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TOWARDS EFFECTIVE MANAGEMENT OF CREDIT RISKS IN COMMERCIAL BANKS: A CRITICAL ANALYSIS OF THE CHALLENGES AND STRATEGIES FOR IMPROVEMENT IN UGANDA'S COMMERCIAL BANKS

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Abstract

Uganda has over the years consistently faced portfolio quality challenges which have led to a series of financial turmoil. A variety of empirical literature associate portfolio performance with credit risk management and suggest the need to improve credit risk management towards enhanced portfolio performance. Contributing to this body of knowledge, this paper explores credit risk management practices in the context of Uganda's commercial banks with a view of identifying strategies for improvement. The paper draws from findings of interviews conducted on purposively selected staff in the credit risk management functions. The respondents included credit risk staff, relationship managers and Credit Officers across eight (8) commercial banks in Uganda. In addition, views of the staff of Bank of Uganda; the regulator as well as the Uganda Bankers Association, the umbrella organization of commercial banks in Uganda were solicited. Findings indicated that credit risk management comprises three key sequential stages. They include; credit risk identification, credit risk assessment and credit risk control. Though the *stages characterize an ideal credit risk management process, critical gaps including shallow risk scoping, shallow risk analysis, invalid risk approval and inadequate monitoring were established. A deeper scan into the root causes of these challenges revealed factors which reflect broadly; staff capacity constraints, organizational constraints and unethical behavior. These findings concur with the assertions of the principal agent theory as well as the information asymmetry theory which assume a possible pursuit of self-interests by the agents and unethical behavior partly due to the problem of adverse selection. The study provides implications for improving credit risk management towards enhanced portfolio and financial performance as well as greater sustainability of commercial banks.*

Keywords: credit risk management, practices, challenges, commercial banks, portfolio performance

INTRODUCTION

Uganda has over the years consistently faced portfolio quality challenges which have led to a series of financial turmoil. Reference can be made to the mergers and closures of some banks in the past years including; closure of National Bank of Commerce in 2012, Global trust Bank in 2014, International Credit Bank and Teefe Bank in early 1990s (New vision, 2018). On the other hand, some banks have been sold such as Gold Trust Bank, Cooperative Bank, Uganda Commercial Bank, International Allied Bank, Nile Bank, Global Trust Bank, National Bank of Commerce and recently Crane Bank (Kasekende, 2018).

A snap short of the NPA sector performance indicates that up to December 2017, the Ugandan banking sector's portfolio quality deteriorated as indicated by the increasing ratio of non-performing loans to total bank credit (BOU Supervision Report June 2018). The aggregate industry NPL ratio in the last 15 years increased to the highest record NPL ratio, 4 percent to 8.3% in June 2016. (BOU supervision report, June 2016). Even though the NPA position slightly improved in 2018, it remained below performance standards of 5% in the Uganda context. Watch loans grew by 56 percent from USh.796.0 billion to USh. 1, 243.2 billion in 2015 and June 2016 respectively. Future projections indicate that Commercial Bank portfolio quality would remain a concern to the banking sector stability in the short term at least as indicators show that watch loans are still increasing. (BOU supervision reports 2014; 2015; 2016, 2017; 2018).

A variety of empirical literature (Kansiime et al., 2019; Korankye, 2014; Adeusi et al., 2013; Haynes, 2005; Kasekende, 2018; Santomero, 1997**),** Geitangi(2015); Fredrick(2012), Justus et al (2016) associate portfolio performance with credit risk management and suggest the need to improve credit risk management towards enhanced portfolio performance. The studies however do not provide a comprehensive understanding of the credit risk management process, the possible interrelationships at the different stages and associated challenges. Besides, there is paucity of knowledge on credit risk management practices in the context of Uganda's commercial banks. The paper addresses this information gap by exploring the credit risk management practices in Uganda's commercial banks with a view to identify strategies for improvement

