EVALUATION OF LOAN PERFORMANCE
A CASE OF AZANIA BANK
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A CASE OF AZANIA BANK

By
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A Dissertation Submitted to Mzumbe University Dar es Salaam Campus
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Degree in Business Administration in Corporate Management of Mzumbe
University
CERTIFICATION

We, the undersigned, certify that we have read and hereby recommends for acceptance by the Mzumbe University, a dissertation entitled: Evaluation of loan performance in Azania Bank Limited: in partial fulfillment of the requirements for award of the degree of Master of Business Administration of Mzumbe University.

Major Supervisor

Internal Examiner

External Examiner

Accepted for the Board of MUDCC

..................................................  
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I, Anna Rugarabamu, hereby declare that this dissertation is my own original work and it has not been presented to any other University for a similar or any other degree award.

Signature……………………………

Date………………………………

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This study has come into completion because of contributions from many people. I firstly express my heartfelt gratitude to the Almighty GOD for giving me strength and good health.

Secondly, I wish to express my appreciation to my supervisor Mary Rutenge for her advice, criticism and corrections right from the scratch of writing the proposal to the final stage of writing this report.

Thirdly, would like to thank to my beloved husband, Richard Bailemba for his encouragement through MBA course and my children Larry and Lavender who persevered with my absence.

Special thanks should be extended to my parents, Mr and Mrs Rugarabamu and relatives for their encouragement during my studies.

I also extend my heartfelt appreciation to the Business Administration Department for injecting me with the knowledge and support during the whole MBA course. Also research respondents both management and other levels of workers for spending time to fill in the questionnaire and oral interview.
DEDICATION

First and foremost this work is dedicated to the Almighty God for enabling me to accomplish this work.

I am particularly indebted to my beloved parents, Mr. and Mrs. Rugarabamu and the family who struggled for my academic success. I also dedicate this work to my beloved husband, Mr. Richard Bailemba and my children Larry and Lavender for encouragement and endless prayers during my studies.
This is the study about evaluation of loan performance in Azania bank. Specifically, this study intended to evaluate interest rate charged from borrowers, to examine the capacity of bank in supervising loans, to assess borrowers’ attitudes towards loans and identify general loan challenges. Qualitative and quantitative methodologies have been applied. The qualitative methodology probed feelings and perceptions of respondents on the research theme, and the quantitative approach made the study capable of producing and presenting numerical information in tables and figures.

The study used sixty respondents; 30 loan officers and 30 borrowers. Two types of data sources that are primary and secondary sources are involved. Interview and questionnaire were the key sources of primary data collection. Qualitative and quantitative data were collected and put in form of percentage and numerical information.

This study has discovered the presence of positive loan performance in Azania Bank due to the fact that interests rates charged are reasonable and affordable, there is adequate loan performance and borrowers have positive attitudes towards loan, proper risk management, integrity of borrowers and tight loan supervision. Key recommendation given is to build capacity of business owners in order to make them more efficient in conduction their business.
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CHAPTER ONE

INTRODUCTION

1.1 General Introduction

The study is about evaluation of loan performance in Azania Bank. It is important to note that bank act as financial intermediary in both micro and macro economy. A financial intermediary is an institution that acts as an intermediary by matching supply and demand of funds (Beck, 2001). Heffernan (1996) defines banks as intermediaries between depositors and borrowers in an economy which are distinguished from other types of financial firms by offering deposit and loan products. Bossone (2001) agrees arguing that banks are special intermediaries because of their unique capacity to finance production by lending their own debt to agents willing to accept it and to use it as money.

Advancing into comprehensive historical background of the problem a nutshell of Tanzania financial sector is crucial. As such according to Triodos Facet (2007) Tanzania’s financial sector is relatively young. Over the past fifteen years, the financial sector as a whole has undergone major changes from the originally state-owned and -controlled system to a liberalized financial sector (Triodos Facet 2007). However, despite the progress, Tanzania’s financial sector remains relatively small, and access to financial services remained stunted for the majority of Tanzanians. This been the case the extent to which loan performance in Tanzania non-state owned banks is effective is yet to be known.

This chapter is about introductory part. This chapter has clearly shown background and statement of the problem. In order to be specific this chapter provides general and specific objectives studied. To arrive into these objectives the study had set out questions that needed answers. Furthermore this chapter has shown significance of the study and study limitations and study organization.
1.2 Background to the Problem

Commercial banks are the dominant financial institutions in most economies as they accelerate economic growth (Greuning and Bratanovic, 2003, Richard, 2011). The traditional role of a bank is lending and loans make up the bulk of their assets (Njanike, 2009). Loans therefore represent the majority of a banks’ assets (Saunders and Cornett, 2005). However, lending is not an easy task for banks because it creates a big problem which is called non-performing loans (Upal, 2009). Due to the nature of their business, commercial banks expose themselves to the risks of default from borrowers (Waweru and Kalami, 2009). Following that over the years, there have been an increased number of significant bank problems in both, matured as well as emerging economies (Richard (2011). Among the problem is non-performing loans.

According to Alton and Hazen (2001) non-performing loans are those loans which are ninety days or more past due or no longer accruing interest. Hennie (2003) agrees arguing that non-performing loans are those loans which are not generating income. This is further supported by Fofack (2005), who define non-performing loans as those loans which for a relatively long period of time do not generate income that is, the principal and or interest on these loans have been left unpaid for at least ninety days. Non- performing loans are also commonly described as loans in arrears for at least ninety days (Guy, 2011).

According to Kroszner (2002) in Waweru and Kalami (2009), non-performing loans are closely associated with banking crises. Greenidge and Grosvenor (2010), argue that the magnitude of non-performing loans is a key element in the initiation and progression of financial and banking crises. Guy (2011) agrees arguing that non-performing loans have been widely used as a measure of asset quality among lending institutions and are often associated with failures and financial crises in both the developed and developing world. Reinhart and Rogoff (2010) as cited in Louzis et al (2011) point out that non-performing loan can be used to mark the onset of a banking crisis. Despite on-going efforts to control bank lending activities, non-performing loans are still a major concern for both international and local regulators (Boudriga et al, 2009).
For example, borrowers from the commercial banks and other financial institutions in Tanzania are already finding it more expensive to indulge in the habit of borrowing following a rapidly rising inflation rate, as well as increased and irregular interest rates mainly on financial instruments (BoT, 2011). According to Bank of Tanzania (BoT) reports (2011), the weighted average interest rates on money market instruments trended upwards. The three major banks in Tanzania—National Micro-Finance Bank (NMB), NBC limited, and CRDB Bank—which together claim 49.4 per cent of the banking market share, were the major contributors of higher profits and deposits in the banking sub-sector.

However, the issue of Non-Performing Loans (NPLs) had remained a big challenge to banking in the country. Currently, the overall industrial rate has remained at nine per cent, though some banks have recorded ten per cent of gross NPL. This has been a wide problem banks have had been indulged to take the requisite approach to mitigate the situation. According to selected financial results, most of the banks, both large and small, recorded profit-after-tax increases compared with the same quarter in 2011. The major drivers of the relatively good performance were loans and advances, followed by foreign exchange dealings and transactions, as well as investments in government securities. Nevertheless, the extent to which loan performance in AZANIA Bank is effective is not known. This study attempted to bridge this missing information.

### 1.3 Statement of the Problem

Studies in other countries show that most of bank failures have been caused by non-performing loans (Brownbridge, 1998). Ahmad (2002), in analyzing the Malaysian financial system, reported a significant relationship between credit risk and financial crises and concluded that credit risk had already started to build up before the onset of the 1997 Asian financial crisis, and became more serious as non-performing loans increased. Li (2003) and Fofack (2005) also found this relationship to be significant. There is evidence that the level of non-performing loans in the US started to increase substantially in early 2006 in all sectors before the collapse of the sub-prime mortgage market in August 2007 (Greenidge and Grosvenor, 2010). In this regard,
the institutions are urged to enhance their credit risk management systems with special emphasis on credit assessment, origination, administration, monitoring and control standards (MPS, 2012). Fofack (2005) argues that when left unsolved, nonperforming loans can compound into financial crisis, the moment these loans exceed bank capital in a relatively large number of banks. Thus it is important to have periodic evaluation of loan performance in financial institutions. Therefore this study attempted to evaluate loan performance in Tanzania

1.4 Research Objective
1.4.1 General Objective
The general objective of this research is to evaluate loan performance in Azania Bank.

1.3.2 Specific Objective
(i.) To evaluate interest rates charged by Azania Bank
(ii.) To examine bank capacity in supervising loans.
(iii.) To assess borrowers attitudes towards loans.
(iv.) Identify general loan challenges.

1.5 Research Questions
(i.) What is interest rate charged by Azania Bank?
(ii.) What is your capacity in supervising loans?
(iii.) What are borrowers’ attitudes towards loans?
(iv.) What do you think are general loan challenges?

1.6 Scope of the Study
The research evaluated loan performance in Azania Bank. The fieldwork was carried out in Dar es Salaam in Azania Bank Limited Headquarters office. Reason for selecting these banks and Dar es Salaam city was based on the easy accessibility of information by the researcher also by considering time allocated for the study.
1.7 Limitations of the Study

The following were expected to be study limitations. Time allocated was too short. Also some respondents lack seriousness. Some respondents refused to complete the questionnaire as they were busy and fear of being reprimanded by their management for what was perceived to be “leaking organization’s information to outsiders”. These limitations were addressed as follows. Regarding time, the researcher tried to squeeze time so as to reach all the respondents. Contrary to expectations, respondents were persuaded very seriously and did not refuse to fill questionnaires although they were very busy. Although respondents had some fears, bank manager assisted in making clarifications.

1.8 Structure of the study

This dissertation is organized into five distinct chapters. Chapter one looked into the introduction and problem statement; chapter two consists of the literature review; chapter three presents the methodology used in this study; chapter four presents the findings of the study and discussion and finally, chapter five offers the conclusion which includes the summary of findings, recommendations and prognosis for future research.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Chapter two is about literature review. This chapter include the following sub-sections; profile of Azania Bank theoretical framework, loan performance in general, bank interest rates, loan supervision, loan attitudes, loan challenges and theoretical literature. Theoretical framework is as hereunder.

2.2 Profile of Azania Bank

Azania Bank Limited is the first indigenous private bank, formerly known as 1st Adili Bancorp Limited established in 1995 following the liberalization of the banking sector.

The major shareholders of the Bank include National Social Security Fund (NSSF) 34.8%, Parastatal Pensions Fund (PPF) 30.1%, Public Service Pensions Fund (PSPF) 17.2%, Local Authorities Pensions Fund (LAPF) 14.2%, East African Development Bank (EADB) 2.3% and several indigenous Minority Shareholders including staff holding 1.4% of the shares the bank.

