MAKERERE UNIVERSITY

FINANCIAL MANAGEMENT PRACTICES, COMPETITIVE ADVANTAGE AND LOAN PERFORMANCE OF MFIS IN UGANDA

BY

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2012/HD10/2358U

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MSC. ACCOUNTING AND FINANCE

A RESEARCH DISSERTATION SUBMITTED TO THE GRADUATE SCHOOL IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF A MASTER OF SCIENCE IN ACCOUNTING AND FINANCE OF MAKERERE UNIVERSITY

SEPTEMBER, 2014.

PLAN A

DECLARATION

I Akankunda Brendah hereby declare that this dissertation titled; “**Financial management Practices, Competitive advantage and Loan performance of MFIS in Uganda”** is my original work except where acknowledged and has not been presented before to any University.

.... ……………………………..........

Signature Date

APPROVAL

This is to certify that this Dissertation titled "**Financial management Practices, Competitive advantage and Loan performance of MFIS in Uganda"** has been done under our supervision and is now ready for our approval.

Signature…………………………………… Signature…………………………………

Dr. Stephen Nkundabanyanga Ms.Irene Nalukenge

Date………………………………… Date………………………………………

DEDICATION

I dedicate this dissertation to my Parents, employers, supervisors, lecturers, colleagues, friends and everybody who has worked tirelessly to ensure that I am what I am today.

ACKNOWLEDGEMENT

First of all, I am highly indebted to the almighty God who has been my provider in all times of need. This work would not be completed without His divine Grace.

Secondly, I extend my sincere appreciation to my employer (Makerere University Business School) who offered me a scholarship to pursue further studies. In particular, I thank the Principal, the Dean faculty of Commerce, the Head department of accounting and management for giving me this lifetime opportunity. Continue enabling the future please.

In the same spirit, I thank my academic supervisors (Dr. Stephen K. Nkundabanyanga and Irene Nalukenge) for their tireless effort and guidance. Similarly I thank Prof. Venancio Tauringana, Ms. Mary Nanyondo, Mr. Ernest Abaho, Mr. John Paul, Mr. Bonny Bagenda, Mr. Ongee Walter Latigo and all lecturers who supported me on this program. It is only God who can reward you what you deserve.

Likewise, I convey my sincere appreciation to my parents and friends for their parental support and care. It was your endurance, support, prayers, among others that I have been able to finish this work.

I cannot forget to thank my fellow students of the MSC in Finance and Accounting 2012/14. I pray that all of you consider this omnibus appreciation.

I also convey my appreciation to all my colleagues of MUBS who have assisted me in ensuring that I am able to finish this work. In particular, let me thank all staff of the accounting department for their willingness to teach on my behalf whenever I requested them. I thank Mr. Johnson Sekakubo, Mr. Gidion Nkurunziza and Mr. David Katamba for their guidance on methodology and data analysis.

Lastly, I must thank the Management and staff of Microfinance support centre-Kampala Offices for their support in proving the relevant information. Along this line, I candidly thank all respondents from the various MFIS that filled and returned the questionnaires for this study. It is only God who can reward what you deserve.

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LIST OF ABBREVIATIONS

AMFIU	:	Association of Micro Finance Institutions of Uganda
DFID	:	Department for International Development.
GTZ	:	Germany Agency for Development Corporation
MFIS	:	Microfinance Institutions.
MFPED	:	Ministry of Finance planning and Economic Development.
MSC	:	Microfinance Support Centre.
OECD	:	Organization for Economic Cooperation and Development.
SACCOS	:	Savings, Credit and Cooperative Societies.
UCSCU	:	Uganda Cooperative, Saving and Credit Union.
U.S.A	:	United States of America
SPSS	:	Statistical Package for Social scientists

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ABSTRACT

The study examined the relationship between financial management practices, competitive advantage and loan performance of MFIS in Kampala region. The study aimed at investigating the cause of a sharp rise in loan defaults in loan performance. A conceptual frame work was developed relating financial management practices (Risk management, Working capital management and Budgeting)

The motivation of this study was the fact that the Bank of Uganda and other stakeholders had directed their effort towards improving the performance of MFIS. Despite this, Bank of Uganda had highlighted declining loan performance of MFIS in Uganda.

The research adopted a blend of cross sectional and descriptive research design and simple random sampling was used for the study. The population included 84 MFIS from which a sample of 70 was obtained. A simple random sampling technique was used. Primary data was obtained from 61 MFIS, providing a response rate of 87%. The data were collected using a self-administered questionnaire with perceptions and beliefs sought to a five point Likert scale.

The data obtained were analysed using factor, correlation, regression and Normality tests. From the analyses, it was established that, financial management practices, competitive advantage have significant and positive effect on loan performance of MFIS with a total contribution of 43%.

In reference to the findings of the Study, the researcher concluded that a significant positive relationship existed between financial management practices, competitive advantage and loan performance of MFIS in Kampala region. As such recommendations were made in line with improving and enhancing the financial management practices and competition of these MFIS such as risk management and working capital gaps assessment in order to achieve a competitive advantage for MFIS products for future loan performance. MFIS strategies to minimize losses require effective Bank management practices that may reduce poor loan performance.

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CHAPTER ONE

1.0 Introduction

This chapter presents the background of the study, Statement of the problem, Purpose of the Study, objectives of the study, research questions, scope of the study, significance of the study and conceptual framework.

1.1 Background of the study

In developing countries, Microfinance Institutions (MFIs) serve as better avenues for providing microfinance services to the disadvantaged members of society as well as to small and medium enterprises (SMEs), than the well-established financial institutions (Parikh, 2006; Kumar, 2009; Collier, 2011; Moti, 2012). However, Kalyango (2005) noted poor loan performance of MFIs in Uganda. Since then a number of researchers (Kasekende, 2009; Ssewanyana, 2009) and commentators have justified Kalyango's observation. These have indicated that the loan performance of Ugandan Microfinance institutions has continued to deteriorate despite the increased effort to boost the firms' competitive advantage through improved investment in intellectual capital assets (Kamukama, 2011; Adongo 2012; Hinz, 2012). While others (Bank of Uganda, 2012) have attributed the deterioration of a fall in loan performance to poor loan portfolio, in the 1990s, a number of researchers suggested a framework, based on the dual concepts of outreach and sustainability, for the assessment of MFIs performance (Kereta, 2007).

Frequently, however, loan performance (Keiding et al., 2004; De Crombrugghe et al., 2008), outreach and efficiency (Chua & Llanto, 1996; Hermes & Lensink, 2011) have featured as performance indicators of MFIs. Chua & Llanto (1996) used two parameters to measure outreach. That is 'average loan size' and 'total loans released to loans outstanding.' Hermes et al., (2008) also considered average loan balance per borrowers and percentage of female borrowers to assess outreach performance of MFIs. Some authors concentrate on financial efficiency and productivity other than outreach (Ejigu, 2009; Hassan & Sanchez, 2009).

Ejigu (2009) for instance measured depth and breadth of outreach by average loan size. In addition, loan performance has also been used as a surrogate for financial sustainability. For example, a study by the Consultative Group to Assist the Poor (CGAP) pointed out in 1996 that loan repayment (measured by default rate) could be used as an indicator for financial sustainability of MFIs, because low default rate would sustain its lending business (Roy &

Goswami, 2013). All this suggest that loan performance has already attracted a growing interest by a number of commentators and researchers. It seems this growing interest is because of its ability to represent MFIs performance from the two angles: outreach and sustainability.

Nevertheless, while literature is replete with the measurement MFI performance, less empirical studies can be noted that have explained loan performance. This lack of knowledge on efficient predictors of loan performance continues to restrain our understanding of why loan performance remains poor. Available evidence suggests that MFIs lending in Uganda reduced to lower levels for the period 2011/2012 as compared 2010/2011 (CGAP, 2012; Bank of Uganda, 2012). Similarly, data from MFIs in the East African region show that the average rate of annual growth of private sector credit was lower in June 2012 at a regional average of 22.4 percent compared to 28.6 percent in June 2011. Moreover, although domestic macroeconomic conditions weakened during the first half of 2011/2012, with higher inflation, exchange rate depreciation and lower aggregate demand affecting loan performance, it is reported that the fall in asset growth was mainly due to a decline in the loan growth rate from 43.6 percent in 2010/2011 and to 10.8 percent in 2011/2012. Thus loan performance challenges still exist particularly in MFIs where default risk was highest (Balasubramani, 2012; Fred, 2012; Noor & Ahmad, 2012; Sseremba, 2012).

This study argued that financial management practice and competitive advantage is the important predictors MFIs' performance (Kamukama, 2011). Azhar (2010) describes financial management practices as financial planning and control, financial analysis, risk management, accounting information, management accounting (pricing and costing), capital budgeting and working capital management. We can therefore predict that proper financial management of MFIs is positively related to loan performance. This argument finds credence since failure to monitor portfolio quality closely (Mulumba, 2011; Adongo, 2012) and take action when necessary is thought to account for the poor loan performance of microfinance institutions (Kalyango, 2005). Similarly, once credit risk remains elevated, manifested by a reduction in asset quality with the ratio of non-performing loans to total loans rising, this can be a pointer to poor financial management.

Some theoretical assertions confirm that competitive advantage mediates the association between financial management and loan performance (Barney & Hansen, 1994), but empirical evidence in the existing literature is limited (Barney, 2001; Detragiache, 2004; McKinnon & Liu, 2013). Thus there are sufficient theoretical underpinnings linking financial management practices and competitive advantage to the performance of MFIs (operationalized by loan performance), yet limited empirical evidence supports the connection. Thus the study seemed to bridge this knowledge gap.