LITERATURE

Credit risk management challenges: Theoretical and empirical perspectives

The analysis of credit risk management practices and associated challenges in this paper draw insights from three theories; the information theory, the risk management theory and agency theory which identify the potential challenges in credit risk management. The agency theory (Ross and Barry, 1972) asserts that, an agency relationship occurs when one or more principals (owner) engage another person (an agent) to perform the service on their behalf (Sunit, 2014). This nature of assignment results in the delegation of some decision-making authority to the agent. This theory is based on the concept of the principal-agent relationship with the assumption that one party; usually the agent holds more information than the principle and therefore is placed in control of a set of economic functions or assets in some form of ownership or property rights (Nance and Smithson, 2003). Bazerman and Loewenstein (2008) assert that, such delegation also requires the principal to place trust in the agent to act in the principal's best interests. Important to note however is that, should concerns arise over the motives of agents and cause principals to question their trust, the relationship is greatly affected. Takang &Ntui (2008) for example used the agency theory to investigate the relationship between Bank performance and credit risk management in financial institutions and their findings revealed that return on equity (ROE) and return on assets (ROA) both measuring profitability were inversely related to the ratio of non-performing loan to total loan of financial institutions, thereby leading to a decline in profitability.

In the context of this paper, the agency theory is used to draw assumptions that banks employ staff into the credit risk management function who may pursue their self-interest at the expense of the banks' strategic lending objectives. On the other hand, the staff may behave unethically to fulfill their interests to compromise the quality of credit risk management. Furthermore, the banks due to some constraints may not be able to adequately support the staff to fulfill their credit risk management mandate. This theory therefore puts the staff and the banks at the spot of the challenges in credit risk management. It opens insight into possible unethical conduct and bank capacity constraints as potential challenges in credit risk management which consequently this paper reflects on.

The theory of asymmetric information developed by George Akerlof, Michael Spence and Joseph Stiglitzin in 1970s and 1980s assumes that in a financial transaction, one of the two parties involved (seller or buyer) will have more information than the other and will have the ability to make a more informed decision. In the case of borrowing or advancing facilities, asymmetric information occurs when the borrower has more information about his financial state than the lender does. The lender is unsure whether the borrower will default on the loan. The lender can set vetting criteria to guide the decision making process for example look at a borrower's credit history and security, but this provides limited information compared to what the borrower knows about their own financial situation hence adverse selection. To account for this asymmetric information, a lender will charge a risk premium to compensate for the disparity in information. The theory underscores the importance of information in credit risk Management and portfolio performance. The information theory was found applicable to the current study. Santomero (1997) recommended that credit applications should be thoroughly appraised of both financial and non-financial information prior to credit award. Collection and verification of sufficient information from both new and existing borrowers is critical in accomplishing effective screening as indicated by symmetric information theory.

In the context of this paper, it is assumed that the borrower could have more information than they may be willing to share with the lender to enable the latter identify, assess and rationally take decision. On the other hand, the lender could face constraints in accessing and utilizing the information to take decision. Consequently, the theory opens insight into potential challenges associated with information access for effective credit risk management. It is also possible that the lender could be more informed on loan products and services than the borrower but would be hesitant to share information that may discourage borrowing particularly in light of the struggle to meet targets.

METHODOLOGY

The paper draws from findings of interviews conducted on staff employed in the credit risk function including, Credit Risk Staff, Relationship Managers and Credit Officers. The respondents were purposively sampled from eight (8) commercial banks in Uganda based on their portfolio performance for the previous four years [2014 – 2017]. The eight (8) commercial banks include all banks (5) which had an NPA of 5% and above across the period under study. The interviews extended to the staff of Bank of Uganda particularly those engaged in supervision and monitoring of commercial banks' performance. In addition, the staff of Uganda

Bankers' Association were engaged. The interviews focused on credit risk management practices and associated challenges drawing from experiences of these vital stakeholders in the credit risk management function at operational and strategic management levels. Emerging data was analyzed qualitatively using content analysis. The analysis generated emerging themes and patterns which leverages the findings in this paper.

FINDINGS

Credit risk management practices and associated challenges

Credit risk management was found to be institutionalized in all the studied commercial banks as one of the major strategies to enhance portfolio performance. The institutional framework for credit risk management and portfolio performance featured credit policies and guidelines which provide a framework to handle the credit risk management process at all stages. The policies also identify portfolio performance objectives and guiding principles in credit risk management. Another key feature of the institutional framework observed across all banks was strategic plans which among other aspects of bank performance, recognize the need for enhanced portfolio performance. The strategic plans also spell out strategies to grow the loan book and reduce loan delinquency.