The Bank is currently providing banking services at 11 locations in Tanzania which are Masdo House along Samora Avenue, Kariakoo Branch along Msimbazi Street, Tegeta Branch along Bagamoyo Road, Mwenge Branch and Mawasiliono Towers(TCRA building) along Sam Nujoma Road in Dar es Salaam, Mbauda Branch and Arusha City Branch along Wapare Street in Arusha, Moshi Branch along Market Street in Kilimanjaro, Kahama Branch in Kahama Town - Shinyanga, Mwaloni Branch near Mwaloni Fish Market and Nkrumah Branch along Nkrumah Street in Mwanza. The Bank is in the process of opening another branch in Geita and three (3) agencies in Lamadi, Kotoro & Kagongwa around Lake Zone before end of June 2012.
The bank is a shareholder of Umoja Switch Company which has more than 23 member Banks sharing a common EFT Switch and payment infrastructure platform through ATM’s throughout the country. Through this shared infrastructure member banks are now implementing additional services like internet banking that will facilitate online fund transfers through accounts in different banks, mobile banking, online air time recharge, utility bill payments and exploring options for institution of gateway to other international networks like VISA/Master Card.

Azania Bank is one of the pioneer bank with an equity investment in Tanzania Mortgage Refinance Company Limited (TMRC), an institution created to provide long term financing to member banks to support creation of a vibrant mortgage market in the country.

**Mission Statement**
Azania Bank Ltd aims at becoming a leading bank in providing banking and financial services to the small and medium sized customers by using professionally, motivated and dedicated staff, applying the state of the art-technology and continually enhance shareholder value.

**Vision**
To be One Stop Financial Centre for the Small and Medium Sized Enterprises.

**Target Market**
Our target market is small and medium sized companies, individuals, NGOs. Providing credit does not guarantee growth in any economy it is how the credit is applied that matters greatly to the development of the economy... Small and Medium Sized Enterprises (SME's) have long been the true engines of economic growth. They are more innovative, faster in growth, possibly more profitable as compared to larger sized enterprises.

Traditionally they produce much, or even most, of the technological innovations in business and industry. They create new jobs at faster pace than larger companies do.
They constitute the most dynamic segment of many transition and developing economies and their significance can furthermore be measured in the sizeable contribution they make to the countries gross national products.

Azania Bank Limited recognizes the fact that fair and reasonable access to credit matters, not just because credit helps small business to grow, but more importantly because small businesses help the economy to grow. We believe that SME’s are crucial for economic and social development for our country.

In Azania we are taking seriously the need to ensure SME’s continue to access credit, savings and other financial service at affordable terms and more conveniently through/by

(i.) Segmenting the market and building up in-depth knowledge of customers.
(ii.) Developing wide range of demand-driven products and services.
(iii.) Leveraging on appropriate technology.
(iv.) Developing multi-channel network for delivery of products and services
(v.) Use of advanced, cost effective tools for comprehensive risk management
(vi.) Aligning organization structure to target market segments
(vii.) Developing an efficient integrated MIS system.
(viii.) Good governance and transparent reporting
(ix.) Building strategic partnerships with global leaders in small business finance and providers of Financial technologies.

**Azania Bank Values**

(i.) Innovation
(ii.) Effective Risk Management
(iii.) Low Cost Services
(iv.) Responsiveness
(v.) Leadership
(vi.) Commitment
(vii.) Integrity
(viii.) Motivation & Teamwork
Shareholding Structure

The Current shareholders of the Bank are as follows:

<table>
<thead>
<tr>
<th>S/N</th>
<th>SHARE HOLDERS</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>National Social Security Fund (NSSF)</td>
<td>34.8</td>
</tr>
<tr>
<td>2</td>
<td>Parastatal Pension Fund (PPF)</td>
<td>30.1</td>
</tr>
<tr>
<td>3</td>
<td>Local Authority Pensions Fund</td>
<td>14.2</td>
</tr>
<tr>
<td>4</td>
<td>Public Service Pension Fund (PSPF)</td>
<td>17.2</td>
</tr>
<tr>
<td>5</td>
<td>East African Development Bank</td>
<td>2.3</td>
</tr>
<tr>
<td>6</td>
<td>Tanzanian Individual including staff</td>
<td>1.4</td>
</tr>
<tr>
<td></td>
<td>TOTAL</td>
<td>100</td>
</tr>
</tbody>
</table>

Types of loans are as follows

Consumer finance:
Loans for salaried individuals guaranteed by their employers.

Personal Loans:
Personal arrangement secured by collateral such as House, Fixed deposit

(i.) To buy anything of your choice for personal use
(ii.) Interest on reducing balances.
(iii.) Up to 24 months repayment period.

Business Loan
This type of loan is used for financing of

(i.) LPO financing
(ii.) Invoice Discounting
(iii.) Bills Discounting
(iv.) Bills Discounting/Negotiating
(v.) Terms Loans
(vi.) Guarantees
(vii.) Bonds
(viii.) Letters of Credit
(ix.) Working Capital Overdrafts
Home Loan
This type of loan is given either to buy or construct a house. A savings account with Azania Bank amounting to 20% of the expected loan. A title deed of the property and a sale agreement if buying a house are needed.

Education Loan
The Azania Education loan is given to all levels primary, secondary school, college/university or professional training. This loan is payable within 12 months at a very low interest.

2.3 Theoretical Framework
The theoretical framework adopted for the paper involved models of lending behavior based on an agency framework (Cook, 2001). Agency theory is concerned with how agency affect the form of the contract and how they can be minimized, particularly, when contracting parties are asymmetrically informed. Fundamentally, the problem arises because lenders are imperfectly informed about the characteristics of potential borrowers, and it may be impossible, as a result, for lenders to distinguish 'good borrowers from 'bad' ones (Fraser, 2004). As Fraser (2004) observes, longer and broader relationships increase the amount and flow of information to lenders, enabling good borrowers to obtain better access to finance over time. Therefore, information asymmetries lead to sub-optimal flows of finance (Cook, 2001).

The theory further tells us that it may be difficult to distinguish good from bad borrowers (Auronen, 2003), which may result into adverse selection and moral hazards problems. The theory explains that in the market, the party that possesses more information on specific item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender) (Auronen, 2003). The party that knows less about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction (ibid).
Adverse selection and moral hazards have led to substantial accumulation of nonperforming assets (NPAs) in banks (Bester, 1994; Bofondi and Gobbi, 2003). The very existence of banks however, is often interpreted in terms of its superior ability to overcome three basic problems of information asymmetry, namely, ex-ante, interim, and ex-post (Uyemura and Deventer, 1993), thus be able to reduce the NPLs. Lending has been, and still is, the mainstay of banking business. This is more true to emerging economies like Tanzania where capital markets are not well developed (Richard, 2008). Firms in Tanzania on one hand are complaining about lack of credits and the stringent requirements set by banks, while banks on the other hand have suffered large losses on bad loans (Richard, 2008). The average loan loss in studied CBs as measured by a ratio of non-performing (NPL) loans to total loans for the five years period from 1999 to 2004 is as shown below.

<table>
<thead>
<tr>
<th>Year</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Loan Loss</td>
<td>30.8</td>
<td>30.6</td>
<td>29.1</td>
<td>28.3</td>
<td>26.7</td>
<td>24.9</td>
</tr>
</tbody>
</table>

*Constructed from Azania Bank financial reports of 1999 to 2004*

### 2.4 Loan Performance in General

The financial sector is very crucial to the economies of various countries. Banks are a core of the financial sector especially when it comes to developing economies where the capital market is not strong enough. In an economy where the capital market is still a developing one, banks serve as important sources of funds for businesses. For this reason, the survival and consistently good performance of banks is an issue of concern to all. Studies that seek to investigate the performance of banks and their various determinants are steps in the right direction to identifying the means of promoting the survival and growth of the sector that serves as the backbone of the financial system of developing economies. Notwithstanding the above, the great depression of the 1940s coupled with bank failures experienced in the United States drove considerable attention to bank performance (Sufian, 2009).
Since then, the attention on bank performance has grown from levels to levels (Ramlall, 2009). Bank size has been established in literature as a significant determinant of performance but the direction of its influence is still in debate. Ramlall (2009) found that there is a positive relation between bank size and profitability. Even in recent times, Sufian (2009) confirms such relationship. The endogenous factors are firm specific factors that result from the decisions and policies of management. Examples of such factors are efficiency, profitability, liquidity, capital structure and asset quality ratios. The exogenous factors are industrial structural factors such as ownership, market concentration and stock market development and other macroeconomic factors. For the purpose of this study, the endogenous factors are used since they are the areas that the banks are expected to differ in. The exogenous factors are not expected to be significantly different since they are not firm specific but affects all firms in the industry.

Baral (2005) asserts that CAMEL framework is the most widely used model and it is recommended by Basle Committee on Bank Supervision and IMF. CAMEL represents Capital adequacy, Asset quality, Management efficiency, Earnings performance and Liquidity. Capital adequacy measures the ability of the bank to absorb shocks. Although it is important for banks to be liquid to avoid a run on it, Kamau (2009) argues that when banks hold high liquidity, they do so at the opportunity cost of some investment, which could generate high returns.

CBs have employed different strategies in attempt to reduce the level of loss caused by poor loan performance. In Japan among other strategies, they pursue a lending strategy backed by appropriate credit risk evaluations (Bank of Japan, 2003 quoted in Waweru & Kalani, 2009). In China, turning over the NPLs to asset management companies was proved very successfully (China Daily, 2002 quoted in Waweru & Kalani, 2009). Others were mostly associated with proper appraisal of borrowers in particular use of credit limit ratios, based on cash flows, use of forecasts and feasibility studies and use of standard lending procedure (Waweru & Kalani, 2009).
Banks as part of financial institutions face various risks. These risks can be categorized into three major groups, financial, operation and strategic risks (Koch and MacDonald, 2005). Financial risk includes capital adequacy, liquidity and credit risk. Operation risks involve risk associated with people and process, mismanagement and fraud, internal system failures, technology, legal, marketing and regulatory as well as external events. While the strategic risks include reputation risk, system risk and risk associated with changes in variables of businesses and strategy. The credit risk is a most expensive risk in financial institutions and its effect is more significant as compared to other risk as it directly threaten the solvency of financial institutions (Chijoriga, 2011).

