COMPARISON OF THE CAUSES OF NON PERFORMING LOAN IN BANK OF BARODA TANZANIA LIMITED, CRDB PLC BANK, AND STANDARD CHARTERED BANK TANZANIA LIMITED
COMPARISON OF THE CAUSES OF NON PERFORMING LOAN IN BANK OF BARODA TANZANIA LIMITED, CRDB PLC BANK, AND STANDARD CHARTERED BANK TANZANIA LIMITED

By

Robert Kibona

A Thesis Submitted to Mzumbe University in Partial Fulfillment of Masters of Business Administration in Corporate Management of Mzumbe University.

2013
CERTIFICATION

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University, a dissertation entitled **Comparison of the Causes of Non-Performing Loan in Bank of Baroda Tanzania Limited, CRDB PLC Bank, and Standard Chartered Bank Tanzania Limited**, in partial/fulfilment of the requirements for award of the degree of Master of Business Administration in Corporate Management of Mzumbe University.

____________________________
Major Supervisor

____________________________
Internal Examiner

Accepted for the Board of …………………

____________________________
DEAN/DIRECTOR, FACULTY/DIRECTORATE/SCHOOL/BOARD
DECLARATION AND COPYRIGHT

I, Robert Kibona, declare that this dissertation is my own original work and that it has not been presented and will not be presented to any other university for a similar or any other degree award.

Signature ___________________________

Date________________________________

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ACKNOWLEDGEMENT

The preparation of this research report has been possible from moral support, encouragement and consultation of many individual persons.

Many individuals and institutions have provided their contributions in successful completion of this piece of work. It is not possible to mention every individual who in one way or another has shown a distinctive contribution. However the following people deserve a mentioning;

First and foremost, I would like to give special thanks to my major supervisor Mrs. Mary Rutenge for her heartfelt guidance from the beginning up to the end of this research report. I would like to thanks the Head of department and the Principal, Pro Mbwambo for their support thought out the study.

I also appreciate the tender love of my late uncle Afumwisye Kibona, my mother Tumanyisigwe Kisha Kibona, and uncle Yohana Seme for their great support thought out my study.

My special appreciation should also be extended to the family of Kibona, my lovely fiancée Lulu Robin, my fellow college mates and all other people who provided support in my field studies.

I am grateful to almighty God because of his abounding grace and blessings in my studies by intellectual ability and divine health. In Him I live, I move and I have my being.
DEDICATION

This work is dedicated late Uncle Afumwisye Y. Kibona, my mother Tumanyisigwe Y. Kibona and my family. Your moral support and encouragement during my study made this work a reality. May God bless you all, I love you.
LIST OF ABBREVIATIONS AND ACRONYMS

BIFIA-Banking and Financial Institution Act
BOT-Bank of Tanzania
GDP-Gross Domestic Product
NPL-Non Performing Loan
PLC- Public Limited Company
ABSTRACT

Loans form very greater party of banks total assets. These assets generate huge interest income for banks which to a large extent determines the financial performance of banks. However, some of these loans usually fall into non-performing status and adversely affect the performance of banks. In view of the critical role banks play in an economy, it is essential to identify problems that affect the performance of these institutions. This is because non-performing loans can affect the ability of banks to play their role in the development of the economy.

The overall objective of this study was to assess comparison of the causes of nonperforming loan to the three banks originating from different continent that Bank of Baroda Tanzania Limited originating in India, CRDB Bank PLC originating in Tanzania, and Standard Chartered Bank originating in Europe and coming up with the measures/recommendations for ensuring that there is a very minimal level of nonperforming loan in the banks.

The study drew a sample of respondents by using purposeful sampling. The respondents were working in the credit departments of the three banks. The data were gathered by using questionnaire, personal interview and documentary methods. The data collected were analyzed using statistical methods to derive information for comparison of the causes of nonperforming loan in the three banks.

The study found that the causes of nonperforming loan relate to the three banks included diversification of fund, lack of integrity on borrower’s side, death of key personnel in the business, lack of effective ways of credit recovery, lack of business skills, poor loan analysis, pressure from top management, and ineffective loan conversant.

From the findings of the current study it was recommended that banks should strengthen the internal control, provide training to staffs and motivate staff to reduce the rate of NPL.
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CHAPTER ONE

INTRODUCTION

1.1 Chapter Overview
This chapter describes the background information to the research problem with some references. It presents research problem, research questions, research objectives and significance of the study.

1.2 Background to the Problem

A simple definition of non-performing, is loan that is not earning income and full payment of principal and interest is no longer anticipated, principal or interest is 90 days or more delinquent, or the maturity date has passed and payment in full has not been made.(Banking and Financial Institution Regulation, 2008)

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. Many researches on the cause of bank failures have found that asset quality is a statistically significant predictor of insolvency for example Dermirgue-Kunt (1989), Barr and Siems (1994), and that failing banking institutions always have high level of non-performing loans prior to failure.

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. For example, as described by Se-Hark Park (2003), during 1990s, there were three different methods of defining NPL in Japan: the 1993 method based on banking laws; the “Bank’s Self-Valuation” in March 1996; and the “Financial Revival Laws-Based Debt Disclosure” in 1999.

These measurements have gradually broadened the scope and scales of the risk-management method. Similar to the trend in Japan, more countries, regulators, and
banks are moving towards adopting and adapting better and more consensus practices. For example, in the U.S.A, federal regulated banks are required to use the five-tier NPL classification system according to BIS: Pass, Special Mention, Substandard, Doubtful, and Loss. Presently, the five-tier system is the most popular risk classification method, or, in some cases, a dual system of reporting according to their domestic policy guidelines as well as the five-tier system. According to BIS, the standard loan classifications are defined as follows:

a) **Passed**: Solvent loans;

b) **Special Mention**: Loans to enterprises which may pose some collection difficulties, for instance, because of continuing business losses;

c) **Substandard**: Loans whose interest or principal payments are longer than three months in arrears of lending conditions are eased. The banks make 10% provision for the unsecured portion of the loans classified as substandard;

d) **Doubtful**: Full liquidation of outstanding debts appears doubtful and the accounts suggest that there will be a loss, the exact amount of which cannot be determined as yet. Banks make 50% provision for doubtful loans;

e) **Virtual Loss and Loss (Unrecoverable)**: Outstanding debts are regarded as not collectable, usually loans to firms which applied for legal resolution and protection under bankruptcy laws. Banks make 100% provision for loss loans.

NPLs comprise the loans in the latter three categories, and are further differentiated according to the degree of collection difficulties.

In addition to the standardized system, efforts have been made to improve the classification of loans. For example, more countries are shortening the period when unpaid loans become past due, intending to put loans on lenders’ timetable sooner and require them to address these loans before losses start to escalate.

The International Accounting Standard 39 revised in 2003 focuses on recognition and measurement of financial instruments and, most importantly, defines and establishes the measurement and evaluation of impaired loans. As lenders usually
make little or no loss provision for impaired loans, they are at risk to be suddenly forced to reclassify such loans as a loss and take a full write-down if the borrowers go bankrupt. The initiation of this standard is to prevent lenders from being caught Off-guard. In addition, many global economists, rating agencies, and organisations such as the World Bank and the Asian Development Bank have begun to evaluate the effects of NPLs on GDP growth. They reduce growth estimates to reflect the time and cost of resolving large NPL issues.

Table 1.1 Loan grading system in Tanzania is as per BOT regulation.

<table>
<thead>
<tr>
<th>Number of days past due</th>
<th>Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>91-180</td>
<td>Sub-Standard</td>
</tr>
<tr>
<td>181-270</td>
<td>Doubtful</td>
</tr>
<tr>
<td>271 and more</td>
<td>Loss</td>
</tr>
</tbody>
</table>

It is argued that the NPL is one of the major causes of the economic stagnation problems. Each NPL in the financial sector is viewed as an obverse mirror image of an ailing unprofitable enterprise. From this point of view, the eradication of NPL is a necessary condition to improve the economic status. If the NPLs 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.

1.3 Statement of the Problem
The main goal of every banking institution is to operate profitably in order to maintain its stability and improve growth and expansion. In a bank's portfolio, losses stem from outright default due to inability or unwillingness of a customer to meet commitments in relation to lending, trading, reduction in portfolio value due to actual or perceived deterioration in credit quality, settlement and other financial transactions
NPLs are a reflection of problems in the banking and corporate sectors. The root of the 1997 Asian crisis was the high level of NPLs in the banking and corporate sectors and the costs of the crisis were enormous, not only in terms of fiscal costs (costs to taxpayers) but also losses to the entire economy (Du, 2006). NPLs create problems for the banking sector’s balance sheet on the asset side. They also create a negative impact on the income statement as a result of provisioning for loan losses. In the worst scenario, a high level of NPLs in a banking system poses a systemic risk, inviting a panic run on deposits and sharply limiting financial intermediation, and subsequently investment and growth. In addition, it could be further exacerbated if it is combined with external shocks, an unfavorable phase of the macroeconomic cycle, or inadequate political or legal support. In this regard, an endeavor has been made in order to determine the inherent factors that cause NPLs.

1.4 Objective of the Study

1.4.1 General Research Objective

The generally objective of this study was to assess the comparison of the causes of NPL in three banks which are; Bank of Baroda Tanzania Limited, CRDB PLC Bank and Standard Chartered Bank Tanzania Limited.

1.4.2 Specific Research Objective

Specifically the study sought:-

i. To examine the causes for NPL from each bank.

ii. To examine the causes of NPL which relate to each of the three banks and the causes of nonperforming loan which are specific (vary) to each in the three banks

iii. To access the reasons for variation of the causes of NPL from the three Banks

iv. To find out the measures to minimize the problem of NPL.

1.4.3 Research Questions

The following questions guided the study to achieve its objectives:
1.4.3.1 General Research Question
What were the causes of NPL in the three banks?

1.4.3.2 Specific Research Questions
i. What are the causes of NPL from each bank?
ii. What causes of NPL in shared across the three banks and what causes differ?
iii. What are the reasons for variation for the causes of NPL from the three Banks?
iv. What measures are undertaken to minimize the problem of nonperforming in banks?

1.5 Hypothesis Statement
NPLs do not affect the performance.

1.6 Significance of the Study
The current study sheds light on the inherent reasoning of loan default. Therefore, the banks can identify the factors contributing to the creation of NPLs and adjust their lending strategy as well.