1.2 Problem Statement

Many financial institutions in developing countries provide financial services such as saving and credit to aid several smallholder enterprises including the poor. This is an effort in line with the Millennium development goals which seeks to reduce poverty by 50% by the year 2015. However, The Central Bank Annual Supervision Report (2012) indicated high incidence of credit risk reflected in the rising levels of non- performing loans, high default rates by the MFI’s in the last 10 years, a situation that has adversely impacted on their profitability, without sound loan performance the sustainability of these microfinance institutions is not possible. Studies designed to address poor loan performance of MFIs have failed to restrain the challenge. Although empirical studies have been carried out to explain loan performance of MFIs using different predictor variables, little is known in examining the dimensions of loan performance in terms of loan cost efficiency and default rates. This study therefore has claimed that the poor loan performance of MFIs is attributed to financial management practices and competitive advantage.

1.3 Purpose of the study

The purpose of the study was to find out the effect of financial management practices and competitive advantage on loan performance of Microfinance Institutions in Uganda.

1.4 Objectives of the study

i. To examine the relationship between financial management practices and loan performance

ii. To examine the relationship between financial management practices and competitive advantage of an MFI

iii. To Establish the relationship between competitive advantage and loan performance of an MFI

iv. To examine the mediation of competitive advantage on the relationship between financial management practices and loan performance

1.5 Research Questions

i. What is the relationship between financial management practices and loan performance?
ii. What is the relationship between financial management practices and competitive advantage?
iii. What is the relationship between competitive advantage and loan performance?
iv. What is the mediation of competitive advantage on the relationship between financial management practices and loan performance?

1.6 Scope of the study

The scope of the study included the subject scope, the geographical scope and the time scope as below:-

Subject scope

The subject scope of this study was financial management practices, competitive advantage and loan performance of microfinance institutions in Kampala.

Geographical scope

The study was conducted on Microfinance institutions registered with the Microfinance Support Centre and AMFIU in Kampala, Kampala was chosen to represent other regions because it is where most of the MFIs are concentrated and also this region has both poor and rich people that use MFI products. As such, the success of MFIs in this region may be a solution to addressing the poverty problem.

1.7 Significance of the study

Since evidence obtained was to the effects that financial management practices and competitive advantage relate to loan performance of MFIs, the significance will include the following:-

Using the findings from this study, MFIs may improve on their loan performance by imbedding financial management practices and competitive advantage in their operations.

In addition, it may help policy makers to direct their policies and boast their advocacy for financial management practices and competitive advantage in MFIs as a means of enhancing their loan performance.

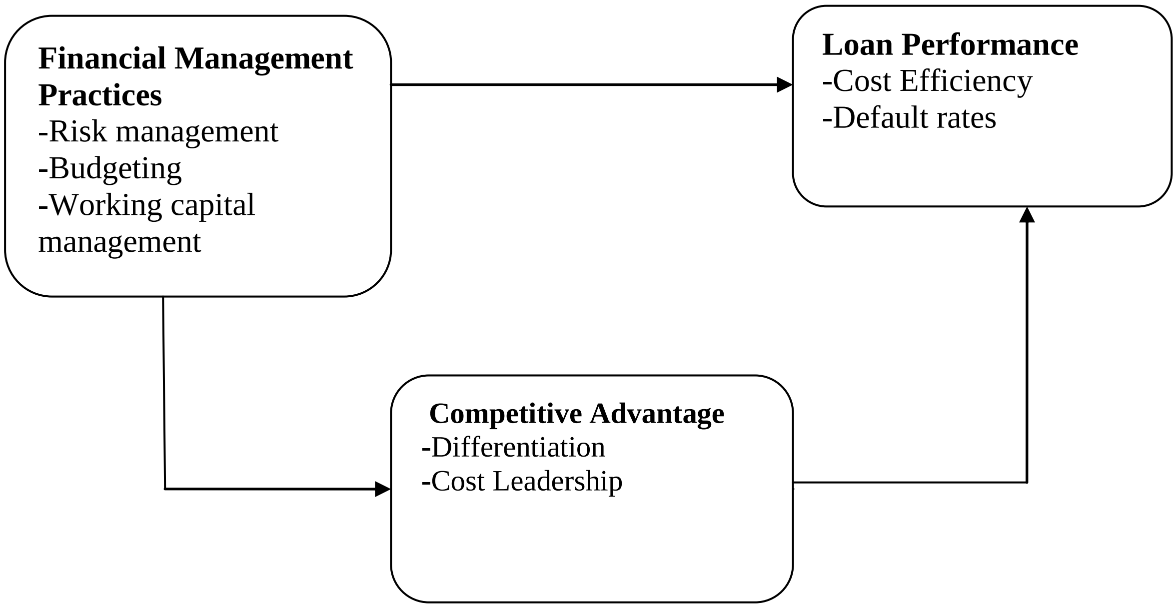
It has also helped to establish the extent to which the variance in loan performance of MFIs could be explained by financial management practices and competitive advantage. This study has also identified a possibility of other unexplained factors that may explain the poor loan performance of MFIs.

Lastly, the findings from this study are also expected to add on the body of existing knowledge in the area of financial management practices, competitive advantage and loan performance of MFIs. Ugandan microfinance can improve its Loan performance whilst still enabling MFIs to achieve financial and operational sustainability. These include government incentives for MFIs to increase their outreach beyond urban limits, capacity building of MFIs to foster suitable products, policies and procedures, and the publication of interest rates and product fees charge by MFIs so as to motivate competition and efficiency in the sector as Several internationally recognized initiatives, such as MF Transparency, are working to help strengthen the sector and improve the delivery of responsible microfinance in Uganda (Katabarwa, 2009).

1. 8 Conceptual Framework

The conceptual frame work below suggests a relationship between financial management practices and loan performance, financial management practices and competitive advantage, competitive advantage and loan performance and the mediation of competitive advantage on the relationship between financial management practices and loan performance. The conceptual framework below, derives from the view that improving financial management practices (ensuring effective working capital management, risk management and budgeting) will enhance effective competitive advantage (cost effectiveness and differentiation); competitive advantage refers to the comparative positional superiority in the marketplace that leads firms to outperform their rivals (Porter & Millar, 1985). In other words, Figure 1 demonstrates the essence of financial management practices in influencing MFIS to attain a distinctive competitive advantage therefore enhancing loan performance (Ahearne et al., 2004; Orobia, 2013).

Figure 1: Conceptual frame work



Source: *Adapted and modified from (Berger, 2005; Porter & Millar, 1985; Rosenberg, 2009; Gonzalez, 2011)*

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter presents the literature reviewed on the study variables as shown in the conceptual framework. In particular, it presents literature on the relationship between financial management practices and loan performance; financial management practices and competitive advantage; and competitive advantage and loan performance. After looking at the literature available, the researcher identified gaps that prompted her quest to carry out this study. This was done to ensure that the objectives of this study were addressed.

2.1 Financial Management Practices

Gitman & Joehnk (2010) defines financial management as the area of business management, devoted to a judicious use of capital and a careful selection of sources of capital, in order to enable an organization to move in the direction of reaching its goals. By extension, (Hunjra & Niazi, 2011) explained that financial management practices as financial planning and control, financial analysis, risk management, accounting information, management accounting (pricing and costing), capital budgeting and working capital management.

Azhar (2010) views financial management practices as the process of managing the financial resources, including budgeting, accounting and financial reporting and risk management.

Moti & Masinde (2011) reveals that a key requirement for effective credit management is the ability to intelligently and efficiently manage customer credit lines. In order to minimize exposure to bad debt, over-reserving and bankruptcies, companies must have greater insight into customer financial strength, credit score history and changing payment patterns. The ability to penetrate new markets and customers hinges on the ability to quickly and easily make well-informed credit decisions and set appropriate lines of credit.

2.1.1 Risk Management

Beresford-Smith & Thompson (2007) provides that the management of credit risk is now commonplace in most financial institutions where safeguards are needed to lower potential losses from defaults on loans. Quantitative methods for managing these and other risks are now required in most countries. Risk management is a cornerstone of prudent banking practice.

Al-Tamimi & Al-Mazrooei (2007) provides that all banks in the present-day volatile environment are facing a large number of risks such as credit risk, liquidity risk, foreign exchange risk, market risk and interest rate risk, among others – risks which may threaten a bank's survival and success. In other words, banking is a business of risk. For this reason, efficient risk management is absolutely required.

According to the consultative paper issued by the Basel Committee on Banking Supervision (1999), Hassan & Sanchez (2009), most banks' loans is the largest and most obvious source of credit risk. Banks are increasingly facing credit in various financial instruments other than loans, including acceptances, interbank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, the extension of commitments and guarantees, and the settlement of transactions.

Lu & Wetmore (2006) examined the relationship between liquidity risk and loans-to-core deposits ratio of large commercial bank holding companies. He concluded that the average loan-to-core deposit ratio had increased over the period studied, which reflects a change in the asset/liability management practices of banks. He also concluded that there is a positive relationship occurring between market risk and the change in loan-to-core deposits ratio after 1994, with a negative relationship occurring before 1994.

Al-Tamimi & Al-Mazrooei (2007) investigated the degree to which the UAE commercial banks use risks management techniques in dealing with different types of risk. The study found that the UAE commercial banks were mainly facing credit risk. The study also found that inspection by branch managers and financial statement analysis were the main methods used in risk identification. The main techniques used in risk management according to this study were establishing standards, credit score, credit worthiness analysis, risk rating and collateral; the study also highlighted the willingness of the UAE commercial banks to use the most sophisticated risk management techniques, and recommended the adoption of a conservative credit policy.

2.1.2 Working Capital

Working capital management is a very important component of corporate finance since efficient working capital management will lead an institution to react quickly and appropriately to unanticipated changes in market variables, such as interest rates, operational costs and gain competitive advantages over its rivals (Appuhami & Perera, 2011). MFI's will consider the cash flow from the business, the timing of the repayment, and the successful repayment of the loan. Anthony & Choi (2006) defines working capital as the cash a borrower has to pay his debt. Cash flow helps the MFI's to determine if the borrower has the ability to repay the debt. The analysis of cash flow can be very technical. It may include more than simply comparing income and expenses. MFI's determines cash flow by examining existing cash flow statements (if available) and reasonable projections for the future (ratios).