The magnitude and level of loss caused by the credit risk as compared to other kind of risks is severe to cause high level of loan losses and even bank failure (Chijoriga 2011 and Richard, et al, 2008). Also loan portfolio not only believed to be the largest asset and pre-dominate source of revenue but also is one of the greatest sources of risk to financial institution’s safety and soundness (Richard, et al, 2008). An effective loan performance is therefore one of the road maps toward safety and the soundness of financial institution through performance, monitoring and prudent actions. This facilitates sustainability which empowers the financial institution through cost-effective provision of financial services. Furthermore sustainability assures access to services over time, raises the probability of expanding both the range of products suited to needs of poor clients and outreach to bankable men and women to urban and pre-urban or rural clients (Kuzilwa, 2005, Richard, et al, 2008 and Fatemi and Fooladi, 2006).

2.5 Credit Origination

Establishing sound, well-defined loan-granting criteria is essential to approving loan in a safe and sound manner. The criteria should set out who is eligible for loan and for how much, what types of loans are available, and under what terms and conditions the credits should be granted.
Banks must receive sufficient information to enable a comprehensive assessment of the true risk profile of the borrower or counterparty. At minimum, the factors to be considered and documented in approving loans must include:

(i.) The purpose of the loan and source of repayment;
(ii.) The integrity and reputation of the borrower or counterparty;
(iii.) The current risk profile (including the nature and aggregate amounts of risks) of the borrower or counterparty and its sensitivity to economic and market developments;
(iv.) the loan borrower’s repayment history and current capacity to repay, based on historical financial trends and cash flow projections;
(v.) a forward-looking analysis of the capacity to repay based on various scenarios;
(vi.) the legal capacity of the loan borrower or counterparty to assume the liability;
(vii.) For commercial loans, the borrower’s business expertise and the status of the borrower’s economic sector and its position within that sector;
(viii.) The proposed terms and conditions of the loan, including covenants designed to limit changes in the future risk profile of the borrower; and
(ix.) Where applicable, the adequacy and enforceability of collateral or guarantees.

Once loan-granting criteria have been established, it is essential for the bank to ensure that the information it receives is sufficient to make proper loan-granting decisions. This information may also serve as the basis for rating the loan under the banks’s internal rating system.

Banks need to understand to whom they are granting loan. Therefore, prior to entering into any new loan relationship, a bank must become familiar with the borrower or counterparty and be confident that they are dealing with an individual or organization of sound repute and creditworthiness. In particular, strict policies must be in place to avoid association with individuals involved in fraudulent activities and other crimes. This can be achieved through a number of ways, including asking for references from known parties, accessing loan reference bureau, and becoming familiar with individuals responsible for managing a company and checking their
personal references and financial condition. However, an institution should not grant loan simply because the borrower or counterparty is familiar to them or is perceived to be highly reputable.

The Bank should have procedures to identify situations where, in considering loan, it is appropriate to classify a group of borrowers as connected counterparties and, thus, as a single borrower. This would include aggregating exposures to groups of accounts, corporate or non-corporate, under common ownership or control or with strong connecting links (for example, common management, family ties).

In loan syndications, participants should perform their own independent loan risk analysis and review of syndicate terms prior to committing to the syndication. Each institution should analyze the risk and return on syndicated loans in the same manner as other loans.

Banks should assess the risk/return relationship in any loan as well as the overall profitability of the account relationship. Loans should be priced in such a way as to cover all of the embedded costs and compensate the institution for the risks incurred. In evaluating whether, and on what terms, to grant loan, banks need to assess the risks against expected return, factoring in, to the greatest extent possible, price and non-price (e.g. collateral, restrictive covenants, etc.) terms. In evaluating risk, banks should also assess likely downside scenarios and their possible impact on borrowers or counterparties. A common problem among banks is the tendency not to price a loan or overall relationship properly and therefore not receive adequate compensation for the risks incurred.

In considering potential loans, banks must recognize the necessity of establishing provisions for expected losses and holding adequate capital to absorb risks and unexpected losses.

The banks should factor these considerations into loan granting decisions, as well as into the overall portfolio monitoring process.
Banks can utilize loan risk mitigants such as collateral, guarantees, and loan derivatives or on balance sheet netting to help mitigate risks inherent in individual loans. However, loan transactions should be entered into primarily on the strength of the borrower’s repayment capacity. Loan risk mitigants should not be a substitute for a comprehensive assessment of the borrower or counterparty, nor can it compensate for insufficient information. It should be recognized that any loan enforcement actions (e.g. foreclosure proceedings) typically eliminate the profit margin on the transaction. In addition, banks need to be mindful that the value of collateral may well be impaired by the same factors that have led to the diminished recoverability of the loan.

Banks should have policies covering the acceptability of various forms of collateral, procedures for the ongoing valuation of such collateral, and a process to ensure that collateral is, and continues to be, enforceable and realizable. With regard to guarantees, banks should evaluate the level of coverage being provided in relation to the loan-quality and legal capacity of the guarantor. Banks should only factor explicit guarantees into the loan decision and not those that might be considered implicit such as anticipated support from the government.

2.6 Approving New Credits and Extension of Existing Credits

In order to maintain a sound loan portfolio, a bank must have an established formal evaluation and approval process for the granting of loans. Approvals should be made in accordance with the bank’s written guidelines and granted by the appropriate level of management. There should be a clear audit trail documenting that the approval process was complied with and identifying the individual(s) and/or committee(s) providing input as well as making the credit decision.

Each loan proposal should be subject to careful analysis by a credit analyst with expertise commensurate with the size and complexity of the transaction. An effective evaluation process establishes minimum requirements for the information on which
the analysis is to be based. There should be policies in place regarding the information and documentation needed to approve new loans, renew existing loans and/or change the terms and conditions of previously approved loans. The information received will be the basis for any internal evaluation or rating assigned to the loan and its accuracy and adequacy is critical to management making appropriate judgments about the acceptability of the loan.

A bank’s loan-granting approval process should establish accountability for decisions taken and designate who has the authority to approve loans or changes in credit terms.

A potential area of abuse arises from granting credit to connected and related parties, whether companies or individuals. Consequently, it is important that institutions grant credit to such parties on an arm’s-length basis and that the amount of credit granted is monitored. Such controls should be implemented by requiring that the terms and conditions of such credits not be more favorable than credit granted to non-related borrowers under similar circumstances and by imposing strict limits on such loans.

Transactions with related parties should be subject to the approval of the board of directors. Any board member who stands to benefit from that transaction should not be part of the approval process.

2.7 Loan Administration

Loan administration is a critical element in maintaining the safety and soundness of the bank. Once a Loan is granted, it is the responsibility of the business function, often in conjunction with a Loan administration support team, to ensure that the credit is properly maintained. This includes keeping the credit file up to date, obtaining current financial information, sending out renewal notices and preparing various documents such as loan agreements.

In developing their credit administration areas, a bank should
ensure:
(i.) the efficiency and effectiveness of credit administration operations, including 
(ii.) monitoring documentation, contractual requirements, legal covenants, collateral, etc;
(iii.) the accuracy and timeliness of information provided to management information systems;
(iv.) the adequacy of controls over all back office procedures;
(v.) compliance with prescribed policies and procedures as well as applicable laws and regulations.

For the various components of credit administration to function appropriately, senior management must understand and demonstrate that it recognizes the importance of this element of monitoring and controlling credit risk.

The credit files should include all of the information necessary to ascertain the current financial condition of the borrower or counterparty as well as sufficient information to track the decisions made and the history of the credit. Banks need to develop and implement comprehensive procedures and information systems to monitor the condition of individual credits and single obligors across the institution’s various portfolios. These procedures need to define criteria for identifying and reporting potential problem credits and other transactions to ensure that they are subject to more frequent monitoring as well as possible corrective action, classification and/or provisioning.

An effective credit monitoring system will include measures to:
(i.) ensure that the institution understands the current financial 
(ii.) condition of the borrower or counterparty;
(iii.) ensure that all credits are in compliance with existing covenants;
(iv.) follow up of customer’s utilization of the approved credit lines;
(v.) ensure that projected cash flows on major credits meet debt servicing requirements;
(vi.) ensure that, where applicable, collateral provides adequate coverage relative to the obligor’s current condition; and
(vii.) identify and classify potential problem credits on a timely basis.

Banks need to enunciate a system that enables them to monitor quality of the loan portfolio on day-to-day basis and take remedial measures as and when any deterioration occurs. Such a system would enable an institution to ascertain whether loans are being serviced as per facility terms, the adequacy of provisions, the overall risk profile is within limits established by management and compliance of regulatory limits. Establishing an efficient and effective credit monitoring system would help senior management to monitor the overall quality of the total loan portfolio and its trends. Consequently, the management could find tune or reassess its loan strategy or policy accordingly before encountering any major setback. The bank loan policy should explicitly provide procedural guideline relating to loan risk monitoring. At the minimum it should lay down procedures relating to:

(i.) the roles and responsibilities of individuals responsible for loan risk
(ii.) monitoring;
(iii.) the assessment procedures and analysis techniques (for individual loans & overall portfolio);
(iv.) the frequency of monitoring;
(v.) the periodic examination of collaterals and loan covenants;
(vi.) the frequency of site visits;
(vii.) the identification of any deterioration in any loan.

2.8 Bank Interest Rates
Credit is the device for facilitating transfer of purchasing power from one individual or organization to another. It indicates that credit provides the basis for increased production efficiency through specialization of functions thus bringing together in a more productive union. The skilled labor force with small financial resolves and though who have substantial resource but lack of entrepreneurial abilities (Oyatoya, 1983).
There are two important respects that a credit market differs from standard market for goods and services. First standard markets, which are focus of classical competitive theory, involve a number agent who are buying and selling a homogenous commodity. Secondly in standard market, the delivery of a commodity by a seller & payment for the commodity a buyer occur simultaneously. In contrast credit received today by an individual or firm in exchange for promise of payment in the future. A loan is a type of debt. Like all debts, a loan involves the real allocation of money over a period of time between the borrower and the lender. This money is paid back either in full or regular installment (Dugassa, 2012).

Acting as a provider of loans is one of the principal task for financial institutions such as a bank. For banks, loans are generally found by deposits. That is how banks usually learn. Their deposits are loaned out and when the borrowers pay with interest earning for the bank. Other types of dept include mortgages, credit card debt, bonds and lines of credit. A mortgage is a very common type of debt used by many individuals to purchase housing. In this arrangement, the money is used to purchase the property (Dugassa, 2012).