Structurally, two approaches to credit risk management were found to be used. The first approach involves credit officers sourcing and acquiring potential clients, assessing and recovering. The second approach involved relationship managers sourcing potential clients, Credit Analysts assessing credit, sanctioners approving and recovery officers recovering the credit. Both approaches were appreciated to undertake practices in an end to end process, although with precautions. The first approach was commended to build strong relationship between credit staff and customer, which is essential for effective recovery. However, it was associated with a high risk of compromising the quality of assessment amidst the strive to meet sales targets. Although the approval is done by an independent party (sanctioner), it is less likely to eliminate bias since the approval is based on Credit Officer's assessment. This approach also enhances customer – staff loyalty as opposed to the ideal customer-bank loyalty. In the long run it affects performance of the credit function and of the bank. In addition, in an event that the credit officer leaves, the bank loses clients hence affecting portfolio performance.

In terms of process, credit risk management in the studied commercial banks involved three key sequential stages. They are; credit risk identification, credit risk assessment and credit risk control. Of interest in the descriptive analysis was to establish the practices employed by the commercial banks, their associated strength and weaknesses from which recommendations for improvement would be subsequently derived. Findings to this effect are presented in the subsequent sub-sections.

Credit risk identification

Banks were found to undertake credit risk identification as the first stage in the credit risk management process. This was done with a major objective of understanding the customer and the environment around them in relation to the business they operated in. Of interest was to understand the practices in the credit risk identification process. Risk identification was mainly done through inspection by relationship managers and analysis of financial statements. The risk identification process involved three key practices: risk conception, root cause analysis and communication.

Conception was considered the first stage of credit risk identification whose major objective was to understand the customer and their business by way of establishing their Names, legal mandates of trading, location, their customer transactions and drawing loops together with an aim of creating a clear picture in the bank staff understanding. The analysis of risk conception intended to identify the practices employed, areas of strength and weaknesses. Commercial banks utilize a systematic framework and have tools in place to guide identification of credit risk. Notably however, there were very strong opinions that the credit risk conception process was associated with inability to consider all possible risks and inability to draw on to wider business environment.

Overall the risk conception process was characterized with major weaknesses than the strength which potentially affect portfolio performance. First was inadequacy in information particularly the availability, accessibility and correctness as well as volatility of the business environment. To this end, Informant interviews revealed two sources of information for understanding the business environment and these were primary and secondary. The sources were however associated with challenges. While primary information can be obtained directly from customers through site visits, quite often they are not done due to time limitation and perception by most credit staffs that customer visit is part of relationship management., Also, this primary source is not fully reliable as sometimes customers are skeptical to give full information regarding their business usually since they are not very certain about who else will access their information. This is usually information relating to tax payments, their suppliers, other lenders and sometimes the actual purpose the funds are sought.

In consideration of the above gaps, Credit Officers seek informal sources of information for example; contacting secondary sources like colleagues in other banks since customers are multi-banked. However, such information was considered to often be partial or incorrect. One respondent gave a scenario of how recoveries staff get to an extent of advising customer to seek credit buyouts by other banks and go ahead to assist clients prepare compelling documents to other banks to enable them exit the risk.

Regarding secondary sources, the technical capacity to scan micro-economic environment which potentially affects the extent to which risks can be conceptualized with reality was found to be lacking. The nationally recognized device for sharing information on customer credit indebtedness was the Credit Reference Bureau (CRB). Despite its potential to provide information regarding credit history, it poses some flaws such as manipulation by unethical human conduct. The CRB also relies on information entered in the specific bank's system, which means that if incorrect data is entered, it is the same that will be utilized by the expected users. Its information update depends on the customer querying available information. In addition, there was minimal regard for its capacity to ascertain the real credit worthiness given that it does not consider information from informal sources, which is also a significant source of credit. To affirm this, some respondent had this to say

"You will realize that the informal sector remains a big source of credit, and obviously these are sources that the credit Reference Bureau card does not put into account. Funds borrowed from friends, relatives, money lenders and recently mobile money (KI2, April 2019)".

