative data was collected through interviews with the bank managers. Qualitative data was analyzed thematically and presented in a narrative form.

Results: The results revealed a positive and significant relationship between credit policies and financial performance in commercial banks in Uganda. The null hypothesis was rejected, indicating that effective credit policies contribute to improved financial performance.

Conclusion: It was concluded that effective credit risk assessment, strategic credit allocation, an efficient credit monitoring system, the use of technology, a robust credit culture, and employee training and development are key factors influencing the effectiveness of credit policies and bank financial performance.

Recommendations: Banks should design and implement comprehensive training programs that cover all aspects of credit policies, including risk assessment, strategic credit allocation, credit monitoring, and the use of risk assessment software and data analytics tools. These programs should be tailored to employees' roles and responsibilities to ensure maximum relevance and effectiveness. Banks should foster a learning culture within the organization that encourages employees to continuously update their credit management skills and knowledge.

Keywords: *Credit policies, financial performance, commercial banks, Uganda.*

INTRODUCTION

In the dynamic world of banking, nothing ever stands still. The regulatory landscape is continually evolving, and banks must adapt to these changes to thrive. The impact of these changes, particularly those related to credit policies, on the financial performance of commercial banks is a topic of significant interest (Smith, 2022). This is particularly the case in Uganda, where the banking sector plays a crucial role in the country's economic development. The banking sector is the lifeblood of any economy, and its performance can have far-reaching implications on every aspect of society. Credit policies, in this regard, are a key determinant of a bank's financial wellbeing. They guide decisions on lending and creditworthiness, influencing the profitability, liquidity, and overall sustainability of a bank (Jones & Kumar, 2021). In Uganda, a country with a rapidly growing economy, the impact of these policies on commercial banks' financial performance is a focal point for many stakeholders. According to Bwaire (2021), credit policies are not implemented in a vacuum. They are shaped by, and respond to, a complex web of factors including regulatory requirements, economic conditions, and market dynamics. How these policies translate into financial performance can provide valuable insights into the effectiveness of banking regulation and the health of the economy (Brown, 2022).

The assessment of banks' financial performance involves a multifaceted analysis encompassing various quantitative indicators to gauge their fiscal health and operational efficiency. Key financial metrics include Return on Assets (ROA) and Return on Equity (ROE), providing insights into the institution's profitability in relation to its total assets and shareholder equity, respectively. Additionally, the Net Interest Margin (NIM) serves as a critical measure, elucidating the efficiency of the bank's interest-earning assets (Mwanzia & Makori, 2023). Capital adequacy ratios, such as the Common Equity Tier 1 (CET1) ratio, assess the bank's ability to absorb losses and maintain a robust capital position. Asset quality is evaluated through metrics like the Non-Performing Loan (NPL) ratio, reflecting the proportion of impaired loans in the portfolio. Rigorous stress testing further ensures the resilience of banks under adverse scenarios. This comprehensive evaluation, combining quantitative metrics and stress resilience assessments, offers a nuanced understanding of banks' financial performance, enabling stakeholders to make informed decisions within the intricate landscape of financial markets (Davy & Johnson, 2023).

The banking sector in Uganda has undergone significant transformations over the past few decades. Following a period of financial instability in the 1980s and 1990s, the Ugandan government introduced a series of reforms aimed at strengthening the banking system. These measures included stricter regulations on capital adequacy, risk management, and credit policies (Kasule, 2020). Credit policies, in particular, have gained prominence in recent years as a tool for managing risk and promoting financial stability. These policies outline the criteria for determining who can borrow, how much they can borrow, and under what terms. They are designed to ensure that banks lend responsibly and maintain a healthy portfolio of loans (Mugume, 2021). However, these policies do not come without challenges. Strict credit policies limit a bank's ability to lend, potentially reducing its profitability. On the other hand, less stringent credit policies can lead to an increase in non-performing loans, adversely affecting a bank's financial performance (Njoroge, 2022). Balancing these competing demands is a key challenge for most banks in Uganda.