Bad loans may considerably rise due to abrupt changes in interest rates (Bloem and Gorter, 2001). Higher interest rates increase non-performing loans but the relationship is not statistically significant (Espinoza and Prasad, 2010). In Africa, Brownbridge, (1998) concluded that many of the bad debts in banks were attributable to moral hazards; the adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending at high interest rates to borrowers in the most risky segments of the credit market. To the borrowers’ side, they also tend to divert the funds to risky investments once they are granted the loans. In Kenya banks shift away from concentration on security based lending and put more emphases on the customer ability to meet the loan repayment. Reduction of interest rates however, was observed to be a successful action taken by bank management (Waweru & Kalani, 2009).
2.9 Loan Supervision

Many factors have been identified as major determinants of loan defaults. A large number of studies has claimed that the disparity in problem loans and losses among commercial banks depend largely on bank internal factors such as management quality, bank size, portfolio composition, cost control, credit policy, capital adequacy and credit risk (Huh and Kim, 1994; Iyoha and Udegbunam, 1998; and Udegbunam, 2000, 2001). However, the lending activities of government credit institutions are different from that of the commercial banks. This is because the cost of administering small business loans is higher for the banks. As Hill and Martin (2000) observe, if default rates and loans administration costs differ between two groups, lenders have an economic motive for applying different lending criteria to different groups.

National economic downturn, insider lending, political connection of bank owners, customer failure to disclose vital information during the loan application process, lack of proper skills amongst loan officials were among major factors identified in other countries to cause non-performing loans (Basel, 1999; Waweru and Kalani, 2009). In Spain, Fernandez, Jorge and Saurina, (2000) pointed out that despite bank supervisors being aware that most banking crises were directly related to inadequate management of credit risk by respective institutions, it was difficult for supervisors from central banks to pursue bank managers to follow more prudent credit policies during economic upturn, that even conservative managers might find market pressure for higher profits very difficult to overcome.

2.10 Loan Attitudes

Additionally, the existence and survival of these financial institutions enable the current and potential customers to have an access of loans over time. These loans enable entrepreneurs or small group of people to start, develop, diversify or expand their businesses (Kessy, 2007). Loans can change peoples’ lives for the better especially the lives of those who need it most. A small loan can make all the difference to a poor or low-income family. With access to loans, they can earn more; build-up assets, and better protect themselves against unexpected setbacks and losses.
They can move beyond day to day survival toward planning for the future, they can invest in better nutrition, housing, health and education for their children. Loans also support the poor households to manage critical financial transactions, stimulate local markets and extend employment opportunities as businesses grow.

Different studies have also found that loans offer more than just material benefits; they can also address issues associated with “non-material” poverty, which includes social and psychological effects that prevent people from realizing their potential (Kessy and Urio, 2006 and Hulme, Moore and Shepherd, 2001). The process of taking a credit, investing and repaying of loans, seems to empower the poor through a personal transformation from a feeling of “I cannot” to one of ‘I can”. I can do something about my poverty. In theory at least, this self-financing feature (financial sustainability) allows for massive expansion of financial institution to reach tens if not hundreds of millions of underserved people. Getting cash into the hands of poor people for example helps increase self-esteem among the poor. It translates them into control over a financial resource which, in turn, builds their economic empowerment, voice and status within the family and ultimately within the community. This again improves family welfare because they can channel more of their incomes to meeting the needs of their households.

2.11 Loan Challenges
Traditional studies of relationship lending deal with the problem of asymmetric information between lender and borrower. Lenders need to measure the risk of each borrower in order to determine how they allocate their loans (Berger and Udell, 2002). Hard market based information about borrowers can sometimes be difficult to obtain by lenders and thus “soft” information is collected over time from the relationships established between lenders and borrowers (Berger and Udell, 2002). This view has often been linked with positive outcomes for credit allocation (Boot, 1999). Lenders are able to gather valuable “soft” information over time to solve asymmetries and therefore more accurately price their loans. Good borrowers benefit from better loan terms because the “soft” information generated from the relationship
makes the borrower less risky provided the “soft” information is positive. This literature, however, seems to be focused in markets with well-developed and functioning financial systems (Boot, 1999).

In Africa, Brownbridge, (1998) in Richard (2011) concludes that many of the bad debts in banks were attributable to moral hazards; the adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending at high interest rates to borrowers in the most risky segments of the credit market. To the borrowers“ side, they also tend to divert the funds to risky investments once they are granted the loans. Palubinskas and Stough (1999) note that the failure of a bank is mainly seen as a result of mismanagement because of bad lending decisions made with respect to wrong appraisal of credit status, or the repayment of non-performing credits and excessive focus on giving loans to certain customers.

Goodhart et al (1998) also state that poor credit control, which results in undue credit risk, causes bank failure. Chimerine (1998) adds that a bad lending tradition leads to a large portfolio of unpaid loans. This results in insolvency of banks and reduces funds available for fresh advances, which eventually causes a financial crisis. Goodhart et al. (1998) add connected lending to the causes of bank failure. Palubinskas and Stough (1999) note that lack of dependable financial information on borrowers to help in assessing creditworthiness causes a bank failure.

2.12 Non Performance Loan

There is no global standard to define non-performing loans at the practical level. Variations exist in terms of the classification system, the scope, and contents. Such problem potentially adds to disorder and uncertainty in the NPL issues. A simple definition of non-performing is: A loan that is not earning income and: (1) full payment of principal and interest is no longer anticipated, (2) principal or interest is 90 days or more delinquent, or (3) the maturity date has passed and payment in full has not been made. The issue of non-performing loans (NPLs) has gained increasing attentions in the last few decades. The immediate consequence of large amount of
NPLs in the banking system is bank failure. Recently banks witnessed rising non-performing credit portfolios and these significantly contributed to financial distress in the banking sector (Sufian, 2009).

It is argued that the non-performing loans are one of the major causes of the economic stagnation problems. Each non-performing loan in the financial sector is viewed as an obverse mirror image of an ailing unprofitable enterprise. From this point of view, the eradication of non-performing loans is a necessary condition to improve the economic status. If the non-performing loans are kept existing and continuously rolled over, the resources are locked up in unprofitable sectors; thus, hindering the economic growth and impairing the economic efficiency. Banks collect deposits and lend to customers but when customers fail to meet their obligations problems such as non-performing loans arise.

The focus in this section is on the determinants of NPLs. A reader, who is interested in the general context and practices of stress-testing, can find several other surveys. For example, the special feature of the Financial Stability Report of the European Central Bank (2006) provides a brief introduction into macro stress testing as well as an overview of EU country-level macro stress testing practices. A detailed introduction into stress testing and an overview of the related literature is given in Sorge (2004). Financial system shocks can emanate from firm specific factors (idiosyncratic shocks) and from macroeconomic imbalances (systemic shocks).

Overall, the literature on the major economies has confirmed that macroeconomic conditions matter for credit risk. Authors who looked at asset-price evidence also found a linkage between credit risk increases and adverse macroeconomic conditions (Mueller, 2000). Kent and D’Arcy (2000) suggested in a study of Australian banks that, although risks tended to be realized during the contractionary phase of the business cycle, they actually peaked at the top of the cycle. Interest rates were also found to be significant in several studies.
In addition to macro-economic factors, many of these studies included bank-specific variables, since they can signal or cause risky lending. For instance, Salas and Saurina (2002) showed for Spanish banks that, in addition to real GDP growth and credit growth, bank size, capital ratio and market power also explained variations in NPLs. Understanding the determinants of risk-taking behavior of banks has been a subject of much attention in the banking literature. Risk-taking tends to be affected by a number of factors, including, among others, moral hazard, agency problems, ownership structure, and regulatory actions.

Because of moral hazard induced by deposit insurance, banks may increase their risk positions and more so as capital declines. In practice, such risk-shifting activities of banks are not common, as empirical evidence for the U.S. would testify. Indeed, risk taking driven by moral hazard is limited by effective regulatory oversight and market discipline. Riskier loans also generate higher costs for banks. As a result, one has to be careful when assessing the direction of causality. Our solution is to use a lagged measure of efficiency in order to prevent avoid this issue of endogeneity. Overall, while studies examining the interplay between capital and portfolio risk have been considered in the literature (Mueller, 2000), little work has been forthcoming on the examination of the relationship between capital and credit risk and its interaction with operational efficiency.

Sorge (2004) documents a number of studies that examine the feedback effects between credit losses and the macro-economy. The feedback effect is in general difficult to assess because it is blurred by the direct effect (from growth to NPLs and balance sheets) and therefore one has to identify a supply shock. Numerous papers have, however, suggested that some form of financing effect must be at play surveys studies that link the real and the financial sectors). For instance, Carling et al. (2003) using a multivariate Granger causality found corporate default as a useful predictor of economic activity. Further he set up a panel VAR to model macro factors and the likelihood of default for Swedish companies and find evidence of macro feedbacks. Von Peter (2004) emphasized the feedback of losses to the macro-economy through
restrictions in lending to meet binding capital constraints. The channel of transmission would seem to a large extent through investment.

2.13 Empirical Literature
Ngoc (2008) carried study on banking market liberalization and bank performance. The paper analyzes the evolution in bank performance following the removal of legal restrictions on the entry of foreign banks in three transition economies: the Czech Republic, Hungary, and Poland. Two modes of foreign bank entry are considered: entry by Greenfield investments, and by foreign mergers and acquisitions of domestic banks. For this purpose, he constructs a panel data of banks from the three countries over the period 1994-2004. He determine the dates on which liberalization occurred in each country.

Obamuyi (2011) carried study about comparative loan performance in banks and micro-credit institutions in Nigeria. The study compares the performance of loans granted to small and medium enterprises by banks with that of micro-credit institutions in Nigeria, using Ondo State as a case study. Descriptive statistics were used to analyze the data collected through primary source. The study reveals that the average repayment rate of 92.93% for banks was higher than the 34.06% for the micro-credit schemes. That is, the banks performed at much higher levels than microcredit schemes. Based on the findings, it was recommended that there should be stern efforts by the credit institutions in screening of loan applications, monitoring of approved loans and enforcing loan contract. Government should provide the basic infrastructural facilities, which unnecessarily increase the cost of doing business in the country.

Timoth et. al (2006) carried out a study about the effect of bank supervision on loan growth. The study quantifies the short-term and long-term impact of bank supervision (measured using CAMEL composite and component ratings) on different categories of loan growth: (a) commercial and industrial loans, (b) consumer loans, and (c) real estate loans. For each of these categories, they perform dynamic loan growth equations at the state level augmented by the inclusion of CAMEL ratings for
all banks in the state, after controlling for banking and economic conditions. They perform these regressions for two distinct subperiods: (1) 1985 through 1993 (which covers the credit crunch period), and (2) 1994 through 2004 (which covers the sustained recovery period).

For the first period, 1985 to 1993, they find that out of the three loan categories considered, business lending is the most sensitive to changes in CAMEL ratings (both the composite and the components), although the other loan categories also show some sensitivity. Overall, however, they find little evidence suggesting that the effects of changes in any of the components of CAMEL ratings differ systematically from the effects of changes in the composite CAMEL. For the second period, we find little evidence that changes in CAMEL ratings (the composite or its components) had any systematic effect on loan growth for any of the loan categories considered.