Abuzayed (2006); Usman & Makki (2006); Ahmad (2012) view that working capital management is concerned with the problems that arise in attempting to manage the current assets, the current liabilities and the interrelationship that exists between them. Not being able to maintain a satisfactory level of working capital, it is likely to become insolvent and may even be forced into bankruptcy.

2.1.3 Budgeting

The management accounting practices of budgeting, and performance measurement and reporting are considered important in the current economic environment (Butterworth & Punt ,1999; Tooley & Guthrie, 2007).

Budgeting is the process of preparing and using budgets to achieve management objectives. A budget represents management's plans of action for future periods of an organization (Pavlatos & Paggios, 2008). Extensive use of budgeting has been documented in studies. Proponents of budgeting argue that budgets have several important roles. Blocher & Miles (2007), for instance argued that budgets help to allocate resources, coordinate operations and provide a means for performance measurement. Hilton (1999) agrees with this view and claim that the budget is most widely used technique for planning and control purposes. The Institute of Cost and Management Accounts defines a budget as a plan quantified in monetary terms, prepared and approved prior to a defined period of time, usually showing planned income to be generated and/or expenditure to be incurred during that period and the capital to be employed to attain given objectives (Mordi & Amobi, 2011).

2.2 Competitive Advantage

Competitive advantage is widely conceptualized as a situation in which a firm earns a higher rate of economic rents than the average competitor (Stoelhorst & Bridoux ,2006; Kamukama & Ahiauzu, 2011). (Porter & Millar, 1985) identifies three generic strategies that offer fundamentally different routes to competitive advantage, combining a choice about the type of competitive advantage sought with the scope of the strategic target in which competitive advantage is to be achieved: Differentiation and cost leadership strategies aim at competitive advantage in a broad range of industry segments, while focus strategies target cost advantage (cost focus) or differentiation (differentiation focus) in a narrow segment. Competitive advantage exposes an MFI to the risk of inertia and lock-in. While ‘‘strategic fit among activities is fundamental not only to competitive advantage but also to sustainability of competitive advantage’’ (Porter & Millar, 1985; Tushman& O'Reilly, 2013; Angellah & Martin, 2010).

2.3 Loan Performance

The concept of loan performance refers to the ratio of nonperforming advances (loans) to the total portfolio. A non performing advance/loan is that part of loan whereby interest and principal instalment are still outstanding for at least six months after they are due (Mugoya, 2012; Bank of Uganda, 1992). It can be calculated as follows:

$$\text{None performing ratio} = \frac{\{\text{Non Performing advances}\}\ \text{X}\ 100}{\text{Total loan portfolio}}$$

According to Bank of Uganda report (1992), a ratio of 10% is accepted to be non-performing and the higher the ratio, the worse the loan performance. Performance of loan portfolio may be measured using proxies for loan cost efficiency and default rates. A high proportion of loans to total assets and rapid growth of the loan portfolio are potential early warning signals of loan quality problems which indicate potential failure (Sinkey Jr & Blasko, 2003).

As noted by (Berkovec & Canner, 1994) simple comparisons of average loan performance between two groups of borrowers can be misleading if the groups do not exhibit similar distributions of expected returns. If, for example, the proportion of highly qualified non-minority borrowers is substantially higher than that of highly qualified minority borrowers, default rates of non-minority borrowers—observed without controlling for other determinants of credit quality would be lower than those associated with minority borrowers. This finding, however, would simply reflect the differences in average creditworthiness for the two groups of borrowers and would not necessarily indicate differential underwriting standards (Ferguson and Peters, 1997) Simple bivariate correlations suggest that default probabilities differ significantly by loan, borrower, and location characteristics. For example, higher default rates appear to be associated with higher loan-to-value ratios, lower incomes, and smaller loan amounts. Another caveat is that the basic theoretical prediction that cost efficiency in better observed relative loan performance depends on the assumption that lending costs are efficient (Berger & Udell, 2004).

Hypotheses development

2.4 Financial Management Practices and Loan Performance

Measuring the effect of financial management practices on loan performance is instrumental to understanding the channels through which internal practices affect the lending process. Rehman & Mahmood (2010) suggests that optimal application and commitment towards financial management practices result in an increased company's perfomance, the financially well managed MFIs are operastionally efficient. Marrison (2002) articulates that the main activity of bank management is not deposit mobilization and giving credit but rather management practices applied, effective credit risk management reduces the risk of customer default.

Loan performance serves as a positive signal for increasing the volume of credit availability to various sectors of the economy (Acquah & Addo, 2012; Heiat & Sah, 2013), but most of the loans default arises from poor management procedures. Kohansal & Mansoori (2009) using a logistic model to investigate the factors affecting loan performance of farmers in Khorasan- Razavi Province of Iran, found that the success of individual MFIs in credit risk management is largely reflected in the proportion of delinquency's loans to gross lending.

In examining loan performance in India, (Deininger & Liu 2009) find that loan monitoring, increase repayment performance. Other studies (Deininger & Liu, 2009; Tuyon & Alfonso, 2009; ACCA, 2009; Varcoe & Wright, 1989; Dowling, 2009; Mensah, 2011, Fatoki, 2012) have reported the positive effects of using selected financial management practices on loan performance. Mitchell (2007) contends that in handling your financial situation in a responsible manner to achieve the desired goals, good financial management requires good planning. Weak financial management – particularly poor working capital management is one of the causes of failure among small businesses (Berryman, 1983; Dunn and Cheatham, 1993; Lazaridis and Tryfonidis, 2006). Other various studies show that financial management practices have a significant effect on the loan performance of MFIs, and these practices have included financial planning and control, financial analysis, risk management, accounting information, management accounting (pricing and costing), capital budgeting and working capital management (Nguyen, 2001; Osman, 2007; Azhar , 2010;Agyei-Mensah, 2011; Maseko & Manyani, 2011; Zaheer, 2010). Given the foregoing review of literature, it is reasonable to expect a positive relationship between financial management practices and Loan performance. As such, and consistent with my 1st objective of this study, the following hypothesis will be stated:

H1: *There is positive relationship between financial management practices and loan performance*

2.5 Financial Management Practices And Competitive Advantage

Financial management practices promote a more strategic consideration of risk and its effective implementation can create a long term competitive advantage (Nocco & Stulz, 2006). Luhmann (2005) argues that risk unlike danger and uncertainty, implies a domain for decision making about the future. Therefore, risk management as a component of financial management practice creates an expectation of decidability and management of uncertainty and opportunity (Power, 2007).

Indeed, certain financial management practices provide strategies that can influence a large number of customers to have a lasting preference for an MFI's products. Thompson, Strickland & Gamble (2009) are of the view that the adoption of financial management techniques may provide an organization with a sustainable competitive advantage over its rivals.

According to Porter (1966), there are two principal ways in which a competitive advantage can be achieved: cost advantage (having a lower cost base than the competition) and differentiation (creating additional value for customers). Financial risk management can be used to achieve either objective. It can create a cost advantage by enabling a company to source the factors of production more efficiently by managing the associated loan risk caused by market volatility. It can also enable differentiation, by providing the ability to deliver an enhanced customer experience through a more stable pricing environment, or an ability to offer more advantageous business terms (e.g. pricing in domestic currency). The management of an MFI in conjunction with financial management function, need to apply competitive management skills in order to remain competitive in their industry. For Banks, Berger (2005) have outlined important bank management issues that may enhance competitiveness. These include adapting to a changing banking environment; analyzing bank performance and establishing profitability and risks; managing interest rate risks; managing the cost of funds, bank capital and liquidity; managing credit given to customers and managing the investment portfolio. It is arguable that these could also be important for an MFI management. In addition, the management accounting function can provide strategies that enhance the management of competitive forces, costs, risks and investments which will lead to the creation of a competitive advantage. It can then be concluded, consistent with my 2rd objective that:

H2: *There is a significant relationship between financial management practices and competitive advantage*

Since it is possible to have a positive relationship between financial management practices and competitive advantage, then it can reasonably be expected and consistent with my 4th objective that:

H3: *There is a positive relationship between financial management practices with an MFI's competitive advantage.*

2.6 Competitive Advantage and Loan Performance

Navajas (2003) studied competition in the Bolivian microfinance market by focusing on two major MFIs (Casa Los Andes & BancoSol), which collectively have around 40 percent market share. The results suggest that outcome of competition is ambiguous since competition leads to innovation thereby expanding outreach. However, it reduces the ability of lenders to cross-subsidize less profitable smaller loans. In a similar study, Vogelgesang (2003) examines how competition affects loan repayment performance for Caja Los Andes. The analysis indicates competition is related with multiple loan taking and higher levels of borrower indebtedness. However, when applied to an MFI for that matter, considerations that form the basis for sound credit management system include: policy and strategies (guidelines) that clearly outline the scope and allocation of a bank credit facilities and the manner in which a credit portfolio is managed, i.e. how loans are originated, appraised, supervised and collected (Basel, 1999; Greuning & Bratanovic, 2003; PriceWaterhouse, 1994). Screening borrowers is an activity that has widely been recommended by, among others, (Derban et al.

2005). The recommendation has been widely put to use in the banking sector in the form of credit assessment. However, borrowers attributes can also be assessed through qualitative models can be assigned numbers with the sum of the values compared to a threshold. This technique is termed as “credit scoring” (Heffernan, 1996; Uyemura & Deventer, 1993). The technique cannot only minimize processing costs but also reduce subjective judgments and possible biases (McIntosh et al., 2005; Derban et al.,2005). The rating systems if meaningful should signal changes in expected level of loan loss (Santomero, 1997).