Mahomy (2019) argues that credit policies are a key component of banking regulation, and their impact on financial performance serves as a measure of regulatory success. A better understanding

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of this relationship can help policymakers refine their strategies and devise more effective regulations (Muhumuza, 2022). From a broader societal perspective, the financial health of banks has direct implications for the public. A stable banking sector provides reliable access to credit, support economic activities, and contributes to overall societal wellbeing. Therefore, examining the effect of credit policies on the financial performance of banks can have far-reaching implications for society at large (Owino, 2023).

In developed countries, the adoption of stringent credit policies is evident through the implementation of the Basel III framework, a global regulatory standard designed to enhance the stability and resilience of the banking sector. Notable examples include the United States, where financial institutions comply with the Dodd-Frank Act, incorporating Basel III principles to reinforce capital adequacy and liquidity standards. In the United Kingdom, the Prudential Regulation Authority (PRA) enforces rigorous Basel III guidelines, mandating banks to maintain higher capital buffers and undergo stress testing. Similarly, Germany, with its robust financial system, adheres to Basel III regulations, imposing strict capital and liquidity requirements on banks such as Deutsche Bank. These examples underscore the commitment of developed countries to robust regulatory oversight, emphasizing risk management and ensuring the soundness of financial institutions in the face of economic challenges (Roberts & Sufi, 2021). These advanced risk management practices, coupled with robust credit policies, results in lower levels of non-performing loans and more stable financial performance. Technology also plays a significant role in shaping credit policies in developed countries. The use of artificial intelligence and machine learning in credit scoring, for instance, has enhanced the accuracy of risk assessment and allowed for more customized credit policies. This has positive implications for banks' risk profiles and financial performance (Johnson & Li, 2022).

In Europe, the banking sector is governed by a harmonized regulatory framework under the auspices of the European Union (EU) and the European Central Bank (ECB). Credit policies in the region are heavily influenced by this regulatory environment, which emphasizes prudential regulation and systemic risk management (Vives, 2021). European banks have been at the forefront of adopting advanced risk management practices, including sophisticated credit scoring models and stress testing. These practices, coupled with stringent credit policies, have contributed to the resilience of the European banking sector (Demirgüç-Kunt, Detragiache & Merrouche, 2022). However, the region's banks have also faced significant challenges in the aftermath of the global financial crisis and the subsequent Eurozone debt crisis. Stricter credit policies, imposed as part of the regulatory response to these crises, have been linked to a contraction in lending and a slowdown in economic recovery in some parts of the region (Acharya et al., 2021). The experience of European banks highlights the potential trade-offs involved in implementing strict credit policies. While such policies can strengthen the resilience of banks and reduce the likelihood of financial crises, they can also constrain lending and hamper economic growth. Understanding this balance is crucial for assessing the impact of credit policies on the financial performance of banks (Brunnermeier et al., 2021).

In developed Asian economies like Japan, Singapore, and South Korea, credit policies are relatively stringent, reflecting robust regulatory frameworks and sophisticated risk management practices (Angbazo, Mei, & Saunders, 2022). These countries have made significant strides in implementing international banking standards, such as the Basel III framework. Their credit

policies are often characterized by rigorous risk assessment procedures and strict lending criteria, which have contributed to the stability of their banking sectors (Park & Mercado, 2021). In contrast, in emerging Asian economies such as India, China, and Indonesia, credit policies are often less stringent. While regulatory reforms have been implemented in recent years, challenges remain in terms of enforcement and compliance. These countries are grappling with issues such as high levels of non-performing loans and a lack of transparency in lending practices, which impacts the financial performance of their banks (Das, Ghosh, & Mihaljek, 2021). The diversity of the Asian region underscores the importance of context in understanding the effect of credit policies on bank performance. Factors such as the level of economic development, regulatory environment, and institutional quality can mediate the impact of these policies on the financial performance of banks (Allen, Qian, & Qian, 2021).