The risk conception process was also observed to be constrained by inability of the new banks to understand the business environment in terms of defining the local customer and their risk attributes. The international and regional banks especially the new ones were found to apply their own pre-determined judgment of the customers' credit needs and capacity to repay. They copy and paste practices which may not match the local market in the area of risk scoping. Ideally, appropriate risk conception was observed to necessitate a customer-to-bank approach where a customer takes lead in deciding choice of credit products depending on actual need and capacity to repay.

Root cause Analysis was universally recognized as the second step of credit risk identification.. The fundamental finding was that good practices in root causes analysis were applied across most commercial banks as observed by most of the respondents. Root cause analysis involved scrutinizing available information using tools like the SWOT analysis and PESTL. It also involved scrutinizing sector risks related to changes in the economic environment as well as determining individual borrower and related party root causes of risks. The general purpose was to identify potential causes of risks. For most banks, it involved undertaking and describing credit risks and their causes. It is worth noting that effectiveness of this process depends on a mix of tools both qualitative and quantitative

In addition, root cause analysis was observed to be constrained by data inaccuracies in secondary data sources and misinformation respectively. Most commonly used documents observed were BOU and financial sector performance reports to identify micro level economic trends such as inflation, interest rate regimes, forex and their implication to credit risk. It also emerged that scientific literature, which would assist further assessment of credit risk was highly challenging to access and utilize. The reading culture, motivation, commitment and technical capacity to interpret the information and time, emerged among the key constraints to utilizing such information. Despite the knowledge and skills of credit staff, they are unable to do thorough analysis considering that effective root cause analysis necessitates consulting a wide range of documents which requires ample time. These are broadly capacity related constraints which continue to affect the quality of roof cause analysis as earlier observed under credit risk conception. Experience was observed as an alternative and most effective means in the face of constraints to accessing information from documents. It was associated with long term staff exposure to the job which creates a wealth of reliable information about the risk. However, this information source was found to be constrained by the high turnover of experienced credit staff.

Communication is another aspect of credit risk identification which was reported as a common practice across the studied commercial banks. It was observed that failure to share anticipated risks is as good as not identifying them. The descriptive analysis intended to understand how risks were communicated, the most effective means of communication and the challenges. Ideally communication was observed to necessitate timely and continuous flow of information with a feedback loop. It is worth noting that these communication practices were found to characterize the communication system of the credit risk function. Credit risk information was reported to regularly flow from Relationship Manager, to Credit Analyst, Risk Managers and senior bank management as the end user. The relationship managers originate information which is passed on to the analyst for assessment.

However, interviews revealed two key challenges at this stage. First information was reported to delay especially between Relationship Managers and Credit Assessment Staff. This was mainly attributed to reluctance of relationship managers while writing visit reports and customers availing information as piece meal. Secondly, tools used in sharing information in many banks were not networked to ease report sharing. Such tools include; the call visit reports and the document management system. Preferably, the need for secure digital communication approaches where information is shared online was identified. Such include; online credit application and sharing of analysis reports with the responsible persons.

Credit risk assessment practices

Credit risk assessment was observed generally as the second stage of credit risk management. The main purpose of credit risk assessment is to measure, plan and approve risk. Of interest in this analysis was to understand the credit assessment practices across the studied banks, whether risk analysis is appropriately done, and how the assessment can be improved.

Credit risk measurement was considered the first stage in credit risk assessment. Risk measurement is intended to determine the magnitude of risks and priotize their handing in consideration of severity of their impact and resource constraints. The analysis intended to identify the most popular practices in credit risk measurement and identify any areas of strength and weaknesses. Findings revealed that credit risk measurement is generally done appropriately although with some areas of weaknesses. It was observed that the credit risk measurement process thoroughly establishes applicant's previous credit performance. In addition, applicant's documentation is often scrutinized thoroughly, their repayment character and capacity to pay often adequately assessed. During measurement, scoring is often done as a way of estimating credit risk. There was however a concern that credit risk measurement was prone to bias. Similarly, the magnitude of impact of the risks is often not appropriately assessed.