The policy makers can have a bird’s eye view regarding the results of their decision previously taken. They also can make prudent judgment in preparing further NPLs alleviating policy.

The study will form a basis for further research on NPLs.

1.7 Research Gap
According to empirical study, it is evident that extensive study or research has been done concerning NPLs. However there is no documented study or published study which shows comparison of the causes of NPL from different banks. From the literature review, many studies have been done on the causes of NPL, but there are no any studies which have been done concerning the comparison of the causes of NPL from different banks especially with different origin. Therefore, the information from this study, recommendations and conclusions will bridge the gap.
1.8 Scope of the Study

The study involved the investigation of the comparison of the causes of nonperforming loan of NPLs three Banks which are; Baroda Tanzania Ltd, CRDB PLC, and Standard Chartered Bank in Dar es Salaam.

1.9 Limitations

Financial Constraints
For the researcher to come up with a good detailed and reasonable report, it depends on how deep the problem has been investigated, and this can be achieved only if there are sufficient funds to enable the researcher undertake detailed research process.
Due to financial constraints facing the researcher, the study was limited to the Head Office of the three Banks only which are Bank of Baroda Tanzania Limited, CRDB PLC Bank and Standard Charted Bank.

Limited Time
As the researcher is full time on duty with his employer, this entails availability of Limited time for collection of data from those above institutions, some respondents not available for interviews, bureaucracy and some refused to be interviewed
In solving this problem the researcher requested leave for the days in which appointment to meet with respondent were made.

CHAPTER TWO
LITERATURE REVIEW

2.1 A Simple ‘BANK MODEL’

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Accommodation</td>
<td>Deposits</td>
</tr>
</tbody>
</table>
Management of Risks Assets
Regulation
(Earning assets)
Other assets Capital Fund
(Tier 1+Tier 2)

2.2 Definitions of the Terms used in Lending

2.2.1 Credit Accommodation
This means loans, overdrafts and advances, leasing, acceptances, performance and bid bonds letters of credit, guarantees, foreign exchange contracts or any other form of direct or indirect financial obligation including interest due and unpaid to a bank or financial institution. The Banking and Financial Institutions (Management Risk Assets) Regulations, 2008.

2.2.2 Credit Risk
This is potential that a bank borrower or counterparty will fail to meet its obligations. The risk of a loan not being partly or fully repaid as per terms and conditions Credit risk can crystallize at any of the following lending stages The Banking and Financial Institutions (Management Risk Assets) Regulations, 2008. Originating stage (The application process)
Funding stage (Approving the loan)
Servicing stage (Collection of Interest and Principal payment)
Monitoring stage (checking the borrowers behavior)
(Risk Management Guidelines for Banks and Financial Institutions (RMGs) of 2010)

2.3 Bank of Baroda Tanzania Limited
Bank of Baroda Tanzania Limited, is wholly owned Subsidiary of Bank of Baroda India, has been incorporated under the companies Ordinance (Cap 212) on 4th December, 2003. The Bank commenced business on 13th October, 2004 with the first Branch in Dar es Salaam, The Bank opened its second branch in Arusha on 11th August 2007. It has a plan to open two more branches in the year of 2013 in Kariakoo in Dar es Salaam and Mwanza.
2.4 Loan Portfolio-Bank of Baroda Tanzania Limited

Table 2.1 Loan Portfolios– Bank of Baroda Tanzania Limited

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan portfolio</td>
<td>35,577,467</td>
<td>36,579,607</td>
<td>47,793,274</td>
</tr>
<tr>
<td>Provision for Bads Debts</td>
<td>1,505,225</td>
<td>982,323</td>
<td>2,042,856</td>
</tr>
<tr>
<td>Percentage</td>
<td>4.23084</td>
<td>2.68544</td>
<td>4.27436</td>
</tr>
</tbody>
</table>

Source: Bank of Baroda Financial statement

Figure 2.1 Graphical presentation of the level of nonperforming loan in percentage at Bank of Baroda Tanzania Limited.

- Key
  - x-axis Year
  - y-axis Percentage of non performing loan

Source: Baroda Tanzania Limited Financial Statement (Tsh. “000”)

2.5 CRDB Bank PLC

CRDB Bank Plc is a commercial bank in Tanzania. It is one of the commercial banks licensed by Bank of Tanzania, the national banking regulator.

The bank is the largest banking institution in Tanzania, by assets, providing commercial banking services to individuals, small-to-medium sized corporate clients.
and large corporations. As of March 2011, CRDB Bank's total assets were valued at about US$1.8 billion (TZS:2,800 billion). In December 2011, shareholders' equity was valued at approximately US$178 million (TZS: 276 billion). The shares of stock of CRDB Bank are listed on the Dar es Salaam Stock Exchange, where they trade under the symbol: CRDB.

CRDB Bank was formed when the former Cooperative Rural Development Bank which was wholly government owned was privatized, recapitalized and restructured. DANIDA played a significant role in re-structuring the new institution and is a part owner of the new bank.

As of December 2011, the stock of CRDB Bank was owned by the following institutions and individuals:

Table 2.2 Loan Portfolio- CRDB BANK PLC

<table>
<thead>
<tr>
<th>CRDB Bank Stock Ownership</th>
<th>Percentage Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rank Name of Owner</td>
<td></td>
</tr>
<tr>
<td>1  Investors Owning Less Than 1%</td>
<td>50.7</td>
</tr>
<tr>
<td>2  Danish International Development Agency</td>
<td>21.5</td>
</tr>
<tr>
<td>3  Investors Owning Between 1.0% and 2.0%</td>
<td>10.2</td>
</tr>
<tr>
<td>4  Tanzanian Parastatal Pension Fund</td>
<td>10.0</td>
</tr>
<tr>
<td>5  Tanzania Public Service Pension Fund</td>
<td>3.3</td>
</tr>
<tr>
<td>6  Blakeney General Partners III</td>
<td>2.3</td>
</tr>
<tr>
<td>7  Tanzania Local Government Pension Fund</td>
<td>2.0</td>
</tr>
<tr>
<td>8  TOTAL</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source CRDB Bank

Table 2.3 CRDB BANK PLC Financial Statements

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan portfolio</td>
<td>949,505.00</td>
<td>1,123,348.00</td>
<td>1,429,269.00</td>
</tr>
<tr>
<td>Provision for Bads Debts</td>
<td>2009</td>
<td>2010</td>
<td>2011</td>
</tr>
<tr>
<td>--------------------------</td>
<td>------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>3,1216.00</td>
<td>20,357.00</td>
<td>31,216.00</td>
<td></td>
</tr>
<tr>
<td>Percentage</td>
<td>3.29</td>
<td>1.8117</td>
<td>2.1841</td>
</tr>
</tbody>
</table>

Source CRDB PLC Bank Financial statement

Figure 2.2 Graphical presentation of the level of nonperforming loan in percentage at CRDB BANK PLC

- Key
  - x-axis Year
  - y-axis Percentage of non performing loan

Source: CRDB BANK PLC Financial Statement.

Figure in Million.

2.6 The Standard Chartered Bank Tanzania

Standard Chartered Tanzania, whose official name is Standard Chartered Bank (Tanzania) Limited, but is often referred to as Stanchart Tanzania, is a commercial
bank in Tanzania, and is a wholly owned subsidiary of Standard Chartered. It is one of the banks licensed by the Bank of Tanzania, the national banking regulator. The bank was established in 1911. In 1967 its assets were nationalized, but was returned to its current owners in 1992. Stanchart Tanzania focuses on banking sectors like agriculture, trading and manufacturing. It also maintains a department solely devoted to small-to-medium enterprises (SMEs)

Stanchart Tanzania is a subsidiary of the Standard Chartered Bank Group, an international financial services conglomerate, headquartered in London in the United Kingdom, with operations in more than seventy countries and a network of over 1,700 branches, employing in excess of 73,000 people. The stock of the Standard Chartered Bank Group is listed on the London Stock Exchange, the National Stock Exchange of India and the Hong Kong Stock Exchange.

As of December 2011, Standard Chartered Bank Tanzania operated a network of seven (7) branches and controlled a network of eight (8) Automated Teller Machines (ATMs)

| Table 2.4 Loan Portfolio- Standard Chartered Bank Tanzania |
|-----------------|-----------------|-----------------|
|                  | 2010            | 2011            |
| Loan portfolio   | 466,731,599     | 630,7420,635    |
| Provision for Bad Debts | 7,420,635 | 8,538,503 |
| Percentage       | 1.58            | 1.35            |

Source Standard Chartered Bank Tanzania Financial Statement

Figure 2.3 Graphical presentation of the level of NPL in percentage at Standard Chartered Bank Tanzania
2.7 Non-performing Loans

The term Non-Performing Loans is used interchangeably with bad loans and impaired loans as identified in Fofack (2005). Berger and De young (1997) also describes these types of loans as “problem loans” In a broad context, loans that are outstanding in both interest and principal for a period of time contrary to terms and conditions spelt out in the loan agreement are considered as NPLs.

Available literatures give varied descriptions of NPLs. Some researchers observe that whilst certain countries use quantitative criteria, e.g. the number of days the credit facility is overdue, others rely on qualitative criteria such as information about the customers financial status and management judgment about future payments.(Bloem and Gorter,2001)
Alton and Hazen (2001) described non-performing loans as loans that are ninety days or more past due or no longer accruing interest. Caprio and Klingebiel (1990) cited in Fofack (2005), consider non-performing loans as loans which for a relatively long period of time do not generate income, that is both the principal and interest on these loans remain unpaid for at least 90 days. A non-performing loan may also refer to one that is not earning income and full payment of principal and interest is no longer anticipated, principal or interest is 90 days or more or the maturity date has passed without payment.

2.8 Causes NPL

The main causes of NPL are mentioned to be, defective methodology, inadequate technology, unfavorable economic situation, political situation and environmental situation (MUCCoBs, 2010).

With regard to methodology, there may be many causes. It may be a poor way of distributing loans or questionable choice of clients. The contracts and collateral security agreements may not be sound enough. NPL may appear if credit officers do not follow the policy or if this policy is poorly adapted to the context. The methodology is also defective when collection policies and procedures are not correctly enforced. Finally, the client who doesn’t or cannot pay back his loan reveals the existence of a weakness in the loan-granting process.

Inadequate technology results in a lack of information about delay in producing the information. This may also be tied to the fact that lending is not institution’s primary activity.

