

**PERFORMANCE OF CREDIT PORTFOLIO AND RISK  
MANAGEMENT: A CASE STUDY OF BARCLAYS BANK  
TANZANIA**

**By**

**Jeremia Henry Msuya**

**A Dissertation Submitted to Dar-es-Salaam Campus College in Partial  
Fulfillment of the Requirements for the Award of Master of Science in  
Accounting and Finance Degree of Mzumbe University.**

**2014**

**CERTIFICATION**

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University, a dissertation entitled **Performance of Credit Portfolio and Risk Management at Barclays Bank Tanzania Limited**, in partial fulfillment of the requirements for awards of the degree of Master of Science in Accounting and Finance (MSc. A&F) of Mzumbe University

.....  
Major Supervisor

-----  
Internal Examiner:

Accepted for the Board of .....

---

**DEAN/DIRECTOR, FACULTY/DIRECTORATE/SCHOOL/BOARD**

**DECLARATION**

**AND**

**COPYRIGHT**

I, **JEREMIA HENRY MSUYA**, declare that this dissertation is my own original work and that it has not been presented at Mzumbe University or any other university for a degree or similar award.

**Signature:** -----

**Date:** -----

**© 2014**

This dissertation is a copyright material protected under the Berne Convention, the copyright Act, 1999 and other international and national enactments, in that behalf, on intellectual property. It may not be reproduced, by any means in full or in part, except for short extracts in fair dealings, for research or private study, critical scholarly review or disclosure with an acknowledgement, without the written permission of Mzumbe University on behalf of the author.

## **ACKNOWLEDGEMENTS**

The preparation of this dissertation has been successful due to the constructive help, suggestions, support and encouragement from several individuals.

Firstly, the researcher would like to express his sincere gratitude to his supervisor Mr. Maige Mwakasege Mwasimba; for his intensive comments, advice and guidance throughout the preparation of the dissertation.

Secondly, he would also like to express his sincere to BBT Credit, recovery and customer care Departments team for their support in collecting information for the whole period of research at BBT Ltd.

Thirdly; he owes many thanks to his dear parents Mr. and Mrs. Henry Leveru Msuya for their kindness, encouragement and care in every area of his life.

Lastly but not least, he is so grateful to anyone who was with him during the hard time of dissertation preparation. He is sure the almighty GOD is going to bless them abundantly.

## **DEDICATION**

This dissertation is dedicated to the researcher's dearest parents for taking care of the family during the difficult period of his studies at Mzumbe University. May God bless her entire life

## **ABBREVIATIONS AND ACRONYMS**

AGM	Annual General Meeting
BBT	Barclays Bank Tanzania
BOT	Bank of Tanzania
CAL	Collection Africa Limited
CBN	Central Bank of Nigeria
CMC	Country Management Committee
CRDB	Co-operative and Rural Development Bank Limited
DFI	Development Financial Institution
EOB	Extra-Ordinary Board Meeting
ICT	Information and Com. Technology
KYC	Know Your Customer
LGs	Lead Generators (Sales Personnel)
LPC	Loan Processing Center
NBFIs	Non-Bank Financial Institutions
NBC	National Bank of Commerce Limited
RRU	Retail Risk Unit
SMEs	Small & Medium Enterprises
SSA	Sub-Saharan Africa
TIB	Tanzania Investment Bank Limited

## **ABSTRACT**

This study was conducted at Barclays Bank Tanzania Limited (BBT) with the main objective of assessing the challenges of risk management in credit portfolio in commercial banks. Lending is the backbone of commercial banking, so lending is what banks should do best. Yet these portfolios proved to be the source of recurring problems and the cause of failure for many commercial banks. Credit portfolio management grew out of the need to improve the financial performance of the large corporate loan portfolios in commercial banks. It is paradoxical that these portfolios created the biggest problems for originators and investors in the marketplace. After all, large corporate loan portfolios typically are composed of loans, commitments, and other lending exposures to banks' most creditworthy customers.

The Tanzanian commercial banks have gained a significant share of banking and financial markets in the country and provide important benefits to the economy, they facilitate the achievement of the objectives of financial liberalization by boosting competition in banking markets, stimulate improvements in services to customers and expand access to credit, especially to domestic small- and medium-scale businesses. But the attainment of these benefits has been jeopardized because the Tanzanian commercial banks have been vulnerable to financial distress due to the presence of various risks in operation. Substantial number of banks has failed, mainly because of the challenges of risk management of credit portfolio. It is important to the bankers to understand all risks embedded in loaning business and their potential impact on the institution. The following are the categories relate to a bank's lending function, that is credit risk, foreign exchange risk, political risk, interest rate risk and liquidity risk.

A researcher uses four different methods in collecting data which are documentation, personal interviews, questionnaire and observation and get all the necessary information from BBTs' annual reports, extraordinary meetings reports, journals, audited financial statements and intranet. Therefore, there are need of improving the credit risk control measures faster and implementing them for its sustainability and portfolio growth.