Regarding the depth of measurement and repayment character, a mix of qualitative and quantitative tools were reported to be used. The quantitative measurement considers the capacity to repay based on the strength of the financial position reflected by cash inflows visavis outflows, status of assets, liabilities and customer's equity. The qualitative measurement was usually done to ascertain customer repayment character based on credit history, payment of creditors and staff and financial discipline on the account with regard to Scrutinization of documentation, banks were observed to often do a thorough check of documentation to ascertain correctness, completeness and clarity of information provided. A credit risk scoring tool was reported to be used by all banks to score the magnitude of risks which are then graded to determine level of risk in terms of frequency of occurrence and severity.

While such a credit risk measurement process would be considered robust, this was sometimes not the case due to some reasons. First, verifications were expected to be prone to bias since they were sometimes done by the relationship managers, the business originator. Secondly, the verification sometimes relies on customer given information which is likely to be subjective. Customer visits and third-party inquiries which would eliminate the bias were found to be lacking. Interviews also affirmed that despite such a comprehensive measurement process, estimating the magnitude of the impact of credit risk remains a challenge especially because volatile market conditions and customers' increasing knowledge and exposure that enables them to defraud the process. Also, the danger that certain unpredictable contingencies may occur causes variances in cash flow projections.

Credit risk planning follows measurement. It was generally observed to be done across all banks, with the ultimate objective of ensuring that the most severe and priority risks are provided for in terms of budget and other resource allocations. Findings revealed that all banks undertake risk planning which scopes most possible future risks and often provides appropriate covenants for risk mitigation. Risk planning further draws appropriate activities or events that could be undertaken to enhance repayment. Notably, the entire risk planning process was observed to consider all identified risks and plan for their mitigation in view of their magnitude. Interviews further revealed four major categories of risk mitigants including: risk avoidance, risk acceptance, risk retention and risk transfer. These were quite often planned for depending on their magnitude. For example retention or acceptances were quite often allocated to very low risks. Acceptance or retention meant that the bank went ahead to approve the facility. In contrast, transfer was often allocated for medium risks which meant that banks approve the facility but shares the risk with a third party. Avoidance was quite often applied to high risks. Notably, allocation of risk mitigants was always followed by convents to minimize chances of occurrence. Finally risk planning across all banks involved resource allocation in terms of responsible persons to handle the risk mitigation process, budget, and further establishment of the methods that will be empowered to handle the risk. It is worth noting that risk planning was observed to face insignificant constraints. It was perceived an easy task to handle since it relied on readily available information with minimal time take to complete the planning.

Credit risk approval was considered as the last component of assessment practiced across all commercial banks. Credit risk approval is a form of judgment that a risk is worth or not considering for credit. The approval process was characterized by several positives. First, credit risk approval was reported to be done in accordance with the banks 'credit policies. In addition, the credit facilities are often appropriately approved. There were general concerns however about granting many exceptions for credit facilities. Exceptions were perceived to be associated with manipulation of the credit risk approval process since they were often recommended from top management to the approvers. Though exceptions were expected to be guided by a standard criterion which existed in all banks, though it was perceived to be quite often violated. There were also some perceptions that exceptions were granted based on technical know who or informal relationships with senior officials.

Though all banks had a credit approval process in place, with various individuals approving different credit amounts as stipulated by credit policy, the approval process was also perceived to be prone to ethical violation. There were concerns that the relevant persons along the process sometimes connive with the loan applicants to manipulate documents towards meeting the loan requirements unrealistically. Notably, a challenge of lack of a specific credit risk management personnel emerged at the risk assessment stage. The credit risk management engages Relationship Manager, Analysts, Credit Officers, Risk Managers and Recovery Officers. The role of the relationship managers is strictly to source business both new and additional within the existing base, the analysts do the credit assessment, Credit Officers sanction credit, Risk Managers review files to ensure risk aspects have been unveiled and mitigated, and recovery officer carry out credit monitoring and reporting as the collect the lent funds. The credit risk management process requires a specific position given the uniqueness and complexity that comes with balancing business credit decisions as well as the technical risk handling dynamics. Like in most banks today, Relationship Managers and Credit Officers are more inclined towards executing business, while risk officers tend to prioritize the operations as risk experts.

Credit risk control practices

Risk control was considered the last stage of the CRM process. The general view was that risk control is the process of responding to risk by providing assurance mechanisms and reporting. The ultimate objective of risk control was to minimize potential occurrence of the risk and its impact. A critical analysis of informant views identified some critical areas of strengths and weaknesses in credit risk control along the dimensions of; risk assurance, monitoring and reporting.