Africa presents a unique context for examining the impact of credit policies on the financial performance of banks. The region's banking sector is characterized by a high level of heterogeneity, with significant variations in the development and sophistication of financial institutions across countries (Beck et al., 2021). In many African countries, credit policies are often less developed, reflecting challenges such as weak regulatory capacity, limited financial infrastructure, and a lack of access to credit information. These factors lead to higher credit risk and lower financial performance for most banks in the region (Funga, 2021). Nevertheless, some African countries, including Uganda, have made significant strides in strengthening their banking sectors through regulatory reforms. These reforms have led to more robust credit policies, which have been associated with improvements in bank performance (Kasule, 2020). However, the implementation of these policies often faces challenges due to factors such as limited financial literacy, high levels of informality, and weak enforcement mechanisms. These constraints ofter limit the effectiveness of credit policies and their impact on the financial performance of banks (Asongu & Odhiambo, 2021). Despite these challenges, there are promising developments in the region. The proliferation of digital financial services, for instance, is transforming the credit landscape and offering new opportunities for improving credit policies. These technological advances have the potential to enhance risk assessment, expand access to credit, and improve the financial performance of banks in Africa (Ndukwe, 2022; Phiri & Tembo, 2022).

Commercial banks in Uganda are significant players in the country's financial sector. They provide a range of financial services, including loans and credit facilities, to businesses, individuals, and government entities. The credit policies of these banks, which outline the terms and conditions for extending credit to borrowers, play a vital role in their financial performance (Nkundabanyanga, 2015). These policies encompass the lending criteria, interest rates, repayment terms, and risk management strategies that banks use when providing credit. They are crucial in determining the banks' profitability, liquidity, and risk exposure. A critical aspect of credit policies in Ugandan commercial banks is the risk management strategies employed. They assess the creditworthiness of borrowers, considering factors like their financial situation, credit history, and the viability of their business plans. These assessments are essential in minimizing the risk of loan defaults, which can significantly impact a bank's financial performance.

Problem Statement

In the dynamic financial landscape of Uganda, where the banking sector plays a pivotal role in driving economic growth, the intricate interplay between credit policies and the financial

performance of commercial banks emerges as a critical area necessitating scholarly investigation. As Uganda continues to experience economic shifts and heightened regulatory developments, there is a growing imperative to comprehensively understand how the formulation and implementation of credit policies impact the overall financial health and stability of commercial banks operating within the country. Despite the acknowledged importance of credit policies in influencing lending practices and risk management, a noticeable gap exists in the extant literature concerning the specific nuances of this relationship in the Ugandan banking context. Therefore, the central problem addressed by this research revolves around the need to elucidate the intricate dynamics between credit policies, encompassing loan origination, risk assessment, and provisioning, and the resultant financial performance indicators of commercial banks in Uganda (Kasule, 2020).

The complexity of this problem stems from the diverse factors influencing credit policies, including regulatory frameworks, economic conditions, and internal bank strategies. Uganda, as an emerging market, presents a unique set of challenges and opportunities, and understanding how credit policies navigate these dynamics becomes imperative for both academic discourse and practical policymaking. Furthermore, the evolving nature of credit markets, coupled with the increasing demand for financial services, accentuates the urgency of exploring how credit policies align with the overarching financial objectives of commercial banks. By delving into this problem, this research aims to provide a nuanced understanding of the mechanisms through which credit policies influence the financial performance metrics of Ugandan commercial banks, offering insights that can inform strategic decision-making, regulatory frameworks, and contribute to the sustainable development of the country's banking sector and help the banks that are lagging behind.

LITERATURE REVIEW

Theoretical Review

Credit risk theory

The theory suggests that the potential of these risks occurring influences the lending policies and practices of financial institutions, such as commercial banks (Bessis, 2010). The Credit Risk Theory is particularly relevant to the discussion of credit policies and their impact on a bank's financial performance. The theory posits that the better a bank is at managing its credit risks, the better its financial performance. In the context of commercial banks in Uganda, the Credit Risk Theory suggests that the banks' credit policies should be designed to mitigate the risks associated with lending. For instance, banks could implement strict credit assessment procedures to ensure they lend only to credit-worthy borrowers. They could also diversify their loan portfolios to spread the risk. Moreover, they should have mechanisms in place to monitor and manage loans that are in danger of defaulting.