As for political, economic and environmental causes, experience has taught that these factors may actually affect the rate of delinquency. However, these factors are extremely rare and limited in scope. These factors require constant monitoring.

2.8.1 Trainings on Delinquency Management

Staff must be trained on delinquency management from the very beginning once they enter financial institution. This will help them to have the required skills to manage
delinquency Deucet (2004). This means that poor trainings will lead to poor delinquency management hence loan delinquency.

Survey results show that various trainings in delinquency management and delinquency collection trainings are offered to managers, loan officers and accountants and bookkeepers of NGOs in Philippines. Given the portfolio quality and the high PAR (Portfolio At Risk) ratios reported in the survey, trainings are important. Access to trainings on delinquency management is mentioned as one of the incentive systems and benefits for borrowers/clients to encourage on time repayment (World Bank, 2009; Consultative Group to Assist the Poor (CGAP, 2008).

2.8.2 Policy and Procedures on NPL

Policies and procedures in any financial institution (such as bank) must be designed in accordance with proper nonperforming loan management practices. This will help in preventing NPL and act on delinquent clients. Deucet (2004). Van Gelder and Denie (2007) prove that the content of the banks’ policies should be of varying quality. It is encouraging to see that a few banks indeed have developed sector and issue policies which (almost) meet best international standards. These policies can provide an important example for other banks, increasing the peer pressure needed to bring the sector as a whole forward. Exceptions aside, the overall quality of the credit policies developed by the 45 banks is fairly poor. The content of many policies hardly exceeds a vague and aspirational level and usually lacks clear criteria and objectives. Often, the content of policies, which may or may not be of good quality are not disclosed at all. Good policies and sound transparency and accountability practices are only the starting point for banks to move forward on the road towards sustainability. The most important dimension on which to judge a banks’ sustainability performance is with the implementation of these policies. Banks’ day to day financing and investment decisions should be consistent with the criteria and objectives described in their credit policies, and their credit portfolio should reflect the proper implementation of these policies.
2.8.3 Global Financial Crisis on NPL

Since the last quarter of 2008 the world has experienced the impacts of the global financial crisis, which turned into an economic crisis, and very soon became an employment and job crisis, hence consequent impact on people’s lives and incomes (Valeta and Banda-Jere, 2010). The global financial crisis has revealed massive financial misconduct that has long been a part of out markets but has been submerged by the euphoria that has dominated these markets (Tomasic, 2011). Many borrowers have become not performing because they have lost their jobs or had their salaries reduced or cut, and thus have been unable to replace the lost income (Protiviti, 2009). According to Yanjia; Yao; Li; Xiao (2010), the slump in the US economy led to a chain reaction all around the world one of it being increases of nonperforming.

Every time when economic performance goes down, the rate of NPLs increases as business performance deteriorates. This means the turnover for businesses reduces hence inability of the business to pay bank debts on time.

It is widely accepted that the quantity or percentage of non-performing loans (NPLs) is often associated with bank failures and financial crises in both developing and developed countries. In fact, there is abundant evidence that the financial/banking crises in East Asia and Sub-Saharan African countries were preceded by high NPLs. The current global financial crisis, which originated in the USA, was also attributed to the rapid default of sub-prime loans/mortgages. In view of this reality it is therefore understandable why much emphasis is placed on NPLs when examining financial vulnerabilities (Khemraj and Pasha, 2009).

2.8.4 Diversion of Fund

Literatures provide evidence that diversion of the use of loans has direct relationship with loan NPL rate. Khaleque (2010) signalizes that the diversion of loan use is
defined as the quotient of the difference between the total amount of loan received and the amount of loan used for the proposed purpose and the total amount of loan received. Since money is fungible, diversion of the use of loan is found among the loan receivers. Such diversion of the use of loan is sometimes intentional and sometimes it is unintentional. The intentional diversion of the use of loan is often used for unproductive activities.

Therefore, the intentional diversion of the use of loan refers to the diversion of loan use from the productive sector to unproductive sector. On the other hand, the unintentional diversion of the use of loan compels the household to spend part of the loan or full of it for the purposes that are not mentioned in the application form.

Many respondents reported that they never liked to divert the loan for any other use than was specified in the loan application. But the circumstances compel them to utilize the loan in different ways. To some, it may be due to acute poverty. To others, illness of the husband, educational needs of the children, sickness of the respondents, and unemployment of the husband or some other needs.

Nissanke and Aryeetey (1998) point out that frequent on site monitoring of project loans is regarded as an effective way of ensuring that borrowers do not divert resources from the purpose for which the money was lent.

2.8.5 The Level of Interest Rates
Two major theories can be used to explain the case of deterioration in credit quality in Nigerian banks. First is the theory of adverse selection, where as a result of high collateral demand and high interest rates, credit market boom in the country only favor institutional and individual borrowers who are less considerate of the harsh lending conditions, and who in turn are more prone to default. Ezeoha.(2011). According to Llanto and Badiola (2009) many developing countries faced sharply tighter credit and higher interest rates from 2009. Helayel (2009) as quoted by Llanto and Badiola (2009) comments that for the poorest borrowers, who spend most of
their meagre incomes on food, the burden of interest payments will be heavier, which may lead to increase in NPL.

2.8.6 Improper Selection of an Entrepreneur

Selection of the right entrepreneur is one of the major factors in the profitability of banks. Two major criteria namely the intention to repay and the capacity to repay should be properly dealt with in credit evaluation. The entrepreneurs who have the willingness, capabilities, qualities and the requisite expertise for successfully setting up and running an industrial unit, should be identified with proper prudence and judiciousness. This is the best way of safeguarding the investment of a bank, thereby ensuring proper and timely repayment. Unbiased survey reports of the site and capability of the entrepreneur must be verified by the surveyor. In other words the credit worthiness of the entrepreneur as well as the project should undergo very careful scrutiny before the sanctioning of the loan. Strict measures and security should taken before the sanctioning of the loan. Lacoma (2009)

2.8.7 Lack of Follow up Measures

“A stitch in time saves nine”. Follow-up measures taken regularly and systematically keep the borrowing unit under constant vigil of the banks. Many ills can be checked through such follow-up measures by keeping the borrowing units on their alertness and guiding them to rectify their mistakes in the first opportunities or extending them a helping hand in tiding over their tight times. Normally, such close follow-up programs are conspicuous by their absence. In the result, the borrowing units not only ignore payment of their dues to banks but also often tread on wrong tracks, much to the detriment of their own financial health and that of the banks. Performance of the borrowing units, if carefully and systematically monitored through regular inspections by scrutiny of returns, annual balance sheet and inspection of site, can be significantly improved. Naturally, such inspections prevent the borrowers from deviating from the terms and conditions of the loan or from diverting any fund for purposes other than those earmarked in the sanction letter and keep the financial health of the units in good order. Lacoma (2009)
2.9 Loan Processing

There is an element of risk in any loan granted because the expected repayment may not occur. The following are the lending process principal repayment in future (Kay Associate Ltd, 2005).

Because of this risk of default in loan repayment, lenders needs to project into the future and make sound judgment that will ensure that repayment is effected at the agreed date. Available literature places so much importance on the lenders role in ensuring good decisions relating to the granting of loans in order to minimize credit risk. The lender must always aim at assessing the extent of the risk associated with the lending and try to reduce factors that can undermine repayment.

The lender should therefore assemble all the relevant information that will assist him/her in arriving at a sound credit decision. In view of the possibility of nonpayment which leads to NPLs, Banks have adopted a standard loan request procedures and requirements usually contained in, Banks credit policy manual to guide loan officers and customers.

Some of the factors that the, Banks consider before granting loans include the following which are often referred to as the canons of good lending

a) The character of the prospective borrower
b) Amount being requested by the customer
c) Margin (Interest margin, commissions and relevant fees.)
d) The purpose of the loan
e) Ability of the borrower to manage business successfully.
f) Repayment (source of repayment must be credible)
g) Insurance (security provided by the customer)
h) Technical and financial viability of the business

Marcellina (2007)

2.10 Strategies way outs for restraining non performing loan.
The Formulation of well-structured non performing loan management strategy covering following areas
• No compromise with due diligence in the sanctioning process. Keeping in mind "prevention is better than cure”.
• Action plan for potential non performing loans
• Identification of highly risk sensitive borrowers in the credit portfolio.
• Identification of geographical area-wise risk sensitivity
  Targeting high value end non performing loan accounts Capacity building of officers and executives in the recovery department. Masoom (2013)

2.10.1 Goals of monitoring and follow up
• To ensure that funds are utilized for the purpose for which they were sanctioned. To see that the terms and conditions are complied with
• To monitor the project implementation for avoiding time lag and consequential cost over runs.
• To evaluate the performance in terms of production, sales, profits on a periodic basis for ensuring that the borrower is keeping to the original plan and is having sufficient profits to service the debts as well as for the sake of maintaining normal business momentum
• To assess the impact of negative externalities on the performance of the company
• To detect the symptom of sickness at the early stage for initiating measures at the opportune moment.
• To keep check on the movement of financial position. Masoom (2013)

2.10.2 Basic indicators of non performance requiring awareness by the banker
• This is a very much commonplace incident for the bankers to face the problem of delinquency and loan default.
• So it is very much the integral part of professional assignment to monitor the credit portfolio in such a manner so that the portfolio which is treated as good today may not become stuck up tomorrow.
- Bankers are required to remain vigilant over the status of their credit portfolio and if any indication of deterioration of performance of the particular borrower is found in that case immediate measure of retrieval should be initiated.
- Apparent stagnation in the business as reflected by slow/negligible turnover in the account.
- Frequent request for overdrawing or issue of cheques without ensuring availability of funds in the account.
- In case of term loan non payment of overdue installment
- Unexplained delays in submission of stock statement.
- Slow movement/stagnation of stocks observed during inspection.
- Persistent delay in compliance or non compliance with vital requirements like execution of documents.
- Diversion of fund to sister units/acquiring capital assets not relevant to the business/large personal withdrawals.
- Non adherence to project schedules causes time over run having consequential effect of cost over run requiring additional funding.
- Pressure on liquidity leading to non payment of wages to workers/statutory dues/rents of office and factory premises.
- Current liabilities exceeding current assets.
- Basic weakness found in the financial statement.