Credit risk response is the first aspect of credit risk control, which was universally observed to be practiced across commercial Banks. Risk control was characterized with several areas of strengths across the banks. Generally, credit risk facilities were often validly declined, and for risks shared with guarantors, the necessary conditions are often validly met. It was also observed that guarantors quite often meet their payment obligations. Some banks often accept risks and undertake credit risk sharing through syndication or partnering with guarantors. However, although it often emerged those banks insure credit facilities; the insurance obligations are sometimes not met. This could be because of the many bureaucracies encountered in the insurance process. Generally, descriptive findings on credit risk response characterized good practices. It was reported that credit insurers sometimes do not meet their obligations. Although they accept to take on insurance, the insurance facility is characterized with complexities. For example while salary loans may be insured by job loss, non-repayment may be caused by death of the client, which the insurance will fail to pay. Sometimes when syndication happens, the terms of the syndication may not be compatible between the two banks though sharing risks with guarantors bear potential for banks to reduce risks. The legal cost of enforcing the insurance obligations are high that banks are reluctant to foot the costs.

Credit Risk assurance (CRA) was considered the second aspect of credit risk response. The general view across all the banks was that CRA was done with a number of good practices. Specifically, credit reviews and monitoring are often done with in time and banks do close follow ups on loan clients. While the weaknesses could be explained by many factors, findings established that many banks had no specific staff responsible for covenant monitoring. This bears an implication on the quality of monitoring and reviews since the assigned staff have huge workloads amidst other responsibilities. To affirm this, views often pointed out that monitoring done by most banks is on desk rather than field visits. Consequently, the information obtained through this kind of monitoring was found to be quite often unreliable. Arguably, effective credit risk review and monitoring was observed to necessitate client visits to validate and get facts and additional informal information beyond online/ desk communication and loan performance records. Banks need to expand their physical engagement with clients beyond the telephone and office environment visits.

The other gap to effective review and monitoring observed by key informants was the frequency of reviews. Banks need to do reviews more frequently preferable on a daily basis and as and when set triggers indicate. This implies that banks have to beef up budgets to conduct such frequent activities. Dependence on online methods of monitoring was associated with minimal effectiveness particularly on account of low level of technologies. Only a few banks particularly international were considered to have invested in advanced technologies for loan monitoring. While it is appreciated that many commercial banks invested in their core banking systems, functionalities relating to credit risk monitoring were found to either be lacking or inactive.

Credit risk reporting was considered =the last aspect of credit risk control. The general view was that credit risk reports were often shared with relevant stakeholders for management decision making. The reports were clear and accessed on time, and as and when required. Similarly, the reports were periodically shared with external stakeholders. This characterized a strong loan reporting mechanism. The banks have strong recovery procedures which are timely and appropriately executed. However their effectiveness remains an issue of concern. The current mechanism employed, where banks tend to use third parties for recovery, the effectiveness was found to still be low. A number of loses are encountered due to inevitable incapacity to repay; for example business running bankrupt, job loss and deaths amidst loan insurance challenges. Market competition has forced banks to come up with more competitive although risky propositions. The unsecured bank loans for example pose a gap to dispose no security if default happened. The effectiveness of the recovery process is also compromised by informal threats from defaulting customers. While the recovery process is well streamlined, in practice events do not follow the straight path, especially with regard to the rural clients. It is important to note that by recovery time, most facilities have reduced in principal value, which puts the customer to discomfort and compromises the recovery process