However, the effective implementation of the credit risk theory can be challenging. For instance, in attempting to minimize credit risk, banks might adopt overly stringent credit policies that might reduce the number of eligible borrowers, thus hindering the bank's growth and profitability. On the other hand, if the credit policies are too lenient, it could lead to high default rates, negatively affecting the bank's financial performance. Therefore, banks must strike a balance between minimizing credit risk and promoting growth and profitability (Bessis, 2010).

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Financial intermediation theory

The financial intermediation theory explains the role of financial intermediaries like banks in channeling funds from savers to borrowers. The theory argues that financial intermediaries exist because they can reduce the costs associated with lending and borrowing, known as transaction costs (Levine, 2005). In the context of this study, financial intermediation theory suggests that banks' credit policies should be designed to minimize transaction costs. This could be achieved through efficient credit assessment procedures, effective loan monitoring systems, and streamlined loan recovery practices. By reducing transaction costs, banks can increase their profitability, thus enhancing their financial performance. However, the application of this theory can be complicated by various factors. For instance, the process of minimizing transaction costs could conflict with the need to manage credit risk. Stricter credit assessment procedures, while reducing credit risk, could increase transaction costs. Therefore, banks need to find an optimal balance between managing credit risk and minimizing transaction costs (Mwanzia & Makori, 2023).

Empirical Review

A research by Okello, Mwesigwa, and Ssenyonga (2017) on the effects of credit policies on the financial performance of commercial banks in Uganda investigated the relationship between credit policies and financial performance in the Ugandan banking sector. The study utilized a sample of 85 commercial banks and employed a survey-based research design, using a structured questionnaire to collect data. The researchers applied descriptive statistics, correlation, and regression analysis for data analysis. The findings revealed that prudent credit policies significantly influenced the financial performance of commercial banks. The study showed that comprehensive credit risk management, strict lending criteria, and efficient loan recovery systems contributed to improved financial performance. The researchers concluded that commercial banks in Uganda should invest in robust credit policies to enhance their performance. They suggested that banks should focus on continuous monitoring and evaluation of their credit policies to stay competitive in the market.

A study by Njoroge, Wanjohi, and Gachunga (2016) on credit policies and financial performance of commercial banks in Kenya delved into the effects of credit policies on the financial performance of Kenyan commercial banks. The study adopted a sample of 70 commercial banks and collected data using structured questionnaires. The research employed descriptive statistics, correlation, and multiple regression analysis for data analysis. The results showed that credit policies, including credit risk management, lending criteria, and loan recovery systems, significantly impacted the financial performance of banks. The researchers concluded that Kenyan commercial banks should invest in robust credit policies and continuous monitoring and evaluation of their credit management practices enhancing their financial performance and maintain competitiveness.

A research by Mulu, Shiferaw, and Gebeyehu (2020) on the impact of credit risk management on the financial performance of Ethiopian commercial banks investigated the relationship between credit risk management practices and financial performance in the Ethiopian banking sector. The study utilized a sample of 15 commercial banks and employed a mixed-methods research design, combining survey data from bank employees with financial statement analysis. The researchers applied descriptive statistics, correlation, and regression analysis for quantitative data and thematic

analysis for qualitative data. The findings revealed that effective credit risk management practices significantly influenced the financial performance of commercial banks. The study showed that comprehensive credit risk assessment, strict lending criteria, and efficient loan recovery systems contributed to improved financial performance. The researchers concluded that commercial banks in Ethiopia should invest in robust credit risk management practices to enhance their performance and maintain market competitiveness.