2.10.3 Some indications of weaknesses in borrower's performance

- The borrower is not traceable
- The borrower does not have any property to be proceeded against or the particulars of the borrower's properties are nor available.
- Although the matter of non-repayment of banks debt has been brought to the notice of the borrower but he/she expressed inability to pay or does not respond.
• The borrower’s business has suffered a setback and he/she has asked for further loan for reviving the business.
• The borrower is an influential person/(PEPS) and maintains political clout that hinders the banker to progress with the issue of recovery.
• The borrower has died and the responsibility of repayment of the loan cannot be fixed up easily/involves wrangle of legal procedures.
• Documentations are irregular or securities are insufficient or not properly charged.

2.10.4 Feature common to non performing loans that should warn a banker
• Unusual or unexplained delays in receiving promised repayments or in communicating with bank personnel. For business loans, restructuring outstanding debt or experiencing a change in credit rating.
• Adverse changes in the price of a borrowing customer's stock. Net earnings losses in one or more consecutive years especially as measured by returns on borrower's assets (ROA), or equity capital (ROE) or earnings before interest and taxes.
• Adverse changes in the borrower's capital structure (equity/debt ratio), liquidity (current ratio or activity levels (ratio of sales to inventory)
• Deviations of actual sales or cash flow from those projected when the loan was sanctioned.
• Sudden unexpected and unexplained changes in deposit balance maintained by the customer

(a) Causes of growth of nonperforming loans- Pre approval phase (Controllable Variables)
• Defectiveness in selection of potential borrower
• Mistake in selection of business where to finance/not to finance
• Long-drawn appraisement /approval process.
• Poor appraisal technique
• End use/purpose not properly tracked
- Defective structuring of credit
- Under/over financing
- Imprudent judgment/wrong conception about sectoral viability/volatility.
- Unusual attachment of importance on collateral security.
- Wrongly conceived projections and not supported by adequate assumptions.

(b) Causes of growth of Nonperforming loans - Post approval phase:-

- Poor Monitoring
- inadequacy in loan documentation
- Un favorable Investment Climate
- Economic Recession
- Inconsistent and erratic govt. fiscal policy
- Credit Culture promote loan default

(c) Steps for recovering bank's funds from a problem loan

- Bankers must always keep the goal of loan workouts firmly taking into consideration the worst case scenario.
- The rapid detection and reporting of any problem with a loan are essential delay often worsens a problem loan situation.
- The loan workout responsibility should be separate from the lending function to avoid possible conflict of interest.
- The concerned credit officer should confer/discuss with the troubled borrower quickly on possible options especially for cutting expenses, increasing cash flow and improving management control. Develop a preliminary plan of action after determining the bank's risk exposure and sufficiency of loan documents, especially any claim against customers collateral other than that held by the bank.
- Estimate what resources are available to collect the troubled loan including the estimated liquidation values of assets and deposits.
• The bank's credit personnel must evaluate the quality, competence and integrity of the current management and visit the site to assess the borrower's property and operations.

• Bank's concerned credit specialist must consider all reasonable alternatives for cleaning up the troubled loan, including making a new, temporary agreement if loan problems appear to be short term in nature or finding a way to help/cooption of strategic partner the customer strengthen cash flow or to inject new capital in to the business. Other possibilities include finding additional collateral, securing guarantees/undertaking/ to initiate the case of foreclosure.

(d) Indicators of a weak or troubled loan

• Irregular or delinquent loan payments
• Frequent alterations in loan terms
• Poor loan renewal records (with insignificant reduction of principal each time the loan is renewed
• Unusual build-up of the borrowing customer's accounts receivables/inventories
• Rising debt to net worth ratio (leverage ratio)
• Poor quality collateral
• Reliance on reappraisal of assets to increase the borrowing customer's net worth.
• Absence of cash flow statements
• Customer reliance on nonrecurring sources of funds to meet loan repayments.

(e) Indicators of poor lending policies

• Poor selection of risks among borrowing customers
• Lending money contingent on possible future events.
• Lending money because a customer promises a large deposit
• Failure to specify a plan for the liquidation of each loan.
• High proportion of loans made to borrowers outside the bank’s territory/beyond the common measure
• Incomplete credit file
• Tendency to overreact to competition (making poor loans to keep customers from going to other banks)
• Lending money to support speculative purchase
• Lack of sensitivity to changing economic conditions.

(f) Legal Proceedings:
In all commercial loan default filing of money suit with the appropriate court of law under the relevant section is the ultimate recourse which should be taken to when all other actions have failed to elicit any result.

Unless the borrower is notoriously recalcitrant and ill motivated and if there is the possibility of recovery when some easy terms are offered in that case Banks should try to rehabilitate the borrower by reviving the business instead of filing of suit.

Under the following circumstances the bankers are generally inclined to file suit as a last resort:

The borrower has failed to repay anything against the dues and also failed to respond to any notice of the Bank to repay.

The borrower has continuously given false hopes to the bank that he is going to pay off immediately but never has paid and created instances of breach of commitment repeatedly. Where some fraud/forgery has been committed and no avenue is open to negotiate with the borrower for repayment of the loan.

The bankers should utilize all the available avenues for alternate dispute resolution/amicable settlement even after filing suit against the borrower on best effort basis.

Masoom (2013)

2.11 Way to reduce Non-Performing Loans in Banks

The incidence of NPLs can be reduced by ensuring that loans are granted to only applicants who demonstrate the ability to repay the loan at the agreed date. Credit analysis of the prospective borrower should be carried out to determine their risk profile and to reach a sound credit decision.
Again, loan repayment should be constantly monitored and whenever there is a default in repayment a quick action should be taken. The Banks should also avoid granting loans to the risky customers or for speculative ventures, monitor loan repayments, and renegotiate loans whenever borrowers get into difficulties. (Kay Associates Ltd, 2005)

Golden and Walker (1993) also identify the 5Cs of bad credit, which represent things to guard against to help prevent the incidence of NPLs.

a) Complacency refers to the tendency to assume that because things were good in the past they will be good in the future. Common examples are over reliance on guarantors, reported net worth or past loan repayments success because things have always worked out well in the past.

b) Carelessness involves poor underwriting typically evidenced by inadequate loan documentation, lack of current financial information or other pertinent information in the credit files and a lack of protective covenants in the loan agreement. Each of these makes it difficult to monitor a borrower’s progress and identify problems before they become unmanageable.

c) Communication ineffectiveness refers to when a Lender’s credit objectives and policies are not clearly communicated. This is when loan problems can arise. Management must effectively communicate and enforce loan policies and loan officers should make management aware of specific problems with existing loans as soon as they appear.

d) Contingencies refer to lender’s tendency to play down or ignore circumstances in which a loan might result in default. The focus is on trying to make a deal work rather than identifying downside risk.

e) Competition involves following competitor’s behavior rather than maintaining the lender’s own credit standards. Doing something because another lender is doing it does not mean it is a prudent business practice. (Golden and Walker (1993)
2.12 Impact of Nonperforming loans

2.12.1 Impact of Nonperforming loans to the Bank Growth
Following were identified as major impacts of Nonperforming loans on Banks Growth/Stability

**Deterioration of Profits**
When loan become Nonperforming loans Interest due for last 3 month and future accruals are required to transfer in to interest in suspense.

**Increase in Provisions**
When a loan or overdraft falls in to substandard category it is required to provide capital provisioning.

**Drop in Reserves**
When a facility is not recoverable capital will be write off at last. This will have an impact on Profits

**Impact on Capital Adequacy**
Banks will have an issue in meeting specified Tier 1 & Tier 11 requirements.

**Increasing Overhead Costs**
It is costly to maintain non performing advances, since it doesn’t generate an income. (Ex: follow up costs, staff costs, legal costs)

**Increasing Market Borrowings**
When advances are not recoverable causes liquidity issue in meeting payments and granting further credit .in order to finance banks tend to borrow from the market at high rate

**Drop in Share Value**
When it is known a bank is having a high Gross Nonperforming loans ratio and Net Nonperforming loans ratio share value will be dropped.

**Negative Image**

In the long run bank will have a negative image due to Nonperforming loans (Gomes P.D.2013)

**2.12.2 Impact of Nonperforming loans on Economy**

**High Interest rates**

In order to compensate the loss of interest in Nonperforming loans banks have to charge high interest rate from other borrowers. This will have an indirect impact on inflation.

**Negative Impact on development**

When funds to lend become scare due to Nonperforming loans countries development will get effected

**Unemployment**

Businesses ceased to exist due to inability to meet its repayment obligations. This will create unemployment.

**Instability in the banking system**

Due to high Nonperforming loans position if liquidity crisis arises and bail out is required, this has huge impact on whole banking sector

**Practical Approach to Manage Nonperforming loans**

**Improving the Appraisal system**

Emphasis should be given to appraisal process to ensure proper evaluation done to establish the credit worthiness of the customer. It should be noted at the appraisal level all required information to submit in order for the approving authorities to take a credit decision.

**Continuous Monitoring supervision and follow up**
Monitoring supervision and Follow-up should not be a task to be implemented when an advance turn in to loss category. Early warning signals should be identified and preventive measures should be implemented

**Availability of historical data**
Availability of historical data is paramount of important in preparation of a credit proposal. So banks should have historical data base to extract past records as and when required.

**Market Intelligence system**
MIS information should be available for various reasons when taking credit decisions. Ex: To rate a customer, to extract performance ratios

**Speedy legal actions**
When all possible attempts for recovery is failed only option is to proceed with legal action and this should be speedy otherwise this will be costly.

**Integrity**
Staff integrity is also vital factors. No member in the approval cycle should take a decision based on financial rewards.

**Rewarding staff**
Introducing a staff rewarding/incentive scheme will also support in reducing it should be noted rewarding staff will be less costly rather than spending (Gomes P.D.2013)

**2.12.3 Loan Grading System**
All outstanding loans and other risk assets are to be reviewed and classified at least once in every quarter as per extant guidelines of Bank of Tanzania and enumerated in our policy for management of NPA.

The assets are graded in five categories namely:

i. Standard/Current,
ii. Especially mentioned,

iii. Sub-standard, Doubtful and

iv. Loss.

Non Performing credit facility shall include Substandard, Doubtful, and Loss and shall be classified as per Regulations of Bank of Tanzania.

Bank shall apply both quantitative and qualitative criteria to all credit facilities.