Espinoza and Ananthankrishan (2010) carried study on non-performing loans in the GCC banking system and their macroeconomic effect. The study shows that the global crisis exposed the vulnerabilities of the banks in the Gulf Cooperative Council (GCC) countries to varying degrees. GCC countries experienced significant increases in banking system credit between 2003 and 2008. The favorable macroeconomic environment in the years preceding the global crisis had been conducive to favorable credit conditions and lower nonperforming loans (NPLs) of banks. In 2009, NPLs increased sharply and credit stagnated, raising worries that the recovery could be slowed down by credit constraints.

The current crisis highlights the importance of linking the macroeconomic conditions to the health of the banking system. The main goal of macroeconomic stress tests, which have become more common with the financial crisis, is to identify structural vulnerabilities in the financial system in order to assess its resilience to shocks in particular losses in the loan books. Credit risk increases as the economic situation deteriorates and interest payments rise, a result found in many credit risk models. Conversely, deterioration in banks’ balance sheets may feedback into the economy because banks will tighten credit conditions, especially if there remain uncertainties on the valuation of projects and of assets.
The study focused on the relationship between macroeconomic variables and NPLs (credit risk) in GCC banks’ books. This is to the best of our knowledge the first attempt to model NPLs in the GCC countries, using bank-level data. This additional level of disaggregation strengthens the accuracy of estimation and allows a discussion of the impact of macro variables and of bank-specific characteristics. It also allows a discussion of meaningful nonlinearities, in particular the finding that banks with higher levels of NPLs are also more sensitive to macroeconomic shocks. The model estimates elasticities that are a key input for stress testing banks’ balance sheets in the GCC. This study also estimates a macroeconomic panel VAR in order to discuss the potential feedback effects of bank performance on the supply of credit and growth. Although there are precedents on other regions, this is the first attempt on GCC countries data.

The study conducts this analysis using bankwise data from Bankscope.

According to a dynamic panel estimated over 1995–2008 on around 80 banks in the GCC region, the NPL ratio worsens as economic growth becomes lower and interest rates increase. Larger banks and banks with lower expenses would also have lower NPLs. Finally, high credit growth in the past could generate higher NPLs in the future. According to all models, NPLs are very persistent, which would suggest that the response of credit losses to the macroeconomic cycle could take time to materialize, although it would also imply that NPL would then cumulate to high levels. The model implies that the cumulative effect of macroeconomic shocks over a three year horizon is indeed large.

The study also investigates the feedback effect of increasing NPLs on growth using a VAR model. Overall, the model suggests that there is strong albeit short-lived feedback effect on non-oil growth, with a semi-elasticity of around 0.4. However, these results are the outcome of an analysis during a period in which the region did not suffer from systemic banking crises. Since the feedback effect is likely to be nonlinear, costs could increase significantly once NPLs cross a certain threshold. Looking ahead, the results of the study have implications for regulation and
supervision of the financial system in the GCC countries. In the context of their exchange rate pegs, a stronger focus on macro prudential regulation, particularly through capital and liquidity buffers and countercyclical provisioning norms would help mitigate the impact of macroeconomic risks on the banking system and the feedback effect of credit risks on the economy.

David (2010) carried study on whether political connection help firms gain access to bank credits in Vietnam. The study established that one of the major contributing factors to Vietnam’s macroeconomic instability has been the massive growth of credit inflows and its often inefficient allocations. Vietnam is in a state of economic transition from state-planned to open market based. The private sector has grown very rapidly but private firms’ demand for credit is still largely crowded out by the state sector. The study specifically focuses on the use and impact of political connections by private firms to gain access to bank loans.

More generally, this is one issue resulting from, and contributing to, the inequality of credit distribution across the Vietnam’s economy. Using individual company level data from 2007 to 2009 inclusive, this study finds that exercising political connections increases a private firm’s probability of accessing a loan by 4.7%. In testing the effect of political connections on loan terms, this analysis found that firms with political connections also paid a price in the form of higher interest rates. Indeed private firms trying to access bank credit apparently pay a premium to their Vietnamese bankers in return for their privileged relationship. This suggests that the benefit of political connections translates into an extra financial advantage to both the lender and borrower.

Ogilo (2012) carried study on the impact of credit risk management on financial performance of commercial bank in Kenya. The study analyzed the impact of credit risk management on the financial performance of commercial banks and also attempted to establish if there exists any relationship between the credit risk management determinants by use of CAMEL indicators and financial performance of commercial banks in Kenya. A causal research design was undertaken in this study
and this was facilitated by the use of secondary data which was obtained from the Central Bank of Kenya publications on banking sector survey.

The study used multiple regression analysis in the analysis of data and the findings have been presented in the form of tables and regression equations. The study found out that there is a strong impact between the CAMEL components on the financial performance of commercial banks. The study also established that capital adequacy, asset quality, management efficiency and liquidity had weak relationship with financial performance (ROE) whereas earnings had a strong relationship with financial performance. This study concludes that CAMEL model can be used as a proxy for credit risk management.

Furthermore bank performance is reflected by accounting measures of profitability, net interest margin, and operating costs. The results show a very limited effect of the entry of Greenfield banks on domestic banking market in the early transition period. In contrast, the foreign entry by mergers and acquisitions of domestic banks exerts significant impacts on bank performance. Indeed, he observes significant declines in banks’ profits and net interest margins, and a significant increase in operating costs. His results have important policy implications for those emerging and transition economies still hesitant to liberalize their banking markets.

Bercoff et al (2002) examine the fragility of the Argentinean Banking system over the 1993-1996 period; they argue that non-performing loans are affected by both bank specific factors and macroeconomic factors. To separate the impact of bank specific and macroeconomic factors, the authors employ survival analysis. Using a dynamic model and a panel dataset covering the period 1985-1997 to investigate the determinants of problem loans of Spanish commercial and saving banks, Salas and Saurina (2002) reveal that real growth in GDP, rapid credit expansion, bank size, capital ratio and market power explain variation in non-performing loans.

Furthermore, Jimenez and Saurina (2005) examine the Spanish banking sector from 1984 to 2003; they provide evidence that non-performing loans are determined by
GDP growth, high real interest rates and lenient credit terms. This study attributes the latter to disaster myopia, herd behavior and agency problems that may entice bank managers to lend excessively during boom periods. Meanwhile, Rajan and Dhal (2003) utilize panel regression analysis to report that favorable macroeconomic conditions and financial factors such as maturity, cost and terms of credit, banks size, and credit orientation impact significantly on the non-performing loans of commercial banks in India.

Babihuga (2007), in an IMF working paper, explores the relationship between several macroeconomic variables and financial soundness indicators (capital adequacy, profitability, and asset quality) based on country aggregate data. She explained the cross-country heterogeneity by differences in interest rates, inflation, and other macroeconomic factors. However, the study does not consider the impact of industry specific drivers of problem loans.

Most empirical studies examine the influence of the macroeconomic environment on non-performing loans (Louzis et al, 2011). Rinaldi and Sanchis-Arellano (2006) analyze household non-performing loans for a panel of European countries and provide empirical evidence that disposable income, unemployment and monetary conditions have a strong impact on non-performing loans. Berge and Boye (2007) find that problem loans are highly sensitive to the real interest rates and unemployment for the Nordic banking system over the period 1993–2005. Lawrence (1995) examines the theoretical literature of life-cycle consumption model and introduces explicitly the probability of default. This model implies that borrowers with low incomes have higher rates of default due to increased risk of facing unemployment and being unable to settle their obligation. Additionally, in equilibrium, banks charge higher interest rates to riskier clients. Rinaldi and Sanchis-Arellano (2006) extend Lawrence’s model by assuming that agents borrow in order to invest in real or financial assets. They argue that the probability of default depends on current income and the unemployment rate, which is linked to the uncertainty regarding future income and the lending rates.
2.13 Conceptual Framework

Palubinskas and Stough (1999) note that the failure of a bank is mainly seen as a result of mismanagement because of bad lending decisions made with respect to wrong appraisal of credit status, or the repayment of non-performing credits and excessive focus on giving loans to certain customers. Goodhart et al (1998) also state that poor credit control, which results in undue credit risk, causes bank failure. Chimerine (1998) adds that a bad lending tradition leads to a large portfolio of unpaid loans. This results in insolvency of banks and reduces funds available for fresh advances, which eventually causes a financial crisis. Goodhart et al. (1998) add connected lending to the causes of bank failure.

Palubinskas and Stough (1999) note that lack of dependable financial information on borrowers to help in assessing creditworthiness causes a bank failure. National economic downturn, insider lending, political connection of bank owners, customer failure to disclose vital information during the loan application process, lack of proper skills amongst loan officials were among major factors identified in other countries to cause non-performing loans (Santomero, 1997; Basel, 1999; Waweru and Kalani, 2009). Controlling non-performing loans is very important for both the performance of an individual bank and the economy’s financial environment (McNulty et.al, 2001). The conceptual map is as hereunder.

**Figure 2.1 Conceptual Map**

Source: Researchers own conceptual map (2013)
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction
The chapter describes the methodology used in this study. The methodology used include the research design, the target population and sampling design, the sampling technique, data collection instruments, that is questionnaire, and data processing and analysis.

3.2 Research Design
According to Cooper and Schindler (2001), research design is the blueprint for fulfilling objectives and answering questions. Selecting a design may be complicated by the availability of variety of methods, techniques, procedures, protocols, and sampling plans. The study adopts a case study design.

The researcher in this study adopted cross sectional case study design in order to capture as many dimensions as possible. The main advantage of this design was not to isolate factors in the same way as quantitative research do and utilizes as much as possible all possible qualitative tools. Since this study involved measuring or counting attributes (i.e. quantities) and also since numerical data were collected and transformed what was collected or observed into numerical data, then the research had to be more quantitative than qualitative.

3.3 Location of the Study
The study was conducted at Azania Bank Ltd. The reason for the choice of this financial institution was that the bank was located at the central business district of Dar es Salaam city where by bank officials serve such a big number of small and medium enterprises annually. This is enough factors to justify a thorough evaluation of loan performance.
3.4 Population of the Study
Population refers to an entire group of individuals, events or objects having a common observable characteristic. In other words, population is the aggregate of all that conforms to a given specification (Orodho and Kombo, 2002). The study population for this research encompassed all loan officers of Azania Bank Ltd (which has total of 205 members of staff) and bank borrowers.

3.5 Sample Size and Sampling Techniques
A sample is a set of individuals selected from a population, usually intended to represent the population in a research study. This is a group of respondents which the researcher was interested in collecting information. Kothari (2004) suggests that the sample should be large as possible, and in practice a large sample constitutes about 30% of the total population. Thus there were 30 loan officers and 30 borrowers making a total of 60 respondents. This study involved one sampling techniques that is probability sampling.