Rosenberg, (2010) concluded that quantitative models make it possible to, among others, numerically establish which factors are important in explaining default risk, evaluate the relative degree of importance of the factors, improve the pricing of default risk, be more able to screen out bad loan applicants and be in a better position to calculate any reserve needed to meet expected future loan losses. Effective lending process and procedures have far reaching effect on loan performance levels. If client does not honour promises to pay, appropriate default recovery method procedures would have direct link to loan performance levels. The foregoing review leads us to believe and consistent with our sixth objective and **H5** that:

H4 (a) *There is a positive relationship between competitive advantage and loan performance*

H4 (b) *Competitive advantage mediates the relationship between financial management practices with loan performance*

2. 7 Conclusion

From the reviewed scholarly work, about financial practices, it is discovered that effective financial management leads to competitive advantage and loan performance (Njeru, 2012 ;Varrecchia, 2010; Tripsas & Gavetti, 2000; Obamuyi, 2011). Many researchers have emphasized the importance of loan performance, especially in lending to the poor (Stearns, 1995; Hulme & Mosely, 1996), Effective financial management practices and procedures have far reaching effect on loan delinquency levels (Njeru, 2012), poor loan performance can waste valuable funds and destroy a valuable service for the disadvantaged and the community as a whole. As a result, the issue of how to get money lent out back has become a priority for MFIs, (Collin et al., 2001). Several authors (Greenbaum et al., 1991; Hoque, 2000) suggest that when a loan is not repaid it may be a result of the policies that traditional lenders have used in their credit assessments procedures, which in turn decides who is granted a loan. However, a synthesis of literature indicates sparse studies on the combinatory effect of financial management practices and loan performance. Moreover my review has not come across any study dealing with the possible mediating effect of competitive advantage on the relationship between a financial management practices and loan performance.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

The chapter covers the methodology that was used in the study. In effect, it covers the research design, study population, sampling procedure and data collection methods, measurement of variables, validity and reliability, and data analysis that were used by the researcher.

3.1 Research Design

The researcher used a cross-sectional research design. That is, data for this study was gathered one-off, studied and results presented. The study involved use of both descriptive and analytical techniques.

3.2 Study Population and Sample Size

The study population comprised of a total of 84 legally registered MFIs in Kampala (AMFIU, 2012; Bank of Uganda Report, 2012). The sample size of 70 MFIs was determined using the formula for sample size determination provided by (Krejcie & Morgan, 1970).

3.3 Research Setting and Sampling Procedure

Simple random sampling was used to select MFIS. A table of random numbers using EPITABLE-random number listings was generated. All the MFIS were listed in alphabetical order and assigned numbers from 01 to 84. The selection criterion was based on the length of the largest numbers on the population list. Consistent with the rules of sampling, the researcher only selected cases from the list for the sample which corresponded with the identified number from the table. Using this process, the researcher ignored all the repeated numbers and numbers which were not on the population list. This process was continued until a desired sample size of 70 was achieved. The unit of analysis was microfinance institutions selected in Kampala and the unit of inquiry consisted of: Managers, Head of credit, Loans officers and Risk Officers. The study targeted three respondents per MFI, giving the targeted number of 210 respondents. The usable questionnaires from the respondents were 183 from 61 MFIS. The response rate was 87%.

The results that follow show both Organisational characteristics and background characteristics of the MFIS and respondents that were involved in the study. 210

questionnaires were administered to respondents in the 70 MFIs. Overall, the complete and usable responses were from 61 MFIS (about 87%). The results are shown in Table 1 below.

Table 1: Background Characteristics of the MFIs

Variable (N=61)	Category	Frequency	Percent
Legal status	Limited liability Company	3	5.4
	Company Ltd. By Guarantee	26	42.7
	Company Ltd by Shares	14	22.7
	SACCO	18	29.2
Duration of operation	5-10 years	15	24.3
	11-15 years	33	54.6
	16-20 years	9	14.1
	Above20 years	4	7.0

Source: Primary data

Regarding the legal status of the MFIs, Table 2 shows that the majority of the respondents (42.7%) were companies limited by guarantee, followed by SACCOs which comprise of 22.7%. The duration of operation of the respondents is such that majority (54.6%) had been in operation for 11 to 15 years, which is long enough for the organization to be in position to avail appropriate information for the study.

Table 2: Background Characteristics of the respondents

Variable (N=183)	Category	Frequency	Percent
Gender	Male	84	45.9
	Female	99	54.1
Education level	A' level	9	4.9
	Diploma	42	23.2
	Degree	123	67.0
	Masters	8	4.3
	Others	1	.5
Position in organisation	Manager	44	23.8
	Head of credit	63	34.6
	Loans officer	70	38.4
	Risk officer	6	3.2
Experience	Below 2years	28	15.1
	2-5 years	117	63.8
	6-9 years	37	20.5
	Above 10years	1	.5

Source: Primary data

Table 1 reveals that most of the respondents were female (54.1%), implying that the study was female dominated; however, this did not affect the study since it was not gender sensitive. The education level of the respondents was such that; most of them (67.0%) had a bachelor's degree, followed by (23.2%) with a diploma. This implies that the respondents had enough education to comprehend the questions and hence provide relevant responses which in turn renders the information provided in the study relevant. Concerning the position of the respondents in the MFIS, most of them (38.4%) were loan officers, followed by the head of credit (34.6%). This implies that most of them were better positioned to be well acquainted with the MFIs and hence in position to provide informed responses to the study questions. Regarding the experience of the respondents in the MFIs, most of them (63.8%), had spent 2 to 5 years, in the MFIs, this duration is long enough for the respondents to be well conversant with the business in the MFIs and hence in position to provide informed responses to the study questions.

3.4 Data Sources

Primary data was collected. The researcher gathered the views from managers, heads of credits, loan officers and risk officers. The researcher used their views as a representative sample for all MFIs in Kampala. The methodology assessed the influence of financial management practices and competitive advantage on loan performance of MFIs' in Kampala. Literature concerning financial management practices, competitive advantage was reviewed form journals, research websites, textbooks, Bank of Uganda, ministry of finance, Uganda Bureau of statistics (UBOS), Association of Microfinance Institutes of Uganda (AMFIU).

3.5 Data Collection

Primary data related to financial management practices, competitive advantage and loan performance was captured through administering a questionnaire. The questionnaires enable the reader to understand the questions and item scales were anchored on 5_ likert scale (strongly disagree, disagree, not sure, agree and strongly agree. The instrument was pre-tested through a pilot study to get rid of any possible errors to ensure its validity and reliability. Research assistants were hired, but guided to ease the data collection process.

3.6 Data Management

Validity of the questionnaire was established using validity Index (CVI) to determine the relevance of the questions in measuring the variables (Campbell and Stanley, 1966). The Reliability of the questionnaire was tested using Cronbach's alpha test as recommended by (Nunnally, 1978). The validity of the instrument was being tested and the internal consistency of the instrument was be tested to find out whether it consistently measures the study variables on the scales used (Anastasi, 1982; Nunnally, 1978). Item–total reliability (a measure of internal consistency) and Cronbach alpha coefficients of study variables were computed. The computed Cronbach alpha coefficient results above 0.6 were acceptable.

Table 1: Reliability analysis

Variable	Cronbach's Alpha	N of Items
financial management practices	.718	25
competitive advantage	.816	17
loan performance	.742	23

The results in table 3 indicated that the research instrument was reliable as the Cronbach Alpha statistic for all the items were above 0.700 implying that the items elicited consistence on multiple administrations.

The researcher carried out test for outliers and missing value of the data set, the missing values were checked using missing value analysis before carrying out multivariate analysis. The result show that the missing values were less than 5% and this is acceptable (Sekaran, 2003). The P-Plots were derived to show outliers of the data.

Parametric test were carried out, testing for normality of data set of the study to check whether data required transformation. The result for normality test was significant as provided by Kolmogorov-Smirnov (KS) test. The linearity tests were carried out and the result show that there was significant fit of regression and correlation of study variables.

3.7 Tests of Normality

In order for the regression model to provide reliable coefficients and standard errors, tests for normality on all variables were conducted on all variables and the test results are summarized in table 7 below;

Table 2: Tests of Normality

Variable	Kolmogorov-Smirnov[a]		
	Statistic	df	Sig.
Financial management practices	.082	68	.200*
Competitive advantage	.058	68	.200*
Loan performance	.101	68	.083

**. This is a lower bound of the true significance.*

a. Lilliefors Significance Correction

Source: Primary data

The results in table 7 above showed that all the variables were normally distributed. This is evidenced from the fact that p values for the Kolmogorov-Smirnov statistic (since df>50) for all the variables was over 5% which is a criterion for failure to reject the hypothesis that the variable (s) is/are normally distributed. This conclusion is supported by the normality plots for all the variables as seen in Appendix 1(figures 1, 2 and 3).

3.8 Measurement of Variables

Financial management was operationalized by measures as risk management, budgeting and working capital management (Surendra, 2005; McMahon, 1991). Competitive advantage was measured as differentiation and cost leadership (Porter, 1966). The dependent variable has constructs which mainly summarized loan performance indicators that were measured in two ways – loan cost efficiency and default rates (Bonaccorsi, 2005; Berger, 2005; European Central Bank, 2013).

3.9 Regression Model

Model specification

Linear Regression analysis was used, that is:

Model $LP = BX_1^{FMP} + BX_2^{CA} + E1$

Variable Definition

LP Loan performance is measured as loan cost Efficiency and default rates

BX_2CA Competitive advantage measures include cost leadership and differentiation

BX_1 FMP Financial management practices measures include Risk management, working capital and budgeting.

The above model found out a positive contribution of competitive advantage on loan performance and the contribution of financial management practices was insignificant both overall and the individual variables.

3.10 Data Processing and Analysis

The collected data was pre-coded and edited, cleaned, and analysed using a blend of both manual and computer data analysis packages. The data was tabulated and input in the Statistical Package for Social Sciences research (SPSS). Principal component analysis was performed to identify patterns in data and to reduce data to a manageable level (Field, 2006) and varimax rotation was applied. Both descriptive and inferential statistics were used to make meaning of the data.