2.13 Quantitative Criteria

Outstanding Credit Accommodations reviewed by quantitative approach shall be classified as follows:

<table>
<thead>
<tr>
<th>Number of days Past due</th>
<th>Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>91-180</td>
<td>Sub-Standard</td>
</tr>
<tr>
<td>181-270</td>
<td>Doubtful</td>
</tr>
<tr>
<td>271 and more</td>
<td>Loss</td>
</tr>
</tbody>
</table>

2.14 Qualitative Criteria

Especially Mentioned Accounts:
Loans especially mentioned are loans that are superior in quality to those classified as substandard but which are potentially weak and thus require closer management supervision. These loans do not have adverse credit information of factors sufficient to warrant their classification as standard. This category includes.
Loans with technical defects and collateral exceptions such as;

- Unallocated collateral file and document including but not limited to title papers and deed, mortgage instruments and promissory notes.
• Improper execution of supporting deed of assignment, pledge agreement or
real mortgage (The Banking and Financial Institutions (management Risk

2.15 Unregistered montage instruments

Collateral not covered by appraisal reports or appraisal whose reports are
unallocated.

Loan where corresponding promissory notes or credit agreements where signed by
person other than the authorized officer of the borrowing firm.

Loans secured by the property the title to which bears an unconcealed lien or
encumbrance. Collateral not insured or with inadequate or inspired insurance
coverage.

Loans to companies not covered by authenticated board resolutions authorizing the
borrowing. Unsecured loans granted to directors and officers contrary to the
provisions of subsection 3(b) of section 37 of the Act.

Loans not supported by up to date and adequate financial statements or credit
information. Included in this group are;

Loans renewed, renegotiated or restructured without up to date financial
statements/or income tax returns.

Loans without credit investigation/analysis reports or up to date credit information
independently verified by the lender.

Loans that need the attention of the management for special or corrective action or
both. This group includes;

• Loans where in efforts to collect are not evident or are deemed inadequate.
• Loans granted beyond the discretionary limit of the approving authority.
• Drawings or availments against an expired credit line or drawings/availment
without prior approval or appropriate Executive officer.
Credit facilities to borrowers who failed to comply with the conditionalities of the credit facilities such as, failure to operate the account satisfactorily.

Loans to firm with profitable operations but belonging to distressed industry.

Combined indebtedness to the bank of the group of persons, firm and/or companies what are related, linked or connected to reach other through common ownership, management or control or through common family or business interest where twenty five percent (25%) or more of such combined indebtedness is past due.

(BAFIA,2008 Risk Management, BOT)

Credit facilities to borrower, who frequently fails to respond to bank calls, visit or demand notices to pay.

Credit facilities the repayment of which may be endangered by economic or market conditions or other factors which in the future may adversely affect the borrower’s ability to meet scheduled repayments such as declining or fluctuating operation, illiquidity, increasing leverage trend or declining market prices over a given period.

**Sub-Standard Accounts**

Credit facilities classified as substandard have well defined weaknesses that jeopardize their liquidation such as weaknesses inherent in loans especially mentioned which are more severe or which have remained uncorrected over the period of ninety days or more. Such weaknesses may include adverse trends or developments of financial, managerial, economic, or political nature or significant weaknesses in collateral. The basic characteristics of credit facilities under Sub-standard classification are as follows;

In addition to classifying credit accommodation as either current or past due, every bank and financial institution shall review qualitatively and classify such credit accommodations into current, especially mentioned, substandard, doubtful or loss (BAFIA,2008 Risk Management, BOT)
**Current Credit Accommodation**

Credit accommodations are those which do not have a greater than normal risk and do not possess the characteristics and weaknesses of classified credit accommodations as described in these regulations.

**Especially mentioned classification**

Especially mentioned credit accommodations are those that are superior in quality to those classified as substandard, but which are potentially weak and thus require closer management supervision and include:

i. Credit accommodations with technical defects and collateral exceptions such as-

   ii. Un-located collateral file and documents including but not limited to title papers and deeds, mortgage instruments and promissory notes;

   iii. Improper execution of supporting deed of assignment, pledge agreement, or real mortgage;

   iv. Unregistered mortgage instruments;

   v. Collateral not covered by appraisal reports or whose appraisal reports are unallocated;

   vi. Credit accommodations where corresponding promissory notes or credit agreements were signed by a person other than the authorized officer of the borrowing firm;

   vii. Credit accommodations secured by property the title to which bears an un-cancelled lien or encumbrance;

   viii. Collateral not insured or with inadequate or expired insurance coverage; and

Credit accommodations to companies not covered by authenticated board resolutions authorizing the borrowings and

Credit accommodations classified as substandard are those with weaknesses that jeopardise their liquidation such as weakness inherent in loans especially mentioned which are more severe or which have remained uncorrected over a period of ninety days or more.
Credit accommodations classified as substandard are those with weaknesses that jeopardise their liquidation such as weakness inherent in loans especially mentioned which are more severe or which have remained uncorrected over a period of ninety days or more.

Credit accommodations classified as substandard are those with weaknesses that jeopardise their liquidation such as weakness inherent in loans especially mentioned which are more severe or which have remained uncorrected over a period of ninety days or more.

The weaknesses under sub-regulation (1) may include adverse trend or of financial, managerial, economic, or political nature, or a significant weakness in collateral.

The basic characteristics of credit accommodations under substandard classification are as follows-

(a) Credit accommodations which are non-performing;
(b) Credit accommodations which possess the technical defects and weakness of loans especially mentioned and which have remained uncorrected for ninety days or more since the occurrence deficiency;
(c) credit accommodations, whether current or past due, which have become unsound due to unfavourable results of operations of the borrower, significant under-capitalisation of the borrower, or absence of favourable track record showing borrower’s financial responsibility;
(d) term loans to borrowers whose cash flows are not sufficient to meet currently maturing debts and or overdrafts whose funds had been diverted or proceeds of the financed projects are not used to repay the amount outstanding.
(e) Credit accommodations to distressed industries repayments of which are imperiled. The Banking and Financial Institutions The Banking and Financial Institutions (management Risk Assets) Regulations,2008.
Doubtful classification

Accommodations having the following basic characteristics shall be classified as doubtful.

(a) credit accommodations classified as substandard in the last quarterly review without any significant improvement since then in terms of full payment of interest due among other things, except where such loans are well-secured by legally enforceable collaterals, standby letters of credit and irrevocable guarantees of top rated international banks, or the government and that legal action has commenced and realization of collateral within one year or enforcement of the guarantees within thirty days from demand can be expected;

(b) unsecured credit accommodations classified as substandard in the last quarterly review which have been extended, renewed or rolled over without repayment of all interest and charges due and at least ten per cent of the principal;

(c) past due loans secured by collaterals such as inventories, receivables, equipment, and other chattels which have declined in value materially, without the borrower offering additional collateral and the borrower’s financial condition does not justify unsecured lending;

(d) past due loans secured by real mortgage title to which property is subject to an adverse claim rendering settlement of the loan through foreclosure doubtful or unviable;

(f) Credit accommodations whose possibility of loss is extremely high but for certain important and reasonably specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until a more exact status is determined. The Banking and Financial Institutions (management Risk Assets) Regulations,2008.

Loss classification

Credit accommodation having the following basic characteristics shall be classified as loss-
(a) Credit accommodations classified as doubtful in the last quarterly review without any significant improvement since then;

(b) credit accommodations to borrowers whose whereabouts are unknown, or who are insolvent, whose earning power is permanently impaired and the guarantors or co-obligors are insolvent, or that their guarantees are not financially supported; and

(c) Credit accommodations considered as absolutely uncollectible. The Banking and Financial Institutions (management Risk Assets) Regulations, 2008.

2.14 Credit facilities which are non-performing
Credit facilities which possess the technical defects and weakness of lions especially mentioned uncorrected for ninety days or more since the occurrence of deficiency. Credit facilities, whether current or past due, which have become unsound due to unfavorable results of operational of borrower, significant under capitalization of the borrower, or absence of favorable track record showing borrower’s financial responsibility.

Term Loan to borrowers whose cash flows are not sufficient to meet currently maturing debts and or overdraft whose funds had been diverted or proceeds of the financed projects are not used to repay the amount outstanding.
Credit facilities to distressed industries repayment of which are imperiled

2.15 Doubtful Accounts
Loans having the following basic characteristics shall be classified as doubtful;
Credit facilities classified as substandard in the last quarterly review without any significant movement since then in terms of full payment of interest due among other things, except where such loans are well secured by legally enforceable collaterals, standby letters of credit, and irrevocable guarantees of top rate international banks, or the government and that legal action has commenced and realization of collateral within one year or enforcement of the guarantees within thirty days from demand can be expected;
Unsecured credit facilities classified as substandard in the last quarterly review which have been extended, renewed or rolled over without payment of all interest and charges due and at least ten percent (10%) of the principal

Past due loans secured by collaterals such as inventories, receivables, equipment and other chattels which declined in value materially, without the borrowers offering additional collateral and the borrower’s financial condition does not justify unsecured lending;

Past due loans secured by real mortgage title to which property is subject to an adverse claim rendering settlement of the loan through foreclosure doubtful or unviable;

Credit facilities whose possibility of loss is extremely high but for certain important and reasonable specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until a more exact status is determined. The Banking and Financial Institutions (management Risk Assets) Regulations, 2008.

2.16 Loss Accounts

The basic characteristics of loans subject to loss classifications are as follows;

Credit facilities classified as doubtful in the last quarterly review without any significant improvement since then

Credit facilities to borrowers whose where about are unknown, or who are insolvent, whose earning power is permanent impaired and guarantors or co-obligators are insolvent, or that their guarantees are not financially supported and

Loans considered as absolutely uncollectible. More than one credit facilities to a borrower or group of related parties, al such credit facilities shall be assigned the least favorable classification given to any one of those credit facilities.

The criteria for classifying credit accommodations shall apply regardless of the type of security held. The Banking and Financial Institutions (management Risk Assets) Regulations, 2008.
2.17 Provision for Bad Debts

Specific provisions shall be maintained for all credit accommodations and other risk assets which shall not be less than the following percentages of the outstanding balance consisting of principal, interest and all other charges and fees which have been capitalized. The Banking and Financial Institutions (management Risk Assets) Regulations, 2008.

<table>
<thead>
<tr>
<th>Classification</th>
<th>Weights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Especially mentioned</td>
<td>5%</td>
</tr>
<tr>
<td>Sub-standard</td>
<td>10%</td>
</tr>
<tr>
<td>Doubtful</td>
<td>50%</td>
</tr>
<tr>
<td>Loss</td>
<td>100%</td>
</tr>
</tbody>
</table>

Where the provisions computed in accordance with International Financial Reporting Standards (IFRS) are less than those required by the Regulation, a specific non-distributable reserve shall be created through an appropriation of distributable reserves to eliminate the shortfall.