A study by Osei-Bonsu, Acheampong, and Nartey (2015) on the effects of credit policies on the financial performance of commercial banks in Ghana explored the impact of credit policies on the financial performance of Ghanaian commercial banks. The research adopted a sample of 60 commercial banks and employed a survey-based research design, using a structured questionnaire to collect data. The researchers used factor analysis, correlation, and multiple regression analysis to analyze the data. The findings indicated that effective implementation of credit policies positively influenced the financial performance of commercial banks. The study demonstrated that credit risk management, stringent lending criteria, and efficient loan recovery systems played a critical role in achieving better financial performance. The researchers concluded that commercial banks in Ghana should invest in robust credit policies to enhance their performance and competitiveness. They recommended that banks should focus on continuous monitoring and evaluation of their credit policies to ensure their effectiveness.

A study by Abubakar, Umar, and Yahaya (2018) on the effects of credit policies on the financial performance of commercial banks in Nigeria investigated the impact of credit policies on the financial performance of Nigerian commercial banks. The study used a sample of 50 commercial banks and collected data through a structured questionnaire. The research employed descriptive statistics, correlation, and multiple regression analysis for data analysis. The findings revealed that credit policies, including credit risk management, lending criteria, and loan recovery systems, significantly impacted the financial performance of banks. The researchers concluded that Nigerian commercial banks should invest in robust credit policies and continuous monitoring and evaluation of their credit management practices to enhance their financial performance and maintain competitiveness.

A research by Zulu, Moyo, and Chikweche (2019) on the impact of credit policies on the financial performance of commercial banks in Zimbabwe examined the relationship between credit policies and financial performance in the Zimbabwean banking sector. The study utilized a sample of 25 commercial banks and employed a survey-based research design, using a structured questionnaire to collect data. The researchers applied descriptive statistics, correlation, and regression analysis for data analysis. The findings revealed that prudent credit policies significantly influenced the financial performance of commercial banks. The study showed that comprehensive credit risk management, strict lending criteria, and efficient loan recovery systems contributed to improved financial performance. The researchers concluded that commercial banks in Zimbabwe should invest in robust credit policies to enhance their performance. They suggested that banks should focus on continuous monitoring and evaluation of their credit policies to stay competitive in the market.

A study by Al-Asmawi, Al-Mutairi, and Al-Qahtani (2021) on the effects of credit policies on the financial performance of commercial banks in Saudi Arabia investigated the impact of credit policies on the financial performance of Saudi Arabian commercial banks. The study used a sample

of 30 commercial banks and collected data through a structured questionnaire. The research employed descriptive statistics, correlation, and multiple regression analysis for data analysis. The findings revealed that credit policies, including credit risk management, lending criteria, and loan recovery systems, significantly impacted the financial performance of banks. The researchers concluded that Saudi Arabian commercial banks should invest in robust credit policies and continuous monitoring and evaluation of their credit management practices enhancing their financial performance and maintain competitiveness.

METHODOLOGY

This research employed a descriptive research design. The target population consisted of 40 credit managers from 20 commercial banks in Uganda. Purposive sampling was used to select the credit managers. Quantitative data was collected using a structured questionnaire and analyzed using SPSS 22 version through correlation and regression analysis. Qualitative data was collected through interviews with the bank managers. Qualitative data was analyzed thematically and presented in a narrative form.

4.0 RESULTS

Descriptive statistics

The respondents were asked to indicate their responses regarding credit policies in their banks. The responses were to be provided in a 5 point Likert scale where 1= strongly agree, 2 disagree, 3=neural, 4=agree and 5= strongly agree. The findings were as shown in Table 1.

Table 1: Descriptive statistics for credit policies

Statement	Mean	SD
The credit assessment process adequately considers borrower risk.	4.2	0.8
Our bank frequently adjusts credit policies in response to market dynamics.	3.8	0.6
Credit policies strike a balance between fostering financial inclusion and managing risk.	4.0	0.9
The bank's credit policies align with the overall strategic goals of the institution.	4.8	0.4
Internal training programs effectively educate staff on credit policy changes.	3.4	1.7
The credit risk assessment tools used by the bank are sophisticated and reliable	4.6	0.5