The pre-coded data (Likert scale) was entered into Statistical Package for the Social Scientists (SPSS), cleaned to cater for inconsistencies and other data capturing problems like missing data. The data was later subjected to factor analysis, correlation analysis, regression analysis and variance analysis.

The Pearson correlation coefficient was carried out in order to establish the relationship between variables (that is, financial management practices, competitive advantage and loan performance.

On the other hand, regression analysis was carried out in order to establish the effect of financial management practices and competitive advantage on loan performance of MFIs in Kampala region.

Furthermore, Tests for mediation were conducted in this study to establish the nature of mediation, and the extent to which competitive advantage influences the association between financial management practices and loan performance. The test for mediation was carried out using MedGraph program (an excel version program) by Jose (2008); which is based on the works of Field (2006); Baron and Kenny (1986).Tests for mediation was carried out using the Jose path model (Jose, 2008), following the four conditions ;

- First when financial management practices was regressed with loan performance, the relationship was significant,
- Second, Financial management practices was regressed with competitive advantage and it was also significant.
- Third, competitive advantage and loan performance was also regressed and it was also positive

- Then forth competitive advantage (mediator) and financial management practices (independent variable) were both regressed and the regression was finally insignificant thus giving a full type of mediation (Baron and Kenny, 1986).

Principal component analysis was performed in order to reduce the data to a manageable level according to Field (2006) and also to find out which items explain the relationship better. The factor structures and items resulting from this procedure are presented in tables that immediately follow.

Table 3: Factor structure of financial management practices

Item/Factor	**Budgeting**	**Risk management**	**Working capital management**
Our institution carries out periodical reviews.	.814		
We usually compare the actual results with the planned.	.628		
We usually set targets for all staff.	.537		
In this institution Debtors' credit period is reviewed	.513		
We're always in touch with our customers about their businesses.		.725	
We always assess our customers before giving them a credit		.719	
We constantly update our customer's record.		.661	
Proper loan assessment is done before approval.		.551	
We usually acquire enough knowledge before assessing loan applicants.		.543	
We usually have alternative cash sources if we forecast a deficit.			.678
There is enough liquidity to meet our obligation to disbures loans to our borrowers.			.592
The Credit Manager establishes all credit limits.			.571
Eigen value	*5.553*	*2.787*	*2.635*
Variance (%)	*22.21*	*11.15*	*10.54*
Cummulative Variance (%)	*22.21*	*33.36*	*43.9*

Source: Primary data

Results in table 3 revealed that of the three factors, budgeting (Eigen value = 5.553, Variance = 22.21%) was the most significant factor of financial management practices, followed by risk management (Eigen value = 2.787, Variance = 11.15%) and working capital management (Eigen value = 2.635, Variance = 10.54%) which explain 22.21%, 11.15% and 10.54% respectively of financial management practices, which is a cumulative variance of 43.9%. More specifically, budgeting was explained by the fact that; the institutions carry out periodical reviews (.814), comparing the actual results with the planned (.628), setting targets for all staff (.537), reviewing debtors' credit period (.513). Risk management was brought out by MFIs; being in touch with their customers about their businesses (.725), assessing their customers before giving them a credit (.719), constantly updating their customer's record (.661), having proper loan assessment before approval (.551) and acquiring enough knowledge before assessing loan applicants (.543). Working capital management was also explained by MFIs; having alternative cash sources if we forecast a deficit (.678), having enough liquidity to meet their obligation to disburse loans to their borrowers (.592) and Credit Manager establishes all credit limits (.571).

Table 4: Factor structure of competitive advantage

Item/Factor	**Differentiation**	**Cost leadership**
We provide value to customers through unique terms of our lending services.	.802	
Our focus is always on the relationship between us and our customers through loan customization.	.719	
Our services are perceived industry-wide as being unique.	.645	
We regularly introduce new products and services	.694	
We have been able to be creative in finding new ways to differentiate our services.	.673	
Our staffs have unique combination of skills because of exposure.	.599	
We ensure cost-benefit analysis for loans.		.783
In this institution, we always strive for efficiencies in our operations.		.765
Our strong capital base has enabled us to charge lower fees.		.736
We charge the lowest fees on our borrowers compared to other industry players.		.654
Eigen value	*2.324*	*2.32*
Variance (%)	*13.67*	*13.64*
Cummulative Variance (%)	*13.67*	*27.31*

Source: Primary data

The factor structure of the competitive advantage of the MFIs was found to be in such a way that, differentiation (Eigen value = 2.324, Variance = 13.67%) was the most significant, followed by cost leadership (Eigen value = 2.32, Variance = 13.64%). However the amount by which factors explains variance in the competitive advantage is almost the same that is 13.67% and 13.64%.

Differentiation was better explained by the fact that MFIs; provide value to customers through unique terms of our lending services (.802), always focus on the relationship between them and their customers (.719), services are perceived industry-wide as being unique (.645), regularly introduce new products and services (.694), have been able to be creative in finding new ways to differentiate their services (.599).

Cost leadership was explained by MFIs; ensuring cost-benefit analyses for loans (.783), always striving for efficiency in their operations (.765), having a strong capital base which has enabled them to charge lower fees (.736) and charging the lowest fees on their borrowers compared to other industry players (.654) .

CHAPTER FOUR

PRESENTATION, ANALYSIS AND INTERPRETATION OF THE FINDINGS

4.0 Introduction

This chapter contains the presentation, analysis and interpretation of the findings. This chapter presents the analysis of the data. The analysis presented include; correlation analysis and regression analysis together with a test for mediation. The results are presented according to the research objectives**.**

4.1. Correlation Analysis

To determine the relationship between the pair of the variables under study, a bi-variate correlation analysis was conducted.

Table 5: Correlation analysis

Variable (N=68)		**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
Financial management practices	**(1)**	**1.000**							
Risk management	(2)	.702**	1.000						
Working Capital	(3)	.768**	.487**	1.000					
Budgeting	(4)	.797**	.295*	.336**	1.000				
Competitive advantage	**(5)**	**.691****	**.404****	**.491****	**.629****	**1.000**			
Cost leadership	(6)	.625**	.390**	.421**	.571**	.910**	1.000		
Differentiation	(7)	.620**	.335**	.464**	.562**	.891**	.622**	1.000	
Loan performance	**(8)**	**.491****	**.194**	**.298***	**.541****	**.670****	**.689****	**.510****	**1.000**

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

*. Correlation is significant at the 0.05 level (2-tailed).

Source: Primary data

4.1.1 The relationship between financial management practices and loan performance

Findings in table 6 revealed that there was a significant positive relationship between the financial management practices of the MFIs and their loan performance (r = .491, P<.01). This implies that robust financial management practices are associated with high loan performance. This points to the fact that MFIs have to keep up with best financial management practices if their loan performance is to improve.

4.1.2 Financial management practices and Competitive advantage

Results also reveal a significant positive relationship between competitive advantage and loan performance(r=0.691, p≤0.01). This means that competitive advantage paves away of improving loan performance of MFIS.

4.1.3 The relationship between competitive advantage and loan performance

Findings in table 6 further revealed that there was a significant positive relationship between the competitive advantage of the MFIs and their loan performance (r = .670, P<.01). This implies that a high level of competitive advantage corresponds with high loan performance. This is indicative of the fact that MFIs; competitive advantage is not in vain in as far as attracting customers to offer loans is concerned.

4.2 Regression analysis

The linear regression model was used for analysis to determine the effect of both the financial management practices of the MFIs and their competitive advantage their loan performance.

Table 6: Regression model of loan performance

	Unstandardized Coefficients		***Standardized Coefficients***	**T**	**Sig.**	**Collinearity Statistics**	
	B	**Std. Error**	**Beta**			**Tolerance**	**VIF**
(Constant)	1.203	.381		3.155	.002		
Financial management practices	.054	.129	.053	.419	.676	.522	1.914
Competitive advantage	.565	.114	.633	4.975	.000	.522	1.914
Dependent Variable: Loan performance							
R Square	*0.45*		*F Statistic*	*26.618*			
Adjusted R Square	*0.433*		*Sig.*	*0.000*			

Source: Primary data

The regression model as presented in Table 8 shows that financial management practices and competitive advantage had a predictive power of up to 43.3% on the variation in loan performance. (Adjusted *R* Square = .433). The regression model was also found to be robust (F = 26.618, p<.01), implying that the independent variable and mediating variable were appropriate determinants of the MFIs' loan performance. The regression model also reveals that competitive advantage had a significant effect on loan performance (beta = .633. $p<.01$), implying that a unit change in competitive advantage led to 0.633 unit change in loan performance. On the other hand the financial management practices did not have a significant effect on loan performance (Beta = .053, $p>.05$), this due to the mediation effect of competitive advantage.

4.3 Testing for Mediation

Mediation tests were performed to establish whether the conditions suggested by Baron and Kenny (1986) are met. Besides the MedGraph program, a modified version of Sobel test was used to compute the Sobel z-value and the significance of the mediation effect of competitive advantage on the association between financial management practices and loan performance. The results are summarized in Table 9 and Figure 2 respectively.