A quarterly report on classification and provisioning of credit facilities and other risk assets including contingent accounts is to be submitted to the Bank of Tanzania not later than the 15th day following the end of the reporting quarter.

Prior approval is to be obtained from Bank of Tanzania of proposed annual provisions for probable losses before finalization of the annual accounts. Draft Balance Sheet, Profit & Loss Account, including detailed account of the provisions made is to be submitted to Bank of Tanzania when seeking approval for provision on probable losses (BAFIA, 2008 Management of Risk Assets).
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
This chapter highlights the scope, mode of operation and techniques that were used in research. It also shows the research design, area of study, research population, sample and sampling technique, data collection procedure, data collection instrument and data analysis technique.

3.2 Study Area
This study was carried out in Bank of Baroda Tanzania Limited, CRD Bank PLC, and Standard Chartered Bank in their respective head offices in Dar es Salaam. The Banks have been operating for more than five years and have experienced the problems of NPLs. This helped the researcher to get enough sample population.

3.3 Population under the Study
Population included credit analysts, relationship manager credits, processing officers, Credit approval officers, credit documentation officers, and director of credits. Officers were randomly chosen to analyze causes of NPLs. Credit analysts, relationship managers, credit processing Officers, credit approval officers, credit documentation officers and director of Credits were interviewed to analyze causes of NPLs from each of the head offices of the Bank of Bank of Baroda Tanzania, CRDB Plc, Standard Chartered Bank.
3.4 Sample Size

Table 3.1 Following is the sample size were chosen from each Bank

<table>
<thead>
<tr>
<th>S/N</th>
<th>Section</th>
<th>No. of respondents</th>
<th>% of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Credit Analyst</td>
<td>5</td>
<td>33</td>
</tr>
<tr>
<td>2.</td>
<td>Relationship Manager Credit</td>
<td>3</td>
<td>20</td>
</tr>
<tr>
<td>3.</td>
<td>Processing Officer</td>
<td>2</td>
<td>13.33</td>
</tr>
<tr>
<td>4.</td>
<td>Credit Approval Officer</td>
<td>2</td>
<td>13.33</td>
</tr>
<tr>
<td>5.</td>
<td>Credit Documentation Officer</td>
<td>2</td>
<td>13.33</td>
</tr>
<tr>
<td>6.</td>
<td>Director of Credits</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>15</td>
<td>100</td>
</tr>
</tbody>
</table>

3.5 Sampling Technique

Purposive Sampling selects people based on the particular purpose or experiment (changingminds.org)

Stratified sampling is a probability sampling technique whereby the researcher divided the entire population into different sub groups or strata, then randomly selected the final subjects proportionally from the different strata. Castillo, (2009).

3.6 Data Collection Procedure

During the data collection, two major methods were employed.

Interview

Personal interviews method requires a person known as the interviewer. It involves asking questions generally in a face-to-face contact to the other person or persons. (At times the interviewee may also ask certain questions and the interviewer responds to these, but usually the interviewer initiates the interview and collects the information.)

Unstructured interview was used since it provides more freedom to ask questions and also in case of need, supplementary questions or at times he may omit certain questions if the situation so requires.
The technique has some weakness such that flexibility results in lack of comparability of one interview with another and the analysis of unstructured responses becomes much more difficult and time-consuming. It also demands deep knowledge and greater skill on the part of the interviewer. Kothari (2004)

The technique explored their views of form each director of credit department as they have more experience in the field of credit about the main factors that cause the non performing loan and measures applied to minimize the problem of NPL in the three Banks that are; Bank of Baroda Tanzania Limited, CRD PLC and Standard Chartered Bank Tanzania Limited.

**Questionnaires**

*Questionnaire* as a general term includes all techniques of data collection in which each person is asked to respond to the same set of questions in a pre-determined order (deVaus, 2002).

Questionnaires were given to the loan officers and some available and willing clients.

*Questionnaire* technique has the following advantages; Because each person (respondent) is asked to respond to the same set of questions, it provides an efficient way of collecting responses from a large sample prior to quantitative analysis, and it is not expensive even if the respondents are widely spread geographically. It is also free from bias of interviewer that is respondent respond on their own words. Respondents, who are not easily approachable, can also be reached conveniently, Large samples can be made and thus the results can be made more dependable and reliable

The following are the disadvantages of questionnaire: - One of them is that researchers are unlikely to have more than one opportunity to collect the data. In particular, will be unable to go back to those individuals who choose to remain anonymous and collect additional data using another questionnaire. It used only when respondents are educated and cooperative. It also is difficult to know whether willing respondents are truly representative. Kothari (2004)
Questionnaires were given to all bank officers working at the credit department in order to get the causes and the measures to minimize the problem of non NPLs from each of the three banks.

3.7 Data Analysis Techniques
The researcher used qualitative and quantitative techniques to analyze data.

Qualitative techniques included

**Summarizing the expressions given by respondents**
The respondent expressions from interview were summarized to analyze the causes of NPL from the three different banks.

3.7.1 Exploratory Data Analysis
Exploratory data analysis approach was useful in these initial stages. This approach emphasizes the use of diagrams to explore and understand the data, emphasizing the importance of using the data to guide the choices of analysis techniques. As it would be expected, it believed that it is important to keep your the question(s) and objectives in mind when exploring the data. However, the exploratory data analysis approach allows the researcher’s flexibility to introduce previously unplanned analyses to respond to new findings. It therefore formalizes the common practice of looking for other relationships in the data, which the research was not initially designed to test. This should not be discounted, as it may suggest other fruitful avenues for analysis. In addition, computers make this relatively easy and quick. (Sparrow, 1989)

3.7.2 Quantitative Techniques
Quantitative techniques are those whose values are measured numerically as quantities. This means that quantifiable data are more precise than categorical as you can assign each data value a position on a numerical scale. It also means that you can analyses these data using a far wider range of statistics. Techniques will include, the
CHAPTER FOUR
DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction
This chapter presents the data analyzes and discusses the research findings obtained from the field using different tools namely, questionnaires, interviews, documentary reviews and observations.

The prime purpose of data analysis was to ultimately assimilate evidence to provide answers to the research questions which were formulated to assist in assessing the overall objective of the study in comparison of the causes of NPL in the three banks, that are Bank of Baroda Tanzania Limited, CRDB PLC bank and Standard Chartered Bank.

The study focused on the following specific research questions

i. What are the causes of NPL from each bank?
ii. What causes of NPL are shared across the three banks and what causes differ?
iii. What are the reasons for variation for the causes of NPL from the three Banks?
iv. What measures are undertaken to minimize the problem of NPL in banks?

4.2. The Causes of NPL:-
The following were the general responses obtained from the study of the causes of NPLs through interview and questionnaire to the three banks that are Bank of Baroda Tanzania Limited, CRDB PLC Bank, and Standard Chartered Bank. The finding of the causes of NPL are discussed in comparison with the causes of NPL in literature review in the chapter two as follows:-
4.2.1 Diversification of Fund

Respondents responded that that there was a diversification of money borrowed to other uses other than the intended purpose of loan. This is due to the fact that fund allocated to unproductive project may result in the business loss leading to failure to meet bank obligation.

Diversification of fund in not a new phenomena in the study as Khaleque (2010 ) signalizes that the diversion of loan use is defined as the quotient of the difference between the total amount of loan received and the amount of loan used for the proposed purpose and the total amount of loan received.

4.2.2 Poor Analysis of Loan Proposal Due to Lack of Credit Training

The respondents responded that poor loan analysis of loan causes over or under financing to borrowers, which results to failure to meet the business plans or allocating the excess fund to other project which are unproductive and which may result to business loss and thus fail to repay the loan.

This is not a new phenomenon as it has been discussed by Deucet, 2004. This means that the lacks of trainings to credit officers lead to an increase of NPL

4.2.3 Lack of Integrity on Borrower Side/Transparency

The respondents reported that some borrowers are not transparency. Some of the borrower’s provided cooked financial statement which they are in need of loan. This might depict high revenue and profit in order to get huge amount of loan which them fail to utilize in their business thus they run into loss which affect the loan repayment.

4.2.4 Death of Key Person in the Business

Respondents reported that death of key person especially in sole proprietor business results into poor business which then results into failure in business and thus lead to NPL.

4.2.5 Lack of Business skills or Entrepreneurship Skills
This happen when the credit officer issues a loan to business loan to a borrower without business skills. These results into the business failure and hence the borrower fails to repay back the loan. This is not a new phenomenon in this study. This also was explained in the study of other literature that selection of the right entrepreneur is one of the major factors in the profitability of banks. Two major criteria namely the intention to repay and the capacity to repay should be properly dealt with in credit evaluation. The entrepreneurs who have the willingness, capabilities, qualities and the requisite expertise for successfully setting up and running an industrial unit, should be identified with proper prudence and judiciousness(www.mbaknol.com/business-finance)

4.2.6 Lack of Effective Credit Follow up

Respondents reported that the some credit officers are not committed in the recovery of loans. This result causes relaxation of the borrower to repay the loan. This finding has been discussed in the literature review as “A stitch in time saves nine”. Follow-up measures taken regularly and systematically keep the borrowing unit under constant vigil of the banks. Many ills can be checked through such follow-up measures by keeping the borrowing units on their alertness and guiding them to rectify their mistakes in the first opportunities or extending them a helping hand in tiding over their tight times. Normally, such close follow-up programs are conspicuous by their absence. In the result, the borrowing units not only ignore payment of their dues to banks but also often tread on wrong tracks, much to the detriment of their own financial health and that of the banks. Performance of the borrowing units, if carefully and systematically monitored through regular inspections by scrutiny of returns, annual balance sheet and inspection of site, can be significantly improved. Naturally, such inspections prevent the borrowers from deviating from the terms and conditions of the loan or from diverting any fund for a purpose other than those earmarked in the sanction letter and keep the financial health of the units in good order(www.mbaknol.com/business-finance)

4.2.7 Issuing of Loan due to Pressure from top Management
This is another causes of NPL, respondents responded that managers may pressurize loan officers to issue loan to some of borrowers without completion of some of the procedure. This results into poor loan analysis which result to decision which may results to over finance or under finance of the borrower thus, resulting to diversification of fund or failure to achieve the business goal leading to non repayment of loan.