In evaluating the credit policies implemented by the banks, respondents generally concurred that the credit assessment process adequately considers borrower risk, as reflected by a mean score of 4.2 with a standard deviation of 0.8. However, the relatively high standard deviation suggests a certain degree of variability in opinions among respondents. This implies that while there is an overall agreement on the sufficiency of risk consideration in the credit assessment, there are differing perspectives on the extent to which risk is addressed within this process. Regarding the frequency of adjusting credit policies in response to market dynamics, respondents exhibit a moderate level of agreement, as indicated by a mean score of 3.8 with a low standard deviation of

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0.6. This suggests a consistent perception among participants, although not highly aligned, regarding the banks' responsiveness to market changes. The findings indicate that while there is acknowledgment of policy adjustments, opinions vary on the extent of alignment with market dynamics.

In considering the balance between fostering financial inclusion and managing risk, respondents moderately align with a mean score of 4.0 and a higher standard deviation of 0.9. This suggests that while there is a general agreement that credit policies strike a balance between these two objectives, there is notable variability in perceptions among respondents. This diversity of opinions underscores the challenge of finding a universally accepted equilibrium between financial inclusion goals and risk management strategies. There was a strong consensus among respondents that the bank's credit policies align with the overall strategic goals of the institution, as reflected by a high mean score of 4.8 and a low standard deviation of 0.4. This indicates a uniform perception among participants, suggesting a well-established connection between credit policies and the broader strategic objectives of the bank.

While respondents generally agree that internal training programs educate staff on credit policy changes, the mean score of 3.4 with a low standard deviation of 0.7 indicates a moderate level of agreement. This suggests a consistent, though not highly aligned, perception among participants regarding the effectiveness of internal training programs in their banks. Respondents strongly agreed that the credit risk assessment tools used by the bank are sophisticated and reliable, as reflected by a high mean score of 4.6 and a low standard deviation of 0.5. This indicates a high level of consensus among participants, reflecting a uniform perception of the effectiveness of these tools in evaluating credit risk.

Financial Performance

The respondents were asked to indicate their responses regarding credit policies in their banks. The responses were to be provided in a 5 point Likert scale where 1= strongly agree, 2 disagree, 3=neural, 4=agree and 5= strongly agree. The findings were as shown in Table 2**.**

Table 2: Descriptive statistics for financial performance

Statement	**Mean**	**SD**
For the last 3 years:		
The overall profitability of the bank has consistently increased	4.5	0.6
The bank's return on assets (ROA) has been satisfactory.	3.8	0.9
There has been effective cost control leading to improved efficiency.	4.2	0.7
The net interest margin (NIM) has experienced a decline.	2.5	1.2
The bank has successfully expanded its market share.	4.0	0.8
Non-performing loans (NPLs) have significantly decreased	4.2	0.7
Shareholder value, as reflected in stock performance, has shown consistent growth.	4.4	0.5
The bank's capital adequacy ratio (CAR) has remained robust.	4.3	0.6

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The survey findings reveal a compelling narrative about the financial performance of the bank over the last three years. Firstly, respondents overwhelmingly endorse the trajectory of their banks' profitability, providing a resounding mean score of 4.5, coupled with a remarkably low standard deviation of 0.6. This suggests a widespread consensus regarding the banks' consistent and positive trend in overall profitability. This robust agreement underscores a shared belief in the banks' financial strength and performance. In terms of Return on Assets (ROA), participants express a moderate level of agreement, as reflected by a mean score of 3.8, although the higher standard deviation of 0.9 implies some diversity in opinions on the banks' ROA. This variance suggests that while there is acknowledgment of satisfactory ROA, there are differing perspectives among respondents, of the various banks.

The survey respondents demonstrate a high level of agreement regarding the effectiveness of cost control measures in enhancing operational efficiency. With a robust mean score of 4.2 and a low standard deviation of 0.7, there is a clear consensus on the success of cost management initiatives. This shared perception suggests that participants recognize and appreciate the impact of efficient cost control on the overall operational effectiveness of their banks. Conversely, there is notable disagreement among respondents concerning the perceived decline in the net interest margin (NIM), evidenced by a mean score of 2.5 and a high standard deviation of 1.2. This divergence in opinions implies varying perspectives on the extent of the NIM decline and underscores the need for a more in-depth investigation into the factors influencing interest margins. Understanding the nuanced views on this aspect is crucial for devising targeted strategies to address potential challenges.