CRM challenges: A nexus between the study findings and theoretical Assumption

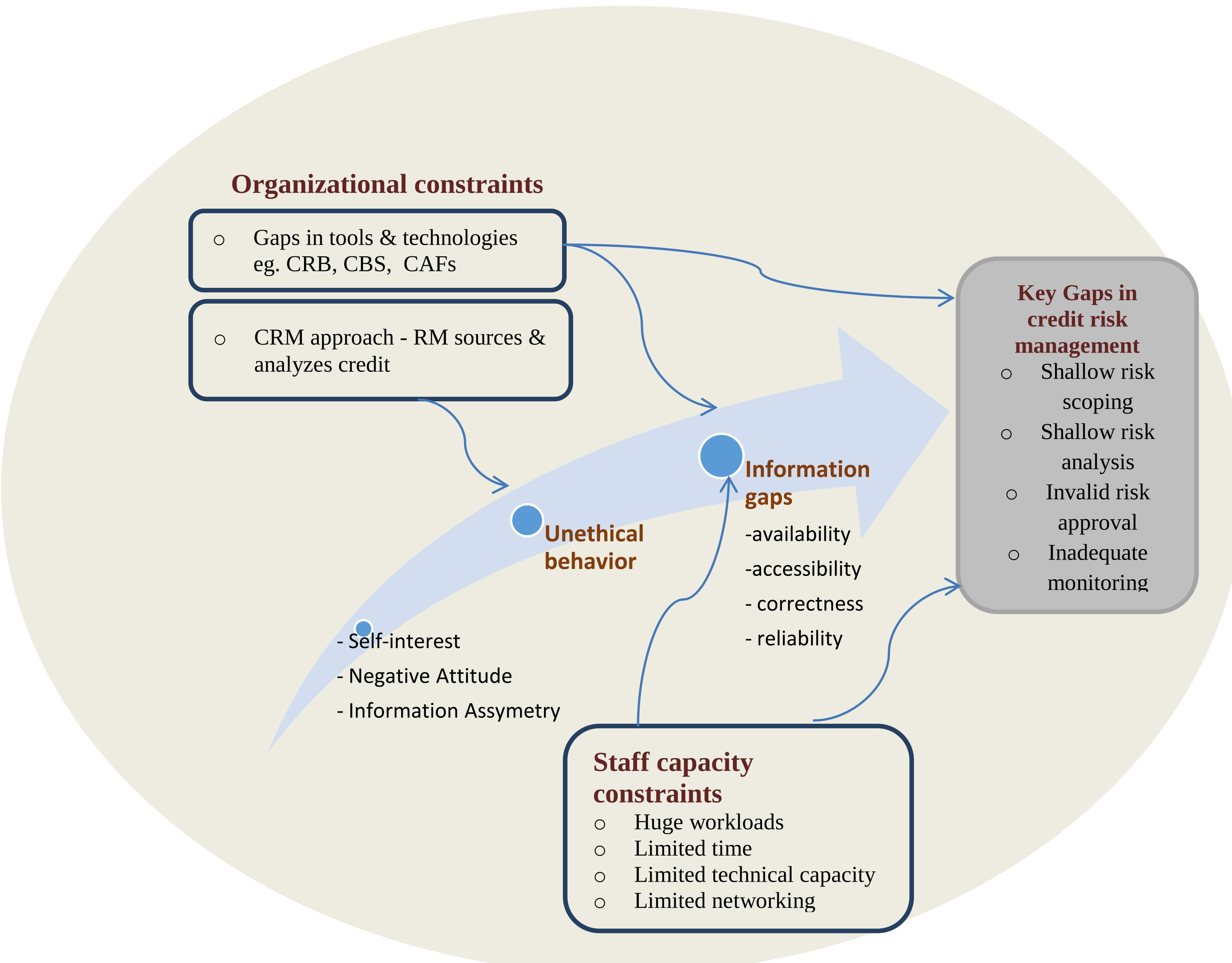

Figure 2: CRM challenges: A nexus between the study findings and theoretical Assumption

As indicated in figure 2, the credit risk management process in Uganda's commercial banks is characterized by shallow risk scoping, shallow risk analysis, invalid risk approval and inadequate monitoring. These gaps mainly feature at the stages of credit risk identification and assessment. A deeper scan into the root causes of these challenges revealed factors which reflect broadly; staff capacity constraints, organizational constraints and unethical behavior. Staff capacity and organizational (bank-specific) constraints are central because they directly cause gaps in credit risk management. Staff capacity gaps entail limited time, huge workloads and technical competence to undertake thorough risk scoping and rigorous analysis. The organizational challenges entail gaps in tools and technologies for risk identification, assessment and monitoring for instance the Credit Reference Bureau (CRB), the Core Banking System (CBS) and Credit Application Forms (CAFs). These challenges indirectly compromise credit risk management by affecting availability of reliable, correct and adequate information to inform risk scoping, analysis and monitoring.