3.6 Data Types
Kothari (2004) states that when deciding on the method for data collection, the researcher should keep in mind the two types of data specifically primary and secondary data. Therefore, in this study both primary and secondary data was collected.

3.6.1 Primary Data
Primary data are data collected directly for the purpose which it is to be used, afresh and for the first time thus happen to be original in character (Kothari, 2004). Primary data provides the researcher with the most accurate and up to date data. Primary data for this study were collected by using personal interviews, observations and by questionnaires.

3.6.2 Secondary Data
These are data which have already been collected by someone else and which have been already passed through the statistical process (Kothari, 2004). For this study
secondary data were obtained through reviewing some relevant documentaries, journals, books, manual, performance appraisal records, reports and publications of various performance appraisal, internal memos and agendas of meeting.

3.7 Data Collection Methods
Kothari (2004) defined data collection methods as methods used in generating or bringing together information that has been systematically observed, recorded, organized, categorized, or defined in such a way that logical processing and inferences may occur. Therefore, the researcher used both primary and secondary data methods and techniques to collect the required information for the study.

3.7.1 Questionnaires
In this study structured and unstructured questionnaire were used as the research instrument. An unstructured questionnaire is an instrument or guide used by an interviewer who asks questions about a particular topic or issue. Although questions guides were provided for the interviewer to direct the interview, the specific questions and the sequence in which they are asked are not precisely determined in advance. A structured questionnaire, on the other hand, is one in which the questions asked are precisely decided in advance. When used as an interviewing method, the questions are asked exactly as they are written, in the same sequence, using the same style, for all interviews. Nonetheless, the structured questionnaire can sometimes be left a bit open for the interviewer to amend to suit a specific context. Saunders, et al (2003) refer to a questionnaire as a general term to include all techniques of data collection in which each person (respondent) is asked to respond to the same set of questions in a predetermined order, hence the questionnaire were used to gather primary data from the targeted population.

3.7.2 Interview
The researcher conducted interviews with the respondents on the issues which are not included in the questionnaires but affect loan performance in Azania bank. The interviewing procedure enabled the researcher to get the inner feeling of the respondent hence provided auxiliary information regarding loan performance. This
method gave room to the researcher to make more elaboration to the respondents at the same time avoiding bias responses to the research questions.

3.8 Data Analysis Methods
In this study data were analyzed through Statistical Package for Social Sciences (SPSS) Software Program (Version 17). Research questions were analyzed using this program. Data collected from the primary sources were processed and analyzed by using Microsoft Office Excel. Descriptive statistics such as frequencies and percentages were used. Qualitative data were processed by categorizing, summarizing and presenting it in tabular forms and content analysis. The collected data were compiled in frameworks which were properly summarized so as to be able to draw an understandable picture. The Analysis considered research objectives.

3.9 Reporting of Findings
The findings of the research are descriptive and narrative form. This detailed presentation will act as a vehicle for communicating the result of the findings to policy makers and financial institutions about loan performance.
CHAPTER FOUR

DATA PRESENTATION AND DISCUSSION OF FINDINGS

4.1 Introduction

Chapter four present and analyze quantitative and qualitative data. This chapter addresses five sub-sections that are personal information, interest rate charged to borrowers, bank capacity in supervising loans, borrowers’ attitudes towards loans and general loan challenges. It is important to notes from the beginning that respondents contacted were thirty loan officers and thirty borrowers each using different data collection tools. Having this in mind personal information is a point of departure.

4.2 Personal Information of Respondents

Personal information is an important aspect in research as it determines accuracy of data provided. It is worth noting that respondent’s gender, education and age determines type of data. The study like this involves review of confidential reports and interviewing loan officers and borrowers with the expectation to disclose all information required. Determined by their gender women and men might have different opinions on similar matter due to their differences in feelings, perceptions and social responsibilities. Age and education determines peoples’ wisdom and thinking capacity. Along this reflection age and education of respondents might determine accuracy and reliability of data. Therefore it is crucial to balance respondents while conducting a research. Within this framework personal information taken into consideration in this study were gender, age, marital status, level of education and both working department and experience for bank officers.

Gender issue is considered in this study in order to assure that accuracy information is collected. Gender aspect is based on the fact that men and women perceive issues differently. In this case, respondents’ distribution by gender was as shown in figure 4.1
Gender inequality generates wasted opportunities and cognitive errors in knowledge. Research has shown that gender bias has important implications for the content of research itself. The integration of sex and gender analysis in the research content increases the quality of research and improves the acceptance of data. Thus in this study gender balance was considered as there were 31(52%) male and 29(48%) female. In some cases gender biasness in working places has been reported and it is still an issue. This means if we treat respondents with biasness to one gender the possibility of getting biased data is higher. Thus gender balancing is very important in order to get unbiased data. That is why respondents for this study are gender balanced.

Marital status was also considered in data collection. Marital status is important to borrowers since it is a spause commitment to the loan taken. For loan officers marital status is important to show that fraud of not following proper loan application procedures are minimized since a loan officer may think once a fraud is committed, then the family will suffer if the job will be lost.
Regarding marital status of respondents 10(17%) loan officers were single while 20(33%) were married. While 2(7%) borrowers were single, 27(45%) were married and 1(2%) was separated. Borrowers are self dependable people as majority are married.

Another personal information to be discussed is regarding level of education. Information on education level of the respondents by education level is as presented in figure 4.3.
Accordingly there were 8(13%) loan officers with college level of education and 22(37%) with university level of education. Additionally, while there were 9(15%) borrowers with secondary level of education, 12(20%) borrowers had college level of education and 9(15%) had university level of education. Level of education is very important indicator of quality data as it broadens peoples thinking capacity hence enhance capacity of looking at issues critically. In this case more loan officers have obtained university level of education as compared to borrowers.

4.3 Bank Interest Rate
This section was an attempt to find out bank interests rate charged from borrowers. Thirty loan officers answered questions related to adequacy of bank rate set, affordability of bank rate set, significant factors causing non performing loans, find out the way bank loan performance is understood, finding out strength and weaknesses of loan performance and whether they have categories of interest rate.
Whether bank rate set is adequate the following were answers from loan officers.

**Figure 4.4: Relatively low Bank Interest Rate Set**

[Bar chart showing percentage responses]

Source: Research findings, 2013

Whether bank had relatively low bank interest rate set 27(90%) responded yes while 3(10%) responded no. During interview one loan officer declared that “we have different categories of loans to ensure that different types of borrowers get loans.” Data shows that bank is charging standard and affordable bank interest rate as perceived by loan providers. However, loan officers could have taken loan adequacy using criteria of profitability. Thus borrowers’ perception is again important although they could also perceive loan interest rate basing on their capacity. Therefore the research sort out standard interest rate charged from different bank and concludes that the interest rate charged with Azania bank is relatively low as loan officers had said.
Whether bank set affordable interest rate responses were as hereunder.

Figure 4.5 : Affordability of Bank Interest Rate Set

Source: Research findings, 2013

Whether bank had affordable bank rate 27(90%) responded yes while 3(10%) responded no. Data shows that bank is charging standard and affordable bank rate as perceived by loan providers. Again the research sort out standard rate charged from different bank and concludes that the interest rate charged with Azania bank is relatively low as loan officers had said.
Finally respondents were had established factors causing non-performing loans as hereunder table 4.1.

Table 4.1: Significant Factors Causing Non-Performing Loans

<table>
<thead>
<tr>
<th>Significant factor of non-performing loans</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inadequate risk management</td>
<td>5(17%)</td>
<td>25(83%)</td>
</tr>
<tr>
<td>Integrity of borrower</td>
<td>4(13%)</td>
<td>26(87%)</td>
</tr>
<tr>
<td>Poor credit monitoring</td>
<td>1(3%)</td>
<td>29(97%)</td>
</tr>
<tr>
<td>Poor credit policy</td>
<td>10(33%)</td>
<td>20(67%)</td>
</tr>
<tr>
<td>Cost of borrowing</td>
<td>11(37%)</td>
<td>19(63%)</td>
</tr>
</tbody>
</table>

Source: Research findings, 2013

83% of Azania Bank officials had adequate risk management as reported by 25(83%) respondents, good credit monitoring as 29(97%) said and good credit policy as 20(67%) reported. The client had also adequate risk management as 26(87%) reported and adequate integrity of borrowers as 19(63%) reported adequate cost of borrowing. During interview it was discovered that there are different categories of loan depending on amount and time taken to return loans as loan officers declared, “different categories of loan gives borrowers capacity to borrow.”

4.4 Loan Supervision

This section is about loan supervision. Things covered in this section include whether they have mechanisms to supervise loan, type of mechanisms in place, whether the bank was adequately assessing credit application, whether there were any policies or procedures in place to reduce non-performing loans, whether bank is adequately assessing credit applications and the way management respond to non-performing loans. Whether bank had mechanisms to supervise loan respondents were as hereunder.
Whether bank had mechanisms to supervise loan, 28(93%) of loan supervisors said yes while 2(7%) of loan supervisors said no. Asserting presence of bank mechanism to supervise loan implies presence of bank policies, guideline and mechanisms to supervise loan. Contrary to what Brownbridge(1998) in Richards (2011) had noted that in Africa many of bad debts in banks were attributed to moral hazards where bank lenders adopt imprudent lending strategies. Also asserting presence of bank mechanism to supervise loan implies transparent mechanism of loan supervision as one loan officer during interview said “among the key factors we consider before giving loans is if borrowers meet our standard.” The other 2 loan officers who said there is no supervision was referring to small loans in which supervision is not as much as for large loans.
Mechanisms used to supervise loan in bank were mentioned as hereunder table 4.2.

**Table 4.2: Mechanisms Used to Supervise Loans**

<table>
<thead>
<tr>
<th>Mechanisms used to supervise loans</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weekly monitoring of borrowers</td>
<td>15</td>
<td>50</td>
</tr>
<tr>
<td>Routinely assessment of borrowers' business</td>
<td>7</td>
<td>23</td>
</tr>
<tr>
<td>Assessment of trends of loans returned by borrowers</td>
<td>5</td>
<td>17</td>
</tr>
<tr>
<td>Assessing periodic business report from borrowers</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>30</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Research findings, 2013

Physical observation and reports review are core mechanisms used to supervise loans. Regarding physical observation, loan officers had to visit borrowers in each week as 15(50%) loan officers declared while 7(23%) loan officers said they had a routinely assessment of borrowers’ business. In assessing reports, 5(17%) loan officers said that they are assessing reports on trends of loan returned by borrowers while 3(10%) loan officers were assessing periodic business reports from borrowers. Note that 73% of loan officers suggest physical supervision of loans implying eye witness as the key mechanisms used to supervise loans. This implies that Azania Bank has good credit control factor which is very important to consider as Chmerine (1998) claimed that poor credit control causes bank failure.