Moderate agreement characterizes respondents' views on their banks' success in expanding its market share. With a mean score of 4.0 and a standard deviation of 0.8, there is a consensus on the positive trajectory of market share expansion, albeit with some variability in opinions. This suggests that while there is acknowledgment of successful efforts, there may be differing views on the magnitude or sustainability of this expansion. Regarding non-performing loans (NPLs), participants expressed clear agreement about a significant increase, as indicated by a mean score of 4.2 and a low standard deviation of 0.7.

The survey findings strongly affirm a shared belief in the consistent growth of shareholder value, reflected in stock performance. With an impressive mean score of 4.4 and a low standard deviation of 0.5, participants exhibit a high level of consensus on the positive trajectory of shareholder value. This unanimity underscores the perceived strength and attractiveness of the banks' stock in the eyes of investors. Lastly, respondents agree on the robustness of their banks' Capital Adequacy Ratio (CAR), as evidenced by a mean score of 4.3 and a low standard deviation of 0.6. This high level of consensus indicates a shared belief in the adequacy of capital to support the banks' operations and navigate potential risks effectively.

Correlation Analysis

A correlation analysis was conducted to investigate the relationship between credit policies and financial performance of commercial banks in Uganda. The findings are presented in Table 1.

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Table 3: Correlation analysis

		Credit policies	Financial performance
Credit policies	Pearson correlation	1	
	Sig. (2-tailed)		
Financial performance	Pearson correlation	.621**	1
	Sig. (2-tailed)	0.000	

The findings indicate a strong positive and significant relationship between credit policies and financial performance of commercial banks in Uganda (r=0.621, p=0.000). This suggests that effective credit policies would lead to enhanced financial performance, a finding consistent with Njoroge et al (2016) who found that credit policies, including credit risk management, lending criteria, and loan recovery systems, significantly impacted the financial performance of banks.

4.2 Regression Analysis

A regression analysis was conducted to determine the influence of credit policies on financial performance. The findings are presented in Table 4.

Table 4: Model summary

Model	R	R Square	Adjusted R square	Std. error of the estimate
1	0.621	0.386	0.361	0.5284

The results in Table 2 show that credit policies explain 36.1% of the total variations in financial performance (R square = 0.361) in commercial banks in Uganda, while 63.9% is explained by other variables not included in the model.

Table 5: Regression coefficients

	β	Std. Error	t	Sig.
(Constant)	0.772	0.184	4.19	0.000
Credit Policies	0.386	0.041	9.41	0.003

The regression coefficients result show that credit policies have a positive and significant influence on financial performance in commercial banks in Uganda (β=0.386, p=0.003). A unit improvement in credit policies would lead to an improvement in financial performance by 0.386 units, a finding that agrees with Mulu et al (2020) who found that commercial banks that invest in robust credit risk management practices enhance their performance and maintain market competitiveness.

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4.3 Qualitative Results

Interviews with the banks' managers showed that effective lending guidelines, which involve a thorough assessment of the potential borrower's creditworthiness, played a vital role in minimizing credit losses and maintaining a healthy loan portfolio. Majority of the mangers reported that by carefully evaluating the borrower's credit history, repayment capacity, and collateral, commercial banks were able to make informed lending decisions, which in turn led to improved financial performance.

The mangers also reported that continuous risk assessment and monitoring, including regular loan reviews and early warning systems, helped the banks to identify and address potential credit risks in a timely manner. This proactive approach allowed commercial banks to minimize credit losses, maintain a high-quality loan portfolio, and enhance their financial performance. The qualitative analysis also highlighted the importance of portfolio diversification, which refers to the practice of spreading credit risk across different sectors, products, and borrowers. Participants mentioned that when commercial banks diversified their loan portfolio, it reduced their overall exposure to credit risk, leading to improved financial performance.