Besides, capacity gaps, information gaps were observed to also result from unethical conduct of staff during execution of credit risk identification and assessment. It emerged that the staff besides working to meet the portfolio quality requirements, were compromised by their self-interests or specifically desire to earn bribes from borrowers. This compromise the quality of risk scoping and assessment and ultimately provide inadequate, biased or incorrect information that misguides the loan decision to the benefit of the customer and the staffs' self-interests. The self-interest problem was exacerbated by the likeliness that the approvers were prone to having inadequate or incorrect information for decision making compared with the agents (relationship managers). In some instances, the relationship managers who solicit the business were at the same the analysts which compromised document verification and risk assessment.

The above findings concur with the assertions of the principal agent theory as well as the information asymmetry theory which assume a possible pursuit of self-interests by the agents and unethical behavior partly due to the problem of adverse selection. The relevance of information for effective credit risk management is consistent with Wideman's risk management model (Wideman, 1992) which assumes that information adequacy is directly related with risk management. The identified individual capacity and organizational challenges which undermine the quality of credit risk management reflect inability of the principal (commercial banks shareholders) or managers of the credit risk process to provide adequate support to the operations staff in credit risk managed. This is in accordance with the assumption of the agency theory that the principal is obliged to fulfill its obligation of supporting the agent to effectively execute the designated mandate.

CONCLUSION

Uganda has over the years consistently portfolio quality challenges which have led to a series of financial turmoil.. A variety of empirical literature associate portfolio performance with credit risk management and suggest the need to improve credit risk management towards enhanced portfolio performance. Contributing to this body of knowledge, this paper explored credit risk management practices in the context of Uganda 'commercial banks with a view to identifying strategies for improvement. Based on interviews conducted on key stakeholders in credit risk management in Uganda's commercial banks, this study establishes that credit risk management involves three key sequential stages. They are; credit risk identification, credit risk assessment and credit risk control. Though the stages characterize an ideal credit risk management process, critical gaps including shallow risk scoping, shallow risk analysis, invalid risk approval and inadequate monitoring were established. A deeper scan into the root causes of these challenges revealed factors which reflect broadly; staff capacity constraints, organizational constraints and unethical behavior. These findings concur with the principal agent theory as well as the information asymmetry theory which assume a possible pursuit of self-interests by the agents and unethical behavior partly due to the problem of adverse selection. In terms of approach to credit risk management, a case where credit officers source and acquire potential clients, assess and recover loans was associated with high risk of compromising the quality of assessment amidst the strive to meet sales targets. Notably, an alternative approach involved relationship managers sourcing potential clients, Credit Analysts assessing credit, sanctioners approving and recovery officers recovering the credit was associated with minimal risks.

RECOMMENDATIONS

Commercial banks need to address capacity gaps and unethical behavior among the staff, institutional challenges as well as information gaps in credit risk management towards improving credit risk management and enhancing its effectiveness with regard to the effect on portfolio performance. Commercial banks need to introduce the Credit Risk Manager position to address potential biases which arise from the credit risk management structure where the relationship managers who solicit the business undertake risk analysis on the other hand which compromises the quality of document verification and risk assessment

Further research is needed to assess banks' compliance with existing policies, guidelines and standards regarding credit risk management. Though the paper establishes that banks have documented policies, guiding policies, principles and standards and relied on the views of respondents to assess the credit risk management practices, it could not affirm whether the documented process and practices are complied with due to a limitation of document inaccessibility. The analysis of compliance should review documents in triangulation with the views shared by respondents in this study and other similar studies regarding the credit risk management process and practices.

Further research is also needed to ascertain effectiveness of the Credit Reference Beurial as major universal source of information which informs analysis of indebtedness and repayment character of the borrower. Such a study can be further rationalized by the prevailing gaps in the Credit Risk Beurial identified in this study which potentially undermine its effectiveness in guiding identification of credit risk.

Last but not least, a detailed capacity assessment of the credit risk management function is needed to precisely identify the specific capacity gaps in terms of human resource skills, tools and technologies contextualized to individual commercial banks. This study was able to identify capacity as a key constraint to effective credit risk management but could not ascertain specific capacity strength and weaknesses for the individual commercial banks.

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