During interview it was discovered that among the mechanisms to supervises bank loans, is to use alternative approaches to measuring banks’ performance using a deeper analysis of the way in which banks run their business and make use of their stress-testing results, or even further enhancement of their high-level discussions with supervisors on consistency between performance and business strategy. This may eventually call for more transparency from banks on their profitability structure, and some adjustment in the governance process. Among other things, these measures comprise a reassessment of the risk function with respect to its independence and the available tools and an adequate level of risk awareness at the top-tier management level.
Whether bank was adequately assessing credit application responses were as shown in figure 4.7.

**Figure 4.7: Whether the Bank Is Adequately Assessing Credit Application**

Source: Research findings, 2013

Whether bank was adequately assessing credit application 26(87%) of loan officers said yes while 4(13%) of loan officers said no. Since 87% of loan officers declared that bank was adequately assessing credit application data implies that bank had set practical mechanisms and criteria to assess credit application factor supported by Beger and Udell (2002) that lenders need to measure their risk of each borrowers in order to determine how they allocate their loans.

During interview loan officer said that “*in order to achieve their objectives credit risk management is very important which is one among the problems facing banks. It is very crucial to note that poor credit risk management can cause liquidity risk and can make a commercial bank insolvent.*” Huh and Kim (1994) noted that a large number of studies claimed that the disparity in problem loan and loss among commercial banks depend largely on bank internal factors such as management quality, bank size, cost control, adequacy and credit risk.
The way management responds to non-performing loans is as in table 4.3 below.

Table 4.3: The Way Bank Management Responds to Non-Performing Loans

<table>
<thead>
<tr>
<th>Credit assessment</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adherence to credit policy</td>
<td>15</td>
<td>50</td>
</tr>
<tr>
<td>Collateral security</td>
<td>7</td>
<td>23</td>
</tr>
<tr>
<td>Training and development</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>Frequent contact with borrowers</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>Effective credit monitoring</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Research findings, 2013

The bank Management has different approaches to respond to non-performing loans such as adherence to credit policy as 15(50%) loan officers responded, collateral security as 7(23%) loan officers said, training and development as 3(10%) loan officers declared, frequent contact with borrowers as 3(10%) loan officers stated and effective credit monitoring as 2(7%) loan officers made a comment. Data are suggesting three things regarding the way bank management responds to non-performing loans. The first suggesting is that bank management adhere to national policies, second management build institutional capacity and third management make close supervision especially to the loan borrowers to ensure what Dugsan(2012) pointed out that all loans involve the real allocation of money is paid over a period of time between the borrowers and the lender. The money is paid either in full or in regular installments.

4.5 Loan borrowers’ attitudes

This section tested loan attitudes of loan borrowers. It is important to note that respondents of this section were loan borrowers. Issues addressed in this section include time borrowers have been taking loan, whether borrowers were thinking of borrowing again, whether they were assessed before qualifying for loan and the way assessment was carried out. Others include main factor which made borrowers to qualify for loans, whether bank make routine monitoring and whether it was easy for borrowers to pay their loan. Furthermore this section assessed whether it was
difficult for borrowers to pay their loan, whether they had managed to pay their loan and whether after paying their loan they still remained in the business. Concerning time borrowers have been taking loan from Azania bank the following were responses.

**Figure 4.8: Frequency borrowers have been taking loan from Azania Bank**

![Pie chart showing frequency of loan taking]

Source: Research findings, 2013

The bank had created conducive borrowing environment which allows routinely borrowing as nearly three quarters of borrowers had already taken loans. 22(73%) of borrowers had taken a loan thrice while 6(20%) of borrowers had taken once and 2(7%) of borrowers had taken twice. Importantly, the 6(20%) of borrowers had been taken loan recently implying that they were still repaying their loan. Following that it was necessary to find out whether they were planning to borrow again.
Whether loan borrowers had a plan to borrow again responses were as hereunder.

**Figure 4. 9: Whether borrowers had a plan to borrow again**

![Bar chart showing responses](chart)

Source: Research findings, 2013

Most borrowers were planning to borrow again as 28(93%) borrowers declared, implying that loan taken was beneficial to loan borrowers. During interview one borrower said “immediately after finishing paying back my loan, I will apply for another loan.” This implies what Kessy and Urio(2006) noted as loan can address issues associated with “non performance”, poverty which include social and psychological effect that prevent people from realizing their potential. Had it been otherwise borrowers could not have an idea of borrowing again.
Reasons for borrowing again were given by borrowers as shown in table 4.4 below.

**Table 4.4: Reasons for Loan Borrowers to Borrow Again**

<table>
<thead>
<tr>
<th>Reasons for borrowing again</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>To expand business</td>
<td>8</td>
<td>29</td>
</tr>
<tr>
<td>To start new business</td>
<td>6</td>
<td>21</td>
</tr>
<tr>
<td>To increase capital</td>
<td>14</td>
<td>50</td>
</tr>
<tr>
<td>Total</td>
<td>28</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Research findings, 2013

Reasons for borrowers to borrow again focused on developing their business as 8(29%) of borrowers had intention of expanding their business, 6(21%) of borrowers had the idea of starting new business and 14(50%) of borrowers had an idea of increasing their capital. This is similar to what Kessy and Urio(2006) declared that loans enables entrepreneurs or small group of people to start, develop, diversify or expand their business. Two respondents who had no idea of borrowing again had failed to manage their business implying limited capacity building. For example during interview one borrower said “it is very difficult for me to borrow again as it was difficult to return my first loan.”

Whether respondents were assessed before taking loan all 30(100%) of loan borrowers said yes implying that credit worthiness is major criteria used before releasing loan.

The way assessment was carried out is shown in table 4.5.

**Table 4.5: The way assessment was carried out**

<table>
<thead>
<tr>
<th>The way assessment was carried out</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessing daily sales</td>
<td>23</td>
<td>77</td>
</tr>
<tr>
<td>Assessing capital</td>
<td>4</td>
<td>13</td>
</tr>
<tr>
<td>Assessing estimated number of customers</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Assessing business skills</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Research findings, 2013
Major criteria for releasing loan were nature of business cycle as 23(77%) of borrowers said that assessment focused on daily sales implying that longer and broader relationship increase the amount and flow of information to lender, enabling good borrowers to obtain better access to financial services overtime (Fraser, 2004). Others borrowers 4(13%) said that their capital were assessed, 2(7%)of borrowers estimated number of customers were assessed and 1(3%) of borrowers said the business skills were assessed.

Factor made loan borrowers to qualify for loans were mentioned as in table 4.6.

**Table 4. 6: Qualification for borrowing loans**

<table>
<thead>
<tr>
<th>The qualification for borrowing loans</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duration of the business</td>
<td>6</td>
<td>20</td>
</tr>
<tr>
<td>Location of the business</td>
<td>5</td>
<td>17</td>
</tr>
<tr>
<td>Business records</td>
<td>12</td>
<td>40</td>
</tr>
<tr>
<td>Size of the business</td>
<td>6</td>
<td>20</td>
</tr>
<tr>
<td>Loan guarantor</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Research findings, 2013

The qualifications for borrowing loans were mentioned as business interval as 6(20%) borrowers said, location of the business as 5(17%) borrowers indicated, business records as 12(40%) borrowers said, size of the business as 6(20%) borrowers said and loan guarantor as 1(3%) responded. Data are suggesting that business stability and geographical accessibility are core determinants of qualification for borrowing loans.
How frequently bank had been making routine monitoring of loan responses were as hereunder.

**Figure 4.10: The extent to which the bank is monitoring loan**

![Bar chart showing monitoring frequency]

<table>
<thead>
<tr>
<th>Weekly basis</th>
<th>Monthly basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 (7%)</td>
<td>28 (93%)</td>
</tr>
</tbody>
</table>

Sources: Research findings, 2013

In most cases bank had a system of monitoring loan on monthly basis as 28(93%) responded implying that thirty days are enough for bank to find out whether business is growing or not growing. During interview it was discovered that although one week is enough to determine progress of business we give our client four weeks in order to give them more chance of circulating their capital. Therefore one month can give us picture whether or not business is growing.
Whether it was easy to pay their loan responses were as hereunder.

**Figure 4.11: Whether it was Easy For Borrowers to Pay Their Loan**

![Pie Chart showing the responses of borrowers regarding easiness to pay their loans]

Sources: Research findings, 2013

Data shows that it was not easy for borrowers to pay their loan as 25(83%) said while 5(17%) claiming that it was easy. Since it is difficulty for borrowers to pay their loan as majority had to say it implies that borrowers are taking loans prior proper studying of their business that is why they are facing difficulties in returning their loans. Probably borrowers are not doing well in business that is why they are facing difficulties in returning their loans. Also data is suggesting that probably borrowers do not have good business skills that is why they are not managing their business well. If they could have managed their business well they could not have difficulties in returning their loans.
Whether bank gave an assessment having failed to pay their loan responses were as hereunder.

**Figure 4.12: Whether Bank Made Assessment When it Was Difficult to Pay Their Loan**

![Pie chart](image)

**Source:** Research findings, 2013

The bank was closely monitoring their loan as they made assessment when it was difficulty for borrowers to pay their loan as 23(92%) responded implying that bankers had to provide advice to borrowers in case of difficulties in their business. Whether borrowers were able to pay their loan having assessed by bankers and been advised accordingly all 25(100%) said yes. However, while 20(80%) remained in the business after paying their loan 5(20%) had to close their business justify Chijoriga(2011) findings which stipulates that the credit risk is the most expensive risk in financial institutions and its effect is more significant as compared to other risks as it is a direct threat to solvency of financial institutions.
4.5 Loan Challenges

This section assessed loan challenges. Three issues were prioritized in this section. Issues prioritized include figuring out borrowers’ attitude towards loan, if they have negative whether there is effort taken to change borrowers attitude and finding out general challenges facing loan borrowers. Thirty loan officers were asked to show what they think was the attitude of borrowers towards loan. Their responses were as hereunder table 4.7.