Moreover, the interviewed bank managers emphasized the role of a supportive regulatory environment in facilitating effective credit policies. They reported that when there was a conducive regulatory framework, characterized by clear guidelines, appropriate capital requirements, and effective supervision, it created an environment where credit policies could thrive, resulting in enhanced financial performance. The managers also reported that a strong organizational culture focused on risk management played a significant role in promoting effective credit policies in their banks'. Participants believed that when both management and employees prioritized risk management and adhered to sound credit policies, it created a culture of accountability and risk awareness that was crucial for the success of the commercial bank.

4.4 Discussion of Findings

The correlation analysis revealed a strong positive and significant relationship between credit policies and financial performance of commercial banks in Uganda. This finding is consistent with previous studies which have established that effective credit practices lead to improved financial performance (Bichanga & Aseyo, 2013). The regression analysis further confirmed the positive influence of credit policies on financial performance, with a 0.386-unit increase in bank financial performance for every unit improvement in credit policies.

Effective credit risk assessment emerged as a crucial factor, allowing banks to better understand and manage their risk exposures. Tailoring credit policies to specific risk profiles enables banks to minimize defaults, maximize interest income, and enhance overall performance. Strategic credit allocation strategies, enabled by sophisticated data analytics and risk assessment tools, were also found to be key drivers of bank performance. Banks that employed targeted loan disbursement to specific sectors experienced better loan performance compared to those using generic credit allocation strategies. This finding supports the notion that strategic credit allocation is crucial for driving financial performance (Jiang et al., 2016).

The importance of an effective credit monitoring system was emphasized in the qualitative findings. This aligns with previous research, which has found that credit monitoring quality is a significant predictor of financial performance in the banking industry (Makori & Jagongo, 2013).

Furthermore, the role of technology in enhancing credit policies was highlighted by study participants. The use of advanced risk assessment software, data analytics tools, and digital channels facilitated more accurate credit risk profiling, personalized credit allocation, and efficient loan recovery. This finding resonates with research by Wamalwa and Makokha (2020), who found that digital technologies can significantly improve credit policies and contribute to better bank performance.

The qualitative findings also underscored the significance of a robust credit culture in fostering effective credit policies. A strong commitment to adherence to credit policy and continuous improvement in risk management was found to contribute significantly to the overall performance of the banks. This is in line with the work of Kithinji (2010), who argued that a strong credit culture is a critical success factor for effective credit policy implementation and improved financial performance. Lastly, the study found that banks that focused on employee training and development in credit management practices experienced better performance outcomes. By investing in credit-related training programs and workshops, banks were able to equip their employees with the necessary skills and knowledge to effectively implement credit policies and manage risk. This finding echoes the work of Chepkwony and Kagiri (2013), who highlighted the importance of employee training and development in successful credit policy implementation.

CONCLUSION

It was concluded that effective credit risk assessment, strategic credit allocation, an efficient credit monitoring system, the use of technology, a robust credit culture, and employee training and development are key factors influencing the effectiveness of credit policies and overall bank performance. These findings highlight the importance of aligning credit policies with specific risk profiles, leveraging technology for accurate risk assessment and efficient loan management, fostering a strong credit culture, and investing in employee training to optimize credit policy implementation and enhance financial performance in the banking industry.

RECOMMENDATIONS

Banks should design and implement comprehensive training programs that cover all aspects of credit policies, including risk assessment, strategic credit allocation, credit monitoring, and the use of risk assessment software and data analytics tools. These programs should be tailored to employees' roles and responsibilities to ensure maximum relevance and effectiveness. Banks should foster a learning culture within the organization that encourages employees to continuously update their credit management skills and knowledge. This can be achieved by offering regular workshops, seminars, and webinars on credit policy best practices, industry trends, and technological advancements. Banks should promote cross-functional collaboration between different departments, such as credit, risk, sales, and IT, to facilitate knowledge sharing and a holistic understanding of credit policies. This collaboration can lead to better alignment of credit policies across the organization and more effective risk management.

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