Table 7: Regressions for partial test of mediation

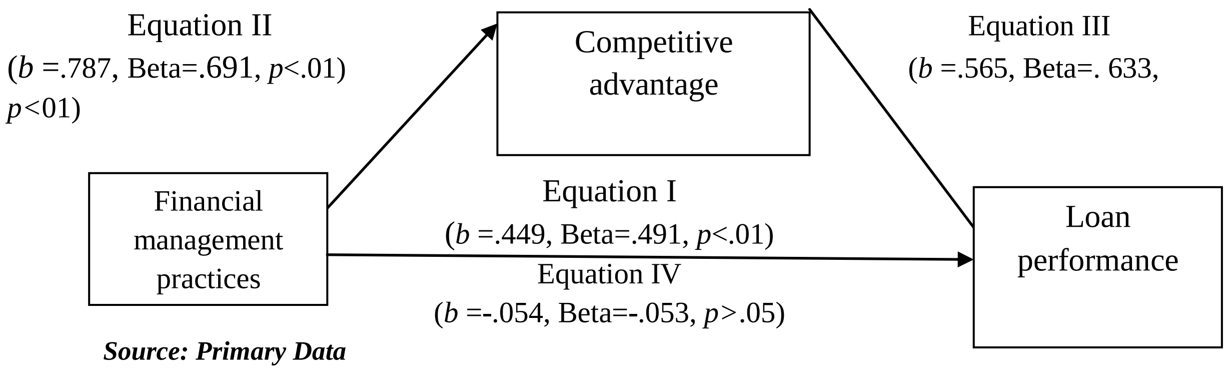
Regression	Coeff.	SE	t	Sig.
b(YX)	.449	.109	4.577	.000
b(MX)	.787	.101	7.768	.000
b(YM.X)	.565	.114	7.768	.000
b(YX.M)	.054	.129	.419	.676
Sobel	**4.1819**	**.106**		**.000**

Y=Loan performance, X=Financial management practices, M= Competitive advantage
Indirect effect = .054, Direct effect = .395, Total effect = .449

Source: Primary Data

Results in table 9 indicated that there was a significant relationship between financial management practices and loan performance (b=.449, $p<.01$) initially as shown in the first regression, which was no longer significant (b=.054, $p>.05$) after introducing, competitive advantage in the model. The regression of competitive advantage on financial management practices was also found to be significant (b=.787, $p<.01$), likewise the regression of loan performance on competitive advantage in equation three was also found to be significant (b=.565, $p<.01$).

Figure 2: Medigraph of the test for mediation effect of competitive advantage on the effect of financial management practices on loan performance



Source: Primary Data

Results in Table 9 and Figure 4 revealed that when loan performance is regressed on financial management practices in equation I, the results indicated that financial management practices had a significant effect on loan performance (beta = .491, p<.01), however on introducing competitive advantage in equation IV, the effect of financial management practices on loan performance became statistical insignificant (beta = .053, p>.05). This finding implied a possibility of a full mediation effect of competitive advantage on the association of financial management practices on loan performance, which finding was confirmed by the sobel test (Z = 4.182, p<.01) as seen from Table 9. This finding implies that the association of financial management practices of the MFIs on their loan performance is dependent on the competitive advantage of the MFIs.

CHAPTER FIVE

DISCUSSION OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter contains the discussion of the study findings, conclusions, recommendations and areas for further research.

5.1 Discussion of the findings of the study

In line with the objectives of the study and the findings presented in chapter four, the researcher made the discussion as below:-

5.1.1 Relationship between financial management practices and loan performance

The findings indicate an insignificant relationship between financial management practices and loan performance.

The above result implies that, a high involvement of credit officers in formulating budgets was found to have an insignificant relationship with loan performance of MFI this helps the credit officers to carry out periodical reviews by comparing the actual results with the planned and it also helps them to be in touch with their customers about their businesses, Similarly an MFI will be able to have alternative cash sources in case a deficit is forecasted and having enough liquidity to meet their obligation to disburse loans to their borrowers, all will improve loan performance, Acquah & Addo (2011) disagrees with the findings of this study which are that the success of individual MFIs in credit risk management is largely reflected in the proportion of delinquency's loans to gross lending.

Similarly the study is not in support with findings by Deininger & Liu (2009) who found out that loan monitoring, increase repayment performance. Other studies (Guttman, 2007; Maata, 2004; Norhaziah, 2013; Dowling, 2009; Mensah, 2011, Fatoki, 2012) have reported the positive effects of using selected financial management practices on loan performance.

This can be attributed to the fact that credit officers are professionals who are able to carry out risk assessments, formulate budgets and carry cash planning and also being able to be in touch with customers and understand their needs.

5.1.2 Relationship between financial management practices and competitive advantage of an MFI

Based on the findings, financial management practices and competitive advantage of MFIS in Kampala region are significantly and positively associated. When risk management, budgeting and working capital management improves, an MFI will have a cost advantage (low cost) and its loan differentiation significantly improves. MFIs will be able to provide value to customers through unique terms of their lending services, and they in turn increase the focus on the relationship between them and their customers and thus MFIs will achieve cost-benefit analyses for loans.

MFI must apply financial management practices by improving on their competitive management skills in order to remain competitiveness in their industry. It can create a cost advantage by enabling a company to source the factors of production more efficiently by managing the associated loan risk caused by market volatility. It can also enable differentiation, by providing the ability to deliver an enhanced customer experience through a more stable pricing environment, or an ability to offer more advantageous business terms.

This is in line with observations made by Thompson, Strickland and Gamble (2009), who established that the adoption of financial management techniques may provide an organization with a sustainable competitive advantage over its rivals. Their study confirmed that indeed, certain financial management practices provide strategies that influence a large number of customers to have a lasting preference for an MFI's products.

Also a study by Koch and MacDonald (2006) concluded that adapting to a changing banking environment, analysing bank performance and establishing profitability and risks management help banks to manage the cost of funds, bank capital and liquidity hence managing credit given to customers and managing the investment portfolio.

5.1.3 Relationship between competitive advantage and loan performance of an MFI

The finding from this study indicates a significant positive relationship between competitive advantage and loan performance of MFIS. As such, cost advantages of the MFI loan product differentiation have a significant relationship on loan performance.

Consistent with the findings of Navajas (2003), the study found a significant relationship between MFIS' competitive advantage and loan performance, the results suggest that outcome of competition is ambiguous since competition leads to innovation thereby expanding outreach. This finding is in agreement with the observations by Navajas (2003), who concluded that competition is ambiguous since competition leads to innovation thereby expanding outreach.

This point of view is also consistent with Vogelgesang (2003), who argued that competition affects loan repayment performance. The analysis indicated that competition is related with multiple loan taking and higher levels of borrower indebtedness. This is because in case of any cost advantage MFI's will have more borrowers and also be able to recover their amounts lent out.

MFIS have cost advantage to provide customers with a correspondence loan product at a lower interest rate, competitive rates by lower unit cost, and lower interest rate to end-user abroad. Cost advantage can help MFI to gain competitive advantage over rivals and return excessive average by providing services at the lowest cost.

The management of MFI needs continuous improvement in the process by an on going search for in operating activities and alimentation of this waste at all levels of process. Changing a process to reduce costs involves modifying or eliminating such as reducing the time or effort required to perform the activities, selecting the low cost alternative from a set of alternatives, and making changes which permit the sharing of activities with other services to yield economies of scale (Capettini, Chow and McNamee, 1998). Thus, increasing competitive advantage encourages MFIS to achieve high loan performance (Camal, Acar and Tanriverdi, 2006).

5.2 Mediation of competitive advantage on the relationship between financial management practices and loan performance

The study further tested whether there was any significant relationship on the mediation of competitive advantage between financial management practices and loan performance.

The study found this relationship to be insignificant; there was a full mediation effect of competitive advantage on the association of financial management practices on loan performance.

The study found out that when an MFI formulates budgets, assesses customers before giving them loans and having enough liquidity to meet their obligation to disburse loans to their borrowers will help an MFI to provide value to customers through unique terms of our lending services and also an MFI will have a cost advantage with its lending operations thus loan performance will improve.

However, a synthesis of literature indicates sparse studies on the mediation effect of competitive advantage on financial management practices and loan performance. Moreover my review has not come across any study dealing with the possible mediating effect of competitive advantage on the relationship between financial management practices and loan performance.

5.3 Conclusions

In line with the set objectives, the findings and the discussion of this research study confirms that, financial management elements (risk management, budgeting and working capital management) and competitive advantage (competitive advantage and differentiation are significant predictors of loan performance in the MFI in Uganda. The researcher has made the following conclusions:-

Financial management practices has proven to be insignificantly related to the loan performance of MFIS where as Competitive advantage significant and positive predictor of loan performance of MFIS in As such; the effort to improve competitiveness among these MFIS must be work hard to have a cost advantage as well as differentiating their loan products.

Drawing from the fact that financial management practices and competitive advantage are explained by 43% of the variance in the loan performance of MFIS, it is important that more studies are done to establish the other factors that explain 57% of the variance in loan performance.

5.4 Recommendations

Based on the findings of this study, the following recommendations have been suggested: Since competitive advantage is significantly and positively associated with the loan performance, all effort should be made to have a cost advantage and product differentiation F

MFIS should commit to efficient lending cots, MFIS should have tight cost controls, Providing unique lending terms and also differentiating their loan products and this help MFIS Customers to have a lasting preference and increase the incomes fro loans.

Further studies should be done to establish the factors that explain 57% of the variance in the loan performance of MFIS. This is because it is important that all the factors affecting the loan performance of these MFIS are addressed together in order to improve their loan performance.

5.5 Limitations and Areas for Further Research

This study has some inherent limitations which include; on a cross sectional research design, that restricts us from studying casual relationships among our variables. The behaviours of the variables over a long time (time series data) was ignored, it could not be completely analyzed which restricted the applicability of the findings as a longitudinal study may give different results from the ones that were obtained.