4.2.8 Provision of Ineffective Loan Covenant to Borrower

Respondents reported that attaching weak terms and condition in the loan agreement which are not legally binding result causes some of the unfaithfully borrower to relax to repay the loan.

4.2.9 Unfaithfully of Bank Staff

Respondent responded that some credit officers issue poor quality of loan due to their personal benefits such as corruption or to meet target. This becomes difficult for them towards loan recovery.

4.3 Causes of NPL at Bank of Baroda Tanzania Limited

(i)Questionnaires were distributed to 15 staffs of Bank of Baroda Tanzania Ltd for the inquiry of the causes of NPL, Responses of the factors for the causes of NPL at Bank of Baroda Tanzania Ltd were as follows:-

Table 4.1 Causes of NPL at Bank of Baroda Tanzania Ltd
<table>
<thead>
<tr>
<th>SN</th>
<th>Factor (BOB)</th>
<th>Frequency response</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Diversification of fund</td>
<td>15</td>
<td>100%</td>
</tr>
<tr>
<td>2</td>
<td>Integrity of borrowers/lack of transparency by borrower</td>
<td>13</td>
<td>87%</td>
</tr>
<tr>
<td>3</td>
<td>Death of key person in the business</td>
<td>10</td>
<td>67%</td>
</tr>
<tr>
<td>4</td>
<td>Lack of effective credit follow up from the credit officers.</td>
<td>10</td>
<td>67%</td>
</tr>
<tr>
<td>5</td>
<td>Business failure/inexperienced or lack of entrepreneurial knowledge on borrowers side</td>
<td>10</td>
<td>67%</td>
</tr>
<tr>
<td>6</td>
<td>Pressure from top management</td>
<td>8</td>
<td>53%</td>
</tr>
<tr>
<td>7</td>
<td>Poor analysis of loan</td>
<td>8</td>
<td>53%</td>
</tr>
<tr>
<td>8</td>
<td>Unfaithfulness of bank staff (corruption)</td>
<td>5</td>
<td>33%</td>
</tr>
<tr>
<td>9</td>
<td>Giving ineffective covenant</td>
<td>2</td>
<td>13%</td>
</tr>
<tr>
<td></td>
<td><strong>Total Response</strong></td>
<td><strong>81</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

A graphical presentation of the factors which were responses for the causes NPL at Bank of Baroda Tanzania Limited.

**Figure 4.1 Causes of NPL at Bank of Baroda Tanzania Ltd**
• Key
  X-axis Factors that causes non performing loan
  Y-axis Percentage of cuases at a bank

1. Diversification of fund
2. Integrity of borrowers/lack of transparency by borrower
3. Death of key person in the business
4. Lack of effective credit follow up from the credit officers.
5. Business failure/inexperienced or lack of entrepreneurial knowledge on borrowers side
6. Pressure from top management
7. Poor analysis of loan
8. Unfaithfulness of bank staff (corruption)
9. Giving ineffective covenant

4.4 The cause of NPL at CRDB Bank PLC
(i) Questionnaires were distributed to 15 staffs of credit department at CRDB BANK PLC for the inquiry of the causes of NPL. Responses for NPL at CRDB BANK PLC were as the follows:

Table 4.2 Causes of NPL at CRDB BANK PLC

<table>
<thead>
<tr>
<th>Factor (CRDB BANK PLC)</th>
<th>Frequency of response</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Diversification of fund</td>
<td>15</td>
<td>100.00%</td>
</tr>
<tr>
<td>2 Integrity of borrowers/lack of transparency by borrower</td>
<td>14</td>
<td>93.33%</td>
</tr>
<tr>
<td>3 Death of key person in the business</td>
<td>13</td>
<td>86.67%</td>
</tr>
<tr>
<td>4 Lack of effective credit follow up from the credit officers.</td>
<td>13</td>
<td>86.67%</td>
</tr>
<tr>
<td>5 Business failure/inexperienced or lack of entrepreneurial knowledge on borrowers side</td>
<td>10</td>
<td>66.67%</td>
</tr>
<tr>
<td>6 Pressure from top management</td>
<td>3</td>
<td>20.00%</td>
</tr>
<tr>
<td>7 Poor analysis of loan</td>
<td>3</td>
<td>20.00%</td>
</tr>
<tr>
<td>8 Unfaithfulness of bank staff (corruption)</td>
<td>2</td>
<td>13.33%</td>
</tr>
<tr>
<td>9 Giving ineffective covenant</td>
<td>1</td>
<td>6.67%</td>
</tr>
<tr>
<td>Total Response</td>
<td>83</td>
<td></td>
</tr>
</tbody>
</table>

A graphical presentation of the factors which causes NPL at CBIRD Bank PLC.

Figure 4.2 Causes of NPL at CRDB BANK PLC.
4.5. The causes of NPL at Standard Chartered Bank

Questionnaires was distributed to 15 staffs of credit department at Standard Chartered Bank Ltd for inquiry for the causes of NPL. Responses of the factors causes NPL at Standard Chartered Bank Ltd at were the follows:-

Table 4.3 Causes of NPL at Standard Chartered Bank Ltd

<table>
<thead>
<tr>
<th>SN</th>
<th>Factor (SCB)</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
</table>

Key
- X-axis: Factors that causes non performing loan
- Y-axis: Percentage of causes at a bank
<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Responses</th>
<th>(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Diversification of fund</td>
<td>15</td>
<td>100%</td>
</tr>
<tr>
<td>2</td>
<td>Integrity of borrowers/lack of transparency by borrower</td>
<td>15</td>
<td>100%</td>
</tr>
<tr>
<td>3</td>
<td>Death of key person in the business</td>
<td>13</td>
<td>86.67%</td>
</tr>
<tr>
<td>4</td>
<td>Lack of effective credit follow up from the credit officers.</td>
<td>12</td>
<td>80%</td>
</tr>
<tr>
<td>5</td>
<td>Business failure/inexperienced or lack of entrepreneurial knowledge on borrowers side</td>
<td>8</td>
<td>53%</td>
</tr>
<tr>
<td>6</td>
<td>Pressure from top management</td>
<td>5</td>
<td>33%</td>
</tr>
<tr>
<td>7</td>
<td>Poor analysis of loan</td>
<td>4</td>
<td>27%</td>
</tr>
<tr>
<td>8</td>
<td>Unfaithfulness of bank staff (corruption)</td>
<td>3</td>
<td>20%</td>
</tr>
<tr>
<td>9</td>
<td>Giving ineffective covenant</td>
<td>3</td>
<td>20%</td>
</tr>
<tr>
<td></td>
<td><strong>Total response</strong></td>
<td><strong>78</strong></td>
<td></td>
</tr>
</tbody>
</table>

A graphical presentation of the factors which were responses of causes NPLs at Standard Chartered Bank Ltd.

**Figure 4.3 Causes of NPL Standard Chartered Bank Ltd**
4.6 The Relation of the Cause of NPL to the three banks
From the study of the causes of the NPL, the following causes related to each of the three banks in terms of the nature and frequency of response-

4.6.1 Diversification of Fund
From each of the three banks diversification of fund was seen to be the major cause of NPL. From the responses, the analysis shows that diversification of fund was the major causes of nonperforming loan as it scored 100%. 15 staff each from the three banks responded that diversification of fund was the cause of NPL.

4.6.2 Lack of Transparency from the Borrower’s Side
Lack of transparency on the borrower’s side was one of the responses as the causes of NPLs. Among of the 15 staffs of Bank of Baroda Tanzania Limited, 13 staffs
responded that lack of transparency was the cause of NPL and this which marked 87% of the total responded, 14 staffs among 15 staffs of the CRDB PLC Bank responded that lack of transparency on the borrower side was the cause of NPL and this marked which marked 93.33 % of the total respondents and 15 among 15 staff from Standard Chartered Banks responded that lack of transparency was the causes of NPL, and this marked 100% of the total respondents.

4.6.3 Death of Key Person in the Business (Borrower)  
Death of a key person in the business as borrower was one of the responses as a cause NPLs. Among 15 staff of Bank of Baroda Tanzania Limited, 10 staff responded that death of a key person in the business was the cause of NPL was equivalent to 67% of the total respondents, 13 among 15 staff, which as equivalent to 87.67% of the total respondents from the CRDB PLC Bank responded that lack of transparency on the borrower side was the cause of NPL. Moreover, 13 among 15 staff from Standard Chartered Banks responded that death of key person in the business was the cause of NPL and this which marked 86.67 % of the total respondents.

4.6.4 Lack of Effective Credit Follow up by Credit Officers  
Lacks of effective credit follow up by credit officers was one the responded cause of NPLs. Among the 15 staff of Bank of Baroda Tanzania Limited 10 of them responded that lack of effective credit follow up by credit officers was one of the cause of NPL which marked 66.67% of the total respondents, 13 among 15 staff of the CRDB PLC Bank responded that lack of effective credit follow up by credit officers was one of the NPL which marked 86.67 % of the total respondents and 12 s of the 15 staff from Standard Chartered Bank responded that lacks of effective credit follow up by credit officers was the one of the cause of nonperforming loan which marked 80 % of the total respondents.

4.6.5 Lack of Business Entrepreneurship/Lack of Business Knowledge/Lack of Business Experience  
Lack of business entrepreneurship/experience was one of the responded causes NPL. Among the 15 staff of Bank of Baroda Tanzania Limited 10 staff responded that
lack of business entrepreneurship/experience was the cause of nonperforming loan which marked 66.67% of the total respondents, 10 staffs among 15 staff from the CRDB PLC Bank responded that improper analysis of loan proposal was the cause of NPL. This marked 66.67 % of the total respondents and 8 staffs of among 15 staff from Standard Chartered Bank responded that lack of business entrepreneurship/experience was cause of NPL which marked 53.33 % of the total respondent.

4.6.6 Pressure from top Management
Loan disbursement due to influence and pressure from top management was one of the responded cause NPLs. Among the 15 staff from Bank of Baroda Tanzania Limited, 8 staff responded that lack of business entrepreneurship/experience was the cause of NPL which marked 53.33% of the total respondents, 3 among 15 staffs of the CRDB PLC Bank responded that loan disbursement due to influence from pressure from top management was the cause of NPL which marked 20% of the total respondents and 5 staff from among 15 staffs Standard Chartered Bank responded that loan disbursement due to influence and pressure from top management was the cause of NPL which marked 33.33 % of the total respondents.