Table 4.7: Attitude of Loan Borrowers

<table>
<thead>
<tr>
<th>Attitude of loan borrowers</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>Percent</td>
</tr>
<tr>
<td>They think loan must be paid</td>
<td>30</td>
<td>100%</td>
</tr>
<tr>
<td>They think loans is a grant</td>
<td>1</td>
<td>3%</td>
</tr>
<tr>
<td>They think loan is a gift</td>
<td>4</td>
<td>13%</td>
</tr>
<tr>
<td>They are not willing to pay loan</td>
<td>28</td>
<td>93%</td>
</tr>
</tbody>
</table>

Source: Research findings, 2013

Borrowers have positive attitude towards loan as 30(100%) respondents said loan borrowers think loan must be paid, 29(97%) respondents said loan borrowers think loan is not a grant, and 26 (87%) respondents said loan borrowers think loan is not a gift. However 28(93%) said that borrowers are not willing to pay loan. The core loan challenge is that although borrowers have positive attitude towards loan yet they are not willing to pay loan. Finally while loan offers have suggested borrowers to be faithful in order to improve loan performance borrowers have suggested to be given more capacity building especially in business skills.

Audited financial reports as at December 2010 and 2011 indicates that there are TZS 4,571,000,000 and TZS 5,673,000,000 of outstanding loans respectively. This is a clear indication of existence of nonperforming loan which is increasing yearly.
CHAPTER FIVE

SUMMARY, CONCLUSION AND POLICY IMPLICATIONS

5.1 Introduction
The main objective of this study was to evaluate loan performance in Azania Bank. The study had covered number of issues including interest rates charged from borrowers, bank capacity in supervision loans, borrowers’ attitudes towards loan and loan challenges.

5.2 Summary
The study is about evaluation of loan performance a case of Azania bank Ltd. the study was an attempt to find out the way loans performance is evaluated. The four objectives that are evaluation of interest rates charged by Azania Bank, examination of bank capacity in supervising loans, assessing borrowers attitudes towards loans and identifying general loan challenges. These objectives were arrived having constructed information in the background of the problem which has shown that borrowers need training in order to manage their projects well so that they can be able to return the loan without any difficulty.

The literature review had looked at terminologies such as bank interest rate ,loan supervision ,loan attitudes and loan challenges with reference to loan performance. Case study research methodology was applicable covering research design, location, population of the study, sample size, sources of data collection and data analysis. The three characteristics of respondents that are gender, level of education and age of respondents were prioritized as they could determine unbiased information regarding studied phenomena.

This study has affirmed cases that conclude presence of positive loan performance in Azania Bank due to the fact that interests rates charged are reasonable and affordable, there is adequate loan performance and borrowers have positive attitudes towards loan. However the study noted some difficulties for few borrowers have in
returning their loans. Possible solution given is to build capacity of business owners in order to make them more efficient in conduction their business.

5.3 Conclusion
Generally the study concludes that there is positive loan performance in Azania bank due to the following reasons. To begin, interest rate charged from borrowers is reasonable and affordable. Also significant factors such as inadequate risk management, integrity of borrowers, poor credit monitoring, poor credit policy and cost of borrowers that were assumed to be among factors causing non-performance loans are not. These factors are well controlled to the extent of assuring excellent loan performance in Azania bank.

Secondly loan performance in Azania bank is assured by adequate loan supervisions. Ensuring adequate loan supervision bank had established good mechanism to supervise loan. Core mechanism is eye witness. Furthermore to ensure adequate loan supervision bank has set adequate assessment of credit application and management. Additionally, bank had set adhering to supervision mechanisms such as setting credit policy, collateral security, training, and development, frequent contact with borrowers and effective credit monitoring.

Thirdly borrowers have positive loan attitudes as they perceive borrowing environment to be conducive. Because of conducive borrowing environment borrowers have a plan to borrow again. Borrowers think that loan is the only means of expanding their business. Regarding criteria for releasing loan borrowers think that criteria set are friendly as well as the qualification for borrowing. Borrowers also have a positive perception that bank is adequately assessing credit application as well as monitoring system.

This study has affirmed cases that conclude presence of positive loan performance in Azania Bank due to the fact that interests rates charged are reasonable and affordable, there is adequate loan performance and borrowers have positive attitudes towards loan. However the study noted some difficulties for few borrowers have in
returning their loans since they do involve part of the loan for personal use. Key recommendation given is to build capacity of business owners in order to make them more efficient in conducting their business by separating business and personal use.

5.4 Recommendations

Major challenge identified in this study is that borrowers are facing difficulties in returning their loans. This means borrowers’ ability to manage their project is still queried.

Borrowers are to be trained in different aspects such as

Cash management

Loan borrowers do not have skills to manage the cash flow from and to the business. As a result, no differentiation between borrowers’ cash and business cash.

Bank should educate the loan borrowers to centralize their banking at one bank and to ask their customers to pay with depository transfer checks, a relatively cheap fund transfer so as to get rid of holding physical cash. Hence money will be available in the account during repayment time.

Entrepreneurship skills should be imparted to loan borrowers so that they may be more creative in running their business by fetching businesses that may result into more cash flows so that they can be in a position to repay their loans. This skills can be used to strengthen their business.

On the side of Azania bank, the following should be done:

Loan officers should avoid including inaccurate and forged information on the loan application assessment. Proper and accurate information should be collected, recorded and analyzed especially on daily sales record in which it will give guidance whether the business has enough cash inflow to allow loan repayment.

Also for other types of loans which depend on the salary, the salary slip should be genuine to show the correct salary of the borrower.
There should be a credit information board whereby all the loan defaulters are to known to all banks to avoid issuing loan to such a borrower.

Collateral management should be conducted where by regular check of value, ownership, physical condition and legal status collateral should always have sufficient value to recover the loan.

Azania Bank should establish a mechanism of independent, ongoing assessment of credit risk management process. The purpose of such review is to assess the credit administration process, the accuracy of credit rating including adequacy of provisions for losses, and overall quality of credit portfolio. All facilities should be subjected to risk review at least quarterly. The results of such review should be properly documented and reported directly to the board, or its sub-committee.

Azania Bank should conduct loan review with updated information on the loan borrower’s financial and business conditions, as well as conduct of account. Exceptions noted in the loan monitoring process should also be evaluated for impact on the loan borrower’s creditworthiness. Loan review should also be conducted on a consolidated group basis to factor in the business connections among entities in a borrowing group.
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APPENDICES

Appendix 1: Questionnaire for loan officers

Dear respondent,

This questionnaire is meant to collect your opinion which will enable the researcher to Evaluate loan performance at Azania Bank Limited. The research will be under supervision of the Mzumbe University Dar es Salaam Campus College and it is purely for academic purposes. All information given and views expressed shall be treated with maximum confidential. It is expected that the findings of the study will be useful to the academicians and the public at large. Your cooperation by filling in this questionnaire promptly is kindly requested.

Thanks for cooperation.

A: Demographic information

1. Sex
   (i.) Male
   (ii.) Female

2. Marital status:
   (i.) Married
   (ii.) Single
   (iii.) Separated

3. Education level:
   (i.) Secondary level
   (ii.) College education
   (iii.) University education
   Others mention .................................................................

4. Working department: ..............................................................
5. Working experience: .................................................................

B: Bank interest rate

6. Does bank rate set adequate?
   (i.) Yes
   (ii.) No

7. Does bank rate set affordable?
   (i.) Yes
   (ii.) No

8. Agree or disagree with significant factors causing non-performing loans.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inadequate risk management</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Integrity of borrower</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poor credit monitoring</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poor credit policy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of borrowing</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

C: Loan Supervision

9. Do you have mechanisms to supervise loan?
   (i.) Yes
   (ii.) No

10. If yes what is the mechanisms in place?
    ___________________________________________________________
    ___________________________________________________________

11. Do you think bank in adequately assessing credit application?
    (i.) Yes
    (ii.) No
12. Are there any policies or procedures in place to reduce non-performing loans?
   (i.) Yes
   (ii.) No

13. In your opinion do you think bank is adequately assessing credit applications?
   (i.) Yes
   (ii.) No

14. How does management respond to non-performing loans?

<table>
<thead>
<tr>
<th>Credit assessment</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adherence to credit policy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collateral security</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Training and development</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Frequent contact with borrowers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective credit monitoring</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

D: Loan attitudes

15. What do you think is borrowers’ attitude towards loan?

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>They think loan must be paid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Take loan as a grant</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Take loan as a gift</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not willing to pay loan</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

16. If it is negative are there efforts taken to change borrowers’ attitudes?
   (i.) Yes
   (ii.) No

E: Loan challenges

17. What are the challenges against non-performing loans?

________________________________________________________________________

________________________________________________________________________

Thank you
Appendix 2: Questionnaire for loan borrowers

Dear respondent,

This questionnaire is meant to collect your opinion which will enable the researcher to Evaluate loan performance at Azania Bank Limited. The research will be under supervision of the Mzumbe University Dar es Salaam Campus College and it is purely for academic purposes. All information given and views expressed shall be treated with maximum confidential. It is expected that the findings of the study will be useful to the academicians and the public at large. Your cooperation by filling in this questionnaire promptly is kindly requested.

Thanks for cooperation.

Demographic information

1. Sex
   (i.) Male
   (ii.) Female

2. Marital status:
   (i.) Married
   (ii.) Single
   (iii.) Separated

3. Education level:
   (i.) Secondary level
   (ii.) College education
   (iii.) University education
   Others mention ………………………………………………………………………
4. How many times have you been taking loan in this bank?
   (i.) Once
   (ii.) Twice
   (iii.) Thrice
   (iv.) Four
   (v.) Five More than four

5. I you thinking of borrowing again?
   (i.) Yes
   (ii.) No

6. If you are thinking of borrowing again provide reasons
   ________________________________________________________________
   ________________________________________________________________

7. If you are not thinking of borrowing again provide reasons
   ________________________________________________________________
   ________________________________________________________________

8. Were you assessed before qualified for loan?
   (i.) Yes
   (ii.) No

9. If you were assessed how was the assessment carried out.
   ________________________________________________________________
   ________________________________________________________________

10. What did you think was the main factor which made you to qualify for loans?
    ________________________________________________________________
11. Did the bank make routine monitoring?
   (i.) Yes
   (ii.) No

12. If the bank made routine monitoring for how long in one year?
   (i.) Weekly basis
   (ii.) Monthly basis
   (iii.) Once
   (iv.) Twice
   (v.) Three times
   (vi.) More than three times

12. After repaying the loan, did you still remain in business?
   (i.) Yes
   (ii.) No

13. Loan challenges
   What are the general challenges do you face while borrowing and paying your loan?
   ____________________________________________________________
   ____________________________________________________________
   ____________________________________________________________

   Thank You
Appendix 3: Interview guide

1. What do you understand by loan performance?
2. Explain strengths and weaknesses of loan performance.
3. Do you have categories of interest rate?
4. What mechanisms do you have to supervise loans?
5. Are mechanisms mentioned appropriate?
6. Are loan borrowers returning loans on time?
7. What do you suggest in order to improve loan performance?