This research indicated that there is a relationship between financial management practices, competitive advantage and loan performance within microfinance institutions. The researchers therefore suggests further researcher on the following:

- Reasons for loan defaults from clients' perspective in microfinance institutions
- Other factors which explain 57% of the variance in the loan performance of MFIS in Kampala region.
- Taking the study to other regions of Uganda,

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Appendix One: Graphs showing Normality tests

Figure 3: Normality plot of financial management practices

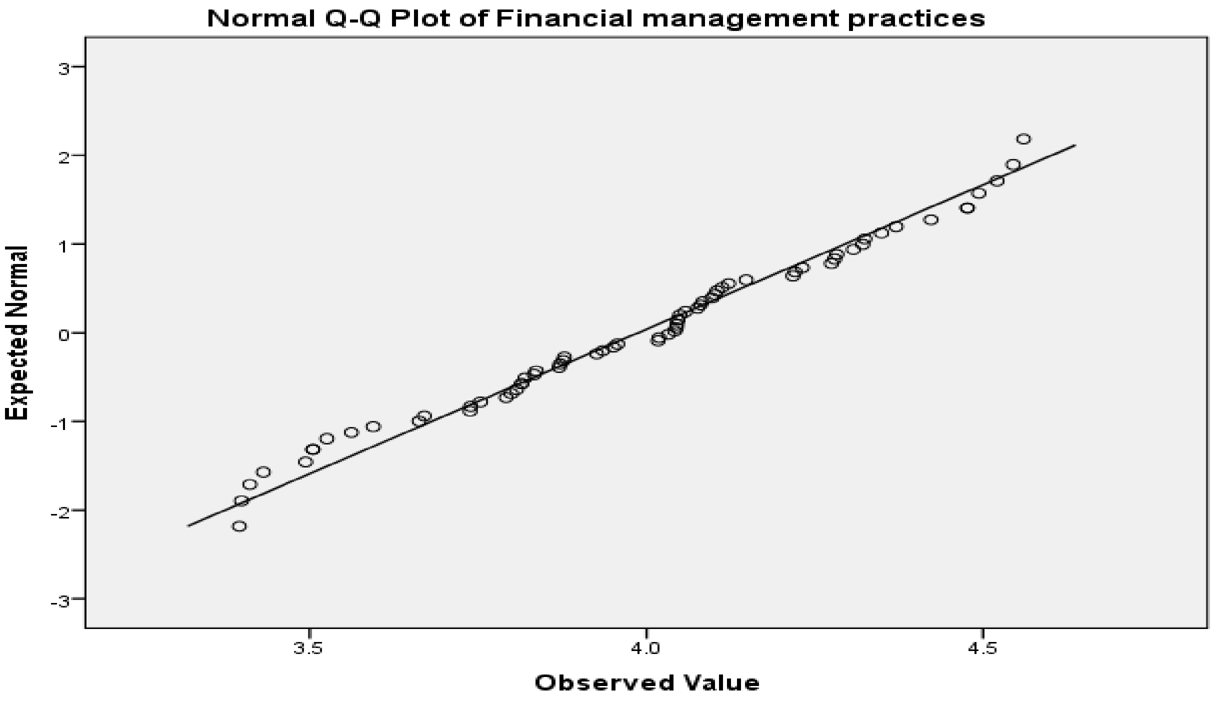


Figure 4: Normality plot of competitive advantage

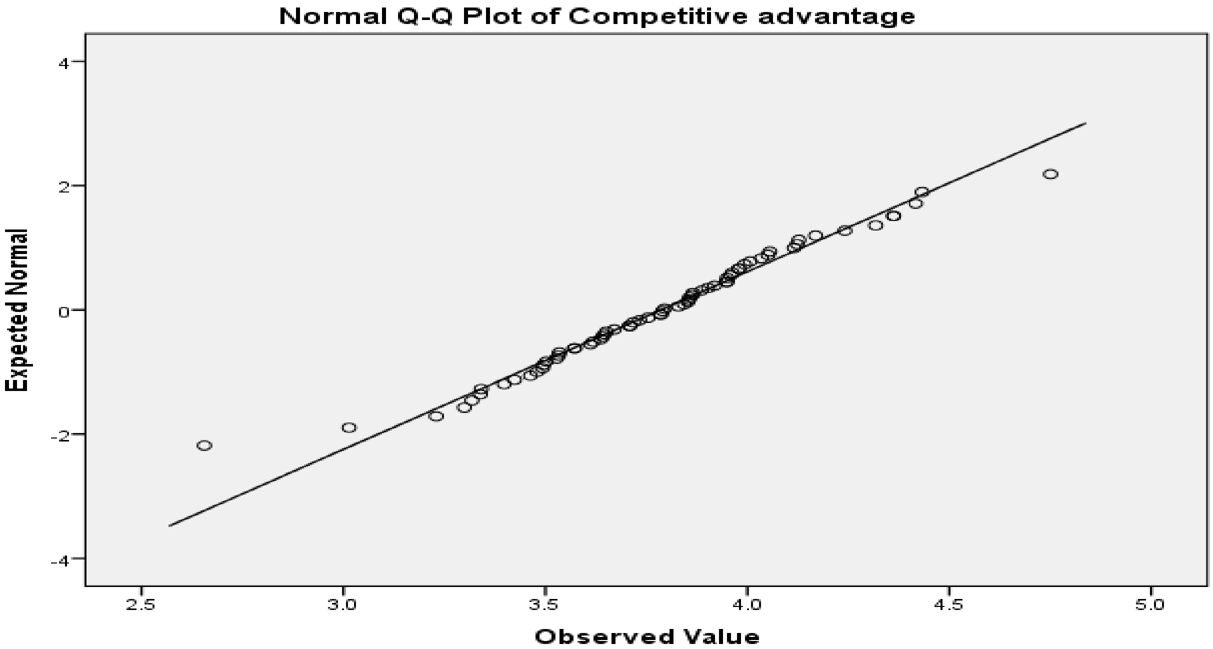
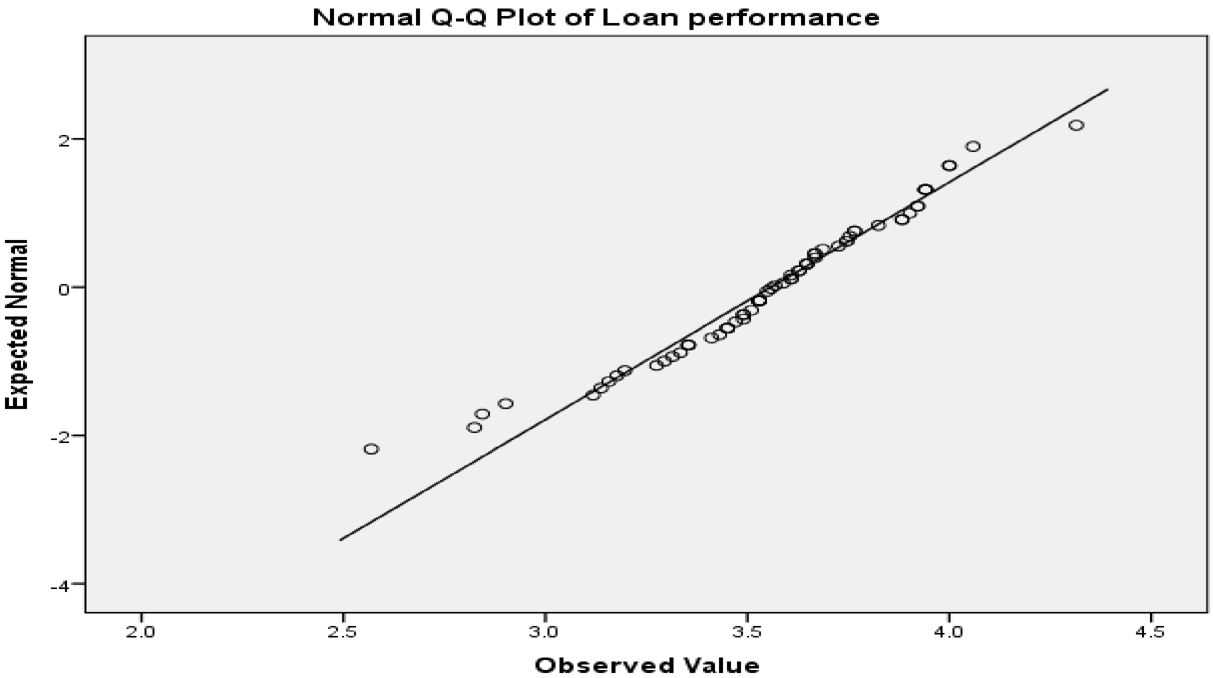


Figure 5: Normality plot of loan performance



Appendix Two : RESEARCH QUESTIONNAIRE

RESEARCH QUESTIONNAIRE FOR REGISTERED MICRFOFINACE INSTITUTIONS (MFIS) IN KAMPALA.

Dear Respondent:

This questionnaire is intended to facilitate research on **'Explaining Loan performance of MFIS in** Kampala to fulfil the requirement for the Award of Masters of Science in Accounting and Finance of Makerere University. You are kindly requested to answer the following questions honestly to facilitate this study, which is purely for academic purposes.

All the information provided will be treated with utmost confidentiality required of the accounting profession. Please kindly fill Questionnaire form with the response that you think is most appropriate by ticking in the box or filling in your contribution.

Thank you for your participation and if you have any questions please do not hesitate to contact me directly on Tel. No. (0701110022).

Sincerely, Brendah Akankunda

A. BACKGROUND INFORMATION

1. Name of the Microfinance Institution……………………………….(Optional)
2. The MFI's Legal status
   a) NGO ☐ b) Credit Union ☐ c) Private Company ☐ d) SACCO ☐
   e) Others specify……………………………
3. Number of years in operation.
   a) 5-10 years ☐ b) 11-15 ☐ c) 16-20 ☐ d) Above 20 years
4. Gender
   Male ☐ Female ☐
5. Your highest level of education.
   a) A' level ☐ b) Diploma ☐ c) Degree ☐ d) Masters ☐ e) Professional
6. What best describes your position in the Bank.
   a) Manager ☐ b) Head of credit ☐ c) Loans officer ☐ d) Risk ☐ officer
7. Number of years of experience in Credit management.
   a) Below 2 years ☐ b) 2-5 ☐ c) 6-9 ☐ d) Above 10 years

B. FINANCIAL MANAGEMENT PRACTICES

Please indicate the extent to which you agree or disagree with the following statements as they relate to financial management practices of your institution.