4.6.7 Improper Analysis of Loan Proposal Due to Lack of Experience and Training by Credit Officers
Improper analysis of loan proposal was one of the responded cause NPLs. Among the 15 staffs of Bank of Baroda Tanzania Limited, 8 staffs responded that improper analysis of loan proposal was the cause of NPL which marked 53.33% of the total responded, 3 among 15 staff of the CRDB PLC Bank responded that improper analysis of loan proposal was the cause of NPL which marked 20% of the total respondents and 4 among 15 staffs Standard Chartered Bank responded that lack of business entrepreneurship/experience was the cause of NPL which marked 26.66 % of the total respondents.
4.6.8 Unfaithfulness of Bank Staff (Corruption)

Unfaithfulness of bank staff (Corruption) was one of the responded causes of NPLs. Among 15 staff of Bank of Baroda Tanzania Limited, only 5 staffs responded that unfaithfulness of bank staff (Corruption) was the cause of NPL, which marked 33.33% of the total respondents, 2 among 15 staff of the CRDB PLC Bank responded that unfaithfulness of bank staff (Corruption) was the cause of NPL which marked 13.33% of the total respondent and 3 among 15 staff from Standard Chartered Bank respondents that loan disbursement due to influence from pressure from top management as the cause of NPL which marked 20% of the total respondent.

4.6.9 Inclusion of Ineffective Loan Covenant in the Terms And Conditions Some of Which are not Legally Binding

Inclusion of ineffective loan covenant in the terms and conditions of credit facilities some of which are not legally binding was one of the responded causes NPLs. Among 15 staff of Bank of Baroda Tanzania Limited, only 2 staff responded that inclusion of ineffective loan covenant in the terms and conditions of credit facilities some of which are not legally binding was the cause of NPL, and this covered only 13.33% of the total respondents, 1 among 15 staff of the CRDB PLC Bank responded that inclusion of ineffective loan covenant in the terms and conditions of credit facilities some of which are not legally binding was the causes of NPL, which marked 6.67% of the total respondent and 3 among 15 staff from Standard Chartered Bank responded that inclusion of ineffective loan covenant in the terms and conditions of credit facilities some of which are not legally binding, is the cause of NPL which marked 20% of the total respondents.

The graphical presentation of the general response of the causes of NPL the three banks that is Bank of Baroda Tanzania Limited, CRDB Bank PLC and Standard Chartered Bank.

Graph No. 1. Bank of Baroda Tanzania Ltd
Graph No. 2. CRDB Bank PLC
Graph No. 3. Standard Chartered Bank

Figure 4.4 The causes of NPL at three banks that is Bank of Baroda Tanzania Limited, CRD Bank PLC and Standard Chartered Bank

![Graph showing causes of NPL](image)

- **Key**
  - **X-axis**: Factors that cause non-performing loan
  - **Y-axis**: Percentage of causes at a bank

**4.7 Reasons for the variation of the causes of the NPL in the Three Banks**

The study reveals that Banks Bank experience the related causes of NPL but the difference were the extent to which each of the three banks tries to ensure that quality loan are issued through so as to minimize the level of NPLs by provision of internal and external training to credit officer, ensuring that loan are properly analyzed to minimize the credit risk, motivation of credit officer so as to speed up the recovery process and ensuring that loan are issued to companies which have strong management teams.
4.8 Measures for Minimizing the Problem of NPLs to banks

Questionnaires were distributed to all the credit staffs of Bank of Baroda Tanzania Limited, CRD PLC Banks, Standard Chartered Bank and the following response were suggested as a means to minimize the problem of NPL in banks

- Minimization of very long timing of legal measures in recovery of NPLs. Maintenance of ethical standard in banking professional is an important way for ensuring high quality loans are issued in financial institution
- Setting targets for recovery for loan recovery officer
- Linking loan defaulter with central bank and proving defaulter from accessing further loan.
- Introduction of incentives for recovery of defaulted loans
- Improving loan screening and monitoring of loans
- Bank officers suggested that there is a need to scrutinize the borrower’s information to make sure that they obtain genuine information for provision of decision for issuing of credit facility to borrowers. Respondents suggested that faithfulness is the best way of the best policy of reducing the problem of NPLs.
- Respondents suggested that canceling of the borrowers is one of the strong measures of changing non performing loan to performing loans. In their responses, respondents said that when a borrower is not paying loan due, he/she becomes in a panic conditions thus he/she may become unable to find the way out to repay the loan, though canceling the borrower helps to change the borrower’s physiology and hence start performing.
- Respondents suggested that the legitimacy of property mortgaged must be properly and directly checked. They said that usually the borrower were unwilling to repay the loan of the property mortgaged has fault or is fake.
• Respondents suggested that credit risk management and credit administration should function properly and with autonomy. This will help to reduce disbursement loan due to undue influence of pressure from directors, board of directors and politicians.
• Credit officer should understand client's business.
• Credit officer should carefully analyze client's financials.
• Bank management and credit officer should frequently visit to clients.
• Bank management should ensure perfection of legal documentation.
• Credit officer and bank management should use credit bureau on checking the borrowers behavior in issues of loan

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 SUMMARY

The research study focused at assessing the comparison of the causes of NPLs in the three banks that are Bank of Baroda Tanzania Ltd, CRDB Bank Plc, and Standard Chartered Bank.

The research was guided by the following research questions
• What are the causes of NPL from each bank?
• What causes of NPL are shared across the three banks and what causes differ?
• What are the reasons for variation for the causes of NPL from the three Banks?
• What measures are undertaken to minimize the problem of NPL in banks?

Due to limited time and funds it was felt by the researcher to conduct the research in three banks that is Bank of Baroda Tanzania Limited, CRDB Bank PLC, and Standard Chartered Bank. Data collection was done through modalities like interviews and questionnaires. Moreover, it was not possible to interview the entire population of the three banks. Samples were chosen, were chosen using simple random sampling and purposive sampling techniques. Lastly, the analysis of data was done.

The findings of this study reveal that the causes of NPL are related to each of three banks. These causes were diversification of fund, lack of integrity on borrower’s side, death of key person in the business, lack of effective credit follow-up by credit officers, lack of entrepreneurial knowledge on borrowers side, pressure from top management, poor analysis of loan, unfaithfully of bank staff (corruption) and giving ineffective loan covenant which are not legally binding. The differences arised were how the each bank tries to minimize (overcome) causes of the NPLs. This can be depicted by different in percentage level of NPL in the three banks. Percentage level of nonperforming loan at Bank of Baroda (Tz) Ltd was at 4.28 % in 2011, CRD Bank PLC was at 2.19% in 2011 and Standard chartered Bank was at 1.35 % in 2011.

5.2 CONCLUSION

The research study on causes NPLs from the three banks were revealed to relate each other although the percentage level of NPLs from the three banks were seen to be different. The difference in the percentage levels of NPL was due to issue of how each banks overcome the causes NPLs.

5.3 RECOMMENDATIONS
Basing on the findings of the study, the following recommendations should be sought ideal in order to minimize the problem of the level of NPL in banks.

Lack of transparency was among the highly ranked cause of NPL in the three banks. This aroused to lack of credit history of the borrower.

Bank of Tanzania (BOT) has established a Credit Reference Bureau. This has made to be mandatory to all financial instruction to the borrower’s information and status in term of the payment of loan.

The bank officers should provide caution on the issue concerning diversification of fund borrowed should also and explain to them the negative impact of diversification of the fund and the clause like diversification fund will not be entertained and it should be included in the terms and conditions of the loan.

The credit risk management and credit administration should function properly to ensure loan disbursement due to undue influence like pressure from top management and politicians is minimized. This will reduce the increase in the rate of NPL in banks.

Credit offers should be trained on the issue of professional ethics and should be responsible to maintain the professional ethics. This will help to reduce the rate of NPLs by reducing the undue disbursement of loan which may be brought about to the issue of corruption.

Management should set recovery targets and provide incentives to recovery officers. This will help to speed up the rate of loan recovery. Loan amount in arrears will be minimized and thus reduction in the NPL.

Government support. That government should ensure that law and procedures formulated concerning loan recovery though legal action will be taking minimal time. This will help to reduce timing of loan recovery through legal action and thus reduction in the rate of NPL in banks.
Bank management and credit officers should undertake frequent site visit. This will help them be aware of the business progress and the position/status of the security coverage for further decision making.

REFERENCE


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APPENDIX

1. Questionnaire for Credit Department regarding the enquiry of the cause of the non performing loan

Dear Sir /Madam,

The questionnaire is designed to collect data for the comparison of the causes of non NPL at three different banks in Tanzania. All the information obtained is purely for the research purposes and no other purpose than to prepare a research report to be submitted to Mzumbe University for the award for the award of Masters Degree of Business Administration in Corporate Management.

For Bank Officer

- Sex of respondent (Tick the correct answer)

  a) Male …………………..

  b) Female ………………….

2) How long have you worked with the department?

  a) Less than five years ………………….

  b) Between 6 to 10 years ………………….
c) Between 11 to 15 years ………………

d) Above 15 years …………………

3) What is your position in the department?

4) What are the credit facilities provided by your banks?

5) What are the necessary conditions which your bank is applying in proving loan to borrower?
7) Is any deviation given to the loan conditions?
(a) Yes , ............ If yes in what situation the deviation of the conditions is allowed
(b) No ..............

6) How much interest rate is charged to your loan?
   a) 14% - 16%
   b) 17% - 19%
   c) 20% - 22%
   d) 23% - 25%
   e) 26% - 28%

7) What the different level of the credit approval with specific limit of approval?

8. What are the monitoring mechanisms applied in the credit management?
9. What are the causes of the non performing loan in your banks?

10. What are methods applied by your banks to minimize the problem of the non performing loan?

11. What are the other measures may be applied to minimize the problem of non performing loan?
Dear Sir /Madam,

The questionnaire is designed to collect data for the comparison of the causes of non-performing loan at three different banks in Tanzania. All the information is obtained purely for the research purposes and no other purpose than to prepare a research report to be submitted to Mzumbe University for the award for the award of Masters Degree of Business Administration in Corporate Management.

For Bank Borrowers

- Sex of respondent (Tick the correct answer)
  a) Male  
  b) Female

2) Why is the borrower failing to repay the bank loan?

- What are the measures to be used to prevent failure in the repayment of Bank loan?