(Strongly Disagree=1 Disagree=2 Not sure=3 Agree =4 strongly Agree=5)

RISK MANAGEMENT

1	We have adequate policies and procedures governing credit risk management.	1	2	3	4	5
2	We always assess our customers before giving them a credit	1	2	3	4	5
3	We constantly update our customer's record.	1	2	3	4	5
4	We are always in touch with our customers about their businesses.	1	2	3	4	5
5	We give money depending on the source of income of the applicant.	1	2	3	4	5
6	In this MFI there are appropriate tools to guard against Entrepreneurial default.	1	2	3	4	5
7	In this MFI proper loan assessment is done before approval.	1	2	3	4	5
8	In this MFI we usually acquire enough knowledge before we assess our loan applicants.	1	2	3	4	5

WORKING CAPITAL MANAGEMENT

1	Our institution uses Cash budgeting	1	2	3	4	5
2	In this institution Debtors' credit period is reviewed	1	2	3	4	5
3	Our cash at hand is always adequate to match the demands of our customers	1	2	3	4	5

4	We usually remind our customers when the obligation is overdue.	1	2	3	4	5
5	Our institution usually has alternative sources of cash in case of we forecast deficit.	1	2	3	4	5
	The institute reviews bad debts.					
7	There is enough liquidity to meet our obligations to disburse loans to our borrowers.	1	2	3	4	5
8	The Credit Manager establishes all credit limits.	1	2	3	4	5

BUDGETING

1	In this institution we normally incorporate our customers' needs in planning.	1	2	3	4	5
2	Our institution usually prepares forecasts for loan disbursements.	1	2	3	4	5
3	In this institution everyone is involved in the planning process.	1	2	3	4	5
4	We always get industry benchmarks that help us to arrive at credit reasonable goals.	1	2	3	4	5
5	We usually set targets for all staff.	1	2	3	4	5
6	Loan officers are given a number of targeted customers to serve.	1	2	3	4	5
7	Our institution carries out periodical reviews.	1	2	3	4	5
8	We usually compare the actual results with the planned.	1	2	3	4	5
9	We usually take actions in cases of variations.	1	2	3	4	5

C. COMPETITIVE ADVANTAGE

Please indicate the extent to which you agree or disagree with the following statements (Strongly Disagree=1 Disagree=2 Not sure=3 Agree =4 strongly Agree=5)

COST LEADERSHIP

1	We compete for a wide customer base based on our favorable loan fees.	1	2	3	4	5
2	In this institution, we always strive for efficiencies in our operations.	1	2	3	4	5
3	We charge the lowest fees on our borrowers compared to other industry players.	1	2	3	4	5
4	We ensure cost-benefit analysis for loans.	1	2	3	4	5
5	Our strong capital base has enabled us to charge lower fees.	1	2	3	4	5
6	The Total costs of a service are always matching with the results achieved.	1	2	3	4	5
7	This MFI has intense supervision of labor.	1	2	3	4	5
8	This MFI has tight cost controls.	1	2	3	4	5
9	We give incentives to employees based on meeting strict quantitative targets.	1	2	3	4	5

DEFFERENTIATION

1	Our lending systems are developed to meet client demand	1	2	3	4	5
2	We provide Value to customers through unique terms of our lending services.	1	2	3	4	5

3	Our services are perceived industry-wide as being unique.	1	2	3	4	5
4	We regularly introduce new products and services					
5	Our focus is always on the relationship between us and our customers through loan customization.	1	2	3	4	5
6	We have been able to be creative in finding new ways to differentiate our services.	1	2	3	4	5
7	We have strong coordination among functions in R&D.	1	2	3	4	5
8	Our staffs have unique combination of skills because of exposure.	1	2	3	4	5

D. LOAN PERFORMANCE

State your opinion on the following statements by ticking the most appropriate response as follows (Strongly Disagree=1 Disagree=2 Not sure=3 Agree =4 strongly Agree=5)

	LOAN COST EFFICIENCY					
1	Our institutional cost of delivering loan and other services is low.	1	2	3	4	5
2	Our MFI controls its administrative costs.	1	2	3	4	5
3	Our MFI is very labour intensive.	1	2	3	4	5
4	The percentage of loan income is higher than loan operating expense.	1	2	3	4	5
5	This MFI always makes improvements in operating systems.	1	2	3	4	5
6	The Cost per Client is usually very low.	1	2	3	4	5
7	Our rates of efficiency are much higher than those of our bench marks.	1	2	3	4	5
	DEFAULT RATES					
1	We have high non-performing loans.	1	2	3	4	5
2	Our borrowers pay back with in speculated time.	1	2	3	4	5
3	Our customers usually fail to pay back their amounts due.	1	2	3	4	5

4	Our delinquency rates are high.	1	2	3	4	5
5	We have healthy repayment rates.	1	2	3	4	5
6	We use credit policies to approve the clients.	1	2	3	4	5
7	We usually experience delays in loan repayments by our customers.	1	2	3	4	5
8	Our clients are reportedly challenged with lack of knowledge on the cost of borrowing.	1	2	3	4	5

Thank you for your time and responses

Appendix three: Table for determining sample size from a given population

N	S	N	S	N	S	N	S	N	S
10	10	100	80	280	162	800	260	2800	338
15	14	110	86	290	165	850	265	3000	341
20	19	120	92	300	169	900	269	3500	246
25	24	130	97	320	175	950	274	4000	351
30	28	140	103	340	181	1000	278	4500	351
35	32	150	108	360	186	1100	285	5000	357
40	36	160	113	380	181	1200	291	6000	361
45	40	180	118	400	196	1300	297	7000	364
50	44	190	123	420	201	1400	302	8000	367
55	48	200	127	440	205	1500	306	9000	368

60	52	210	132	460	210	1600	310	10000	373
65	56	220	136	480	214	1700	313	15000	375
70	59	230	140	500	217	1800	317	20000	377
75	63	240	144	550	225	1900	320	30000	379
80	66	250	148	600	234	2000	322	40000	380
85	70	260	152	650	242	2200	327	50000	381
90	73	270	155	700	248	2400	331	75000	382
95	76	270	159	750	256	2600	335	100000	384

Note: "N" is population size

"S" is sample size.

Appendix four: LIST OF MFIS IN UGANDA AS PER 2013 (AMFIU)

1.Advance Uganda Ltd
2. Agaru Cooperative Savings & Credit Society Limited
3. Alut Kot SACCO
4. APAS Financial Services Ltd
5. Bancs Microfinance Ltd
6. Banyakyaka SACCO
7. Blue Employee Benefits
8. BRAC- Uganda
9. Budadiri Microfinance Company
10. Busimbi Community Development Trust
11. CENTA SACCO
12. Centenary Rural Development Bank
13. CIDI Microfinance Ltd.
14. Community Development Microcredit Ltd.
15. Ebirungi Biruga Omututu (EBO) SACCO
16. Ecumenical Church Loan Fund (ELOF)- Uganda
17. EMESCO Development Foundation

18. Enterprise Support & Community Devt Trust (ENCOT)
19. Equity Bank Uganda ltd
20. Federation of Rwenzori MF (FORMA)
21. Finance Trust
22. FINCA- Uganda
23. Five Talents Uganda Ltd.
24. Gatsby Microfinance Ltd.
25. HOFOKAM
26. Ibanda Cooperative Savings and Credit Society Ltd
27. Ikongo Rural Co-operative Savings and Credit Society Ltd.
28. Issia Cooperative Savings & Credit Society Ltd
29. KACITA Cooperative Finance
30. Kagadi Womens Finance Trust
31. Kahunge Rural SACCO
32. Kakuto SB SACCO
33. Kalibayimukya SACCO
34. Kambuga SACCO
35. Kamuli Twisania SACCO Ltd
36. Kamwenge Zibumbe SACCO
37. Katweyombeke Savings & Credit Cooperative Ltd.
38. Kayonza Microfinance SACCO
39. Kebisoni SACCO
40. Kidea Co-operative Savings & Credit Society Ltd
41. Kigarama Farmers' SACCO
42. Kigarama Peoples' SACCO
43. Kihihi Development Co-operative SACCO
44. Kijura SACCO Ltd.
45. Kitgum Cooperative Savings & Credit Society
46. Kiwafu Co-operative Savings and Credit Society Ltd
47. Koboko United SACCO
48. Kolping Enterpreneurs' Development Program (KEDEP)
49. Kyamuhunga SACCO
50. Kyangyenyi Modern Rural Coop. Finance Ltd

Indexes: Alphabetical Listing of MFIs 7

51. Lwengo Microfinance Coop Society
52. Lyamujungu Cooperative Financial Services
53. Masaka Microfinance Development Coop Trust Ltd
54. Micro Credit for Development and Transformation (MCDT) SACCO
55. Micro Enterprise Development Network (Med-net)
56. Micro Uganda Ltd.
57. Moyo SACCO
58. Letshego Financial services
59. Muhame Financial Services Co-operative Ltd
60. Nyaravur Farmers' SACCO
61. Ochero Cooperative SACCO Ltd

62. Opportunity Uganda
63. Pakwach Nam SACCO
64. Panyimur SACCO
65. Pearl Microfinance Ltd.
67. PRIDE Microfinance Limited (MDI)
68. Remode Enterprises Ltd.
69. Rubabo People's Co-op S&C Society Ltd.
70. Rukiga Savings and Credit Scheme Coop. Society Ltd.
71. Rural - Urban Savings and Credit Association (RUSCA Ltd)
72. Rural Credit Finance Co. Ltd
73. Rushere SACCO
74. Shuuku Cooperative Savings & Credit Society Ltd.
75. Silver Upholders Ltd.
76. Success Microfinance Services Ltd (SMS)
77. The Hunger Project-Uganda
78. Tulihamu Budongo SACCO Ltd
79. Uganda Agency for Development (UGAFODE) Ltd
80. Uganda Cares- Social Economic Empowerment Program (SEEP)
81. Victoria Basin S&MCTL
82. Voluntary for Development (VAD)
83. Wazalendo SACCO
84. Y Save Cooperative Savings & Credit Scheme