## TABLE OF CONTENTS

<b>CERTIFICATION</b> .....	<b>i</b>
<b>DECLARATION ANDCOPYRIGHT</b> .....	<b>ii</b>
<b>ACKNOWLEDGEMENTS</b> .....	<b>iii</b>
<b>DEDICATION</b> .....	<b>iv</b>
<b>LIST OF TABLES</b> .....	<b>xii</b>
<b>LIST OF FIGURES</b> .....	<b>xiii</b>
<b>ABBREVIATIONS AND ACRONYMS</b> .....	<b>v</b>
<b>ABSTRACT</b> .....	<b>vi</b>
<b>CHAPTER ONE</b> .....	<b>1</b>
<b>PROBLEM SETTING</b> .....	<b>1</b>
1.0 Introduction .....	1
1.1 Background to the Problem .....	1
1.1.1 Evolution of Risk management .....	3
1.2 Background information of the Research Setting .....	4
1.2.1 Barclays Vision .....	5
1.3 Statement of the Problem .....	5
1.4 Research Objectives .....	6
1.4.1 General Objective.....	6
1.4.2 Specific Objectives .....	6
1.5 Research Questions .....	6
1.5.1 General Question .....	6
1.6.2 Specific Questions .....	6
1.7 Significance of the study .....	7
1.8 Scope of the Study.....	7
1.9 Limitation of the Study.....	7
1.10 Delimitation of the Study .....	7
<b>CHAPTER TWO</b> .....	<b>8</b>
<b>LITERATURE REVIEW</b> .....	<b>8</b>
2.1 Introduction .....	8

2.2	Theoretical Literature Review .....	8
2.2.1	Theoretical definitions .....	8
2.2.2	Meaning of risk in different perspectives .....	8
2.2.3	Theories and concept .....	11
2.2.3.1	Theory of Performance .....	11
2.2.3.2	Rationale for a Theory of Performance .....	11
2.2.3.4	Modern Portfolio Theory: The Basics .....	12
2.2.3.5	Modern Portfolio Theory .....	12
2.2.3.6	Diversification .....	12
2.2.3.7	Types of Risk .....	12
2.2.3.8	Efficient Frontier .....	13
2.2.3.9	Investment Decisions .....	13
2.2.3.10	Theory of Constraint .....	13
2.2.3.11	Extreme Value Theory .....	14
2.3	Empirical Literature Review .....	17
2.3.1	Emerging Trends .....	17
2.3.2	Subjective Analysis in lending (5 C's) .....	19
2.4	Conceptual framework .....	23
<b>CHAPTER THREE .....</b>		<b>24</b>
<b>RESEARCH METHODOLOGY .....</b>		<b>24</b>
3.1	Introduction .....	24
3.2	Research Design .....	24
3.2.1	Area of study .....	25
3.3	Target population .....	25
3.4	Sampling .....	26
3.4.1	Sampling Procedure .....	26
3.4.2	Sample Size .....	26
3.5	Methods of Data Collection .....	27
3.5.1	Interview .....	27
3.5.2	Questionnaire .....	27
3.5.3	Observation .....	28

3.5.4	Documentation .....	28
3.6	Data Analysis techniques .....	28
3.6.1	Reliability .....	29
3.6.2	Validity .....	29
<b>CHAPTER FOUR.....</b>		<b>30</b>
<b>PRESENTATION OF FINDINGS, ANALYSIS AND DISCUSSION.....</b>		<b>30</b>
4.1	Introduction .....	30
4.2	Response Rate .....	30
4.3	Demographic Characteristics of Respondents.....	30
4.4	The BBT Financial Procedures and Loan Performance .....	32
4.4.1	BBT Credit Risk Unit.....	32
4.4.2	BBT's Credit Culture and Risk Profile .....	33
4.4.3	Analysis of Data from Questionnaires Feedback .....	34
4.5	What are the weaknesses of policy and financial procedures dealing with Credit risks?.....	34
4.5.1	Is there adherence to rules, polices and principles of credit risk management in BBT during credit appraisal? .....	34
4.3.3	Are the suggestions on credit risk management from customers implemented by BBT? .....	36
4.4.2	The implementation of the credit analysis process.....	40
4.4.3	The positive effects of the credit analysis and approval procedures to the customers and BBT .....	40
4.4.4	The implementation of the credit analysis process.....	41
4.4.5	The effects of the credit analysis and approval procedures in relation to services deliverance to the customers .....	42
4.4.6	BBT Policy on Credit Risk.....	43
4.4.6.1	BBT's Five Risk Classes on Credit Portfolio.....	43
4.4.6.2	Regulatory Classifications of Credit Risk Rating .....	45
4.4.7	BBT Loan Portfolio Strategic Planning, Growth and Profitability .....	48
4.5	What are the challenges that affect effective implementation of risk management process?.....	49

4.5.1	Are knowledgeable staffs in credit department incorporated in Bank's decisions and implementation? .....	50
4.5.2	The application of the determinants of credit risk management (5Cs) in BBT .....	50
4.5.3	The implementation of the suggestions on credit risk management from various stake holders by Tanzanian commercial Banks .....	51
4.5.4	BBT's Effective Credit Management System .....	52
4.5.5	The use of collection agents when the internal ways have failed is encouraged by BBT.....	54
4.5.6	The use of external agents instead of bank's staff to collect debts has been more effectively .....	55
4.5.7	The improvement of the weak points in recovering the bank's money .....	55
	Analysis of the Feedback from Customers.....	56
4.5.8	The use of collection agents when the internal ways have failed.....	56
4.5.9	The use of external agents instead of bank's staff to collect debts has been more effective.....	57
4.5.10	Unemployment of BBT's Customers .....	58
4.5.11	BBT Credit Risk Diversification .....	58
4.6	The analysis of general questions, part 2 (i.e. questions 6 to 10).....	59
<b>CHAPTER FIVE.....</b>		<b>65</b>
<b>SUMMARY, CONCLUSIONS AND RECOMMENDATIONS .....</b>		<b>65</b>
5.1	Summary of Findings .....	65
5.2	Conclusions .....	66
5.2.1	The BBT financial procedures and loan performance.....	66
5.2.2	The analysis of underwriting process, growth and profitability.....	66
5.2.3	BBT policy on credit risk. ....	66
5.2.4	BBT credit administration and recovering process .....	67
5.2	Recommendations .....	67
5.3.1	Familiarity with credit policy and risk profile of the bank.....	67
5.3.2	Improving the loan structure and pricing .....	67
5.3.3	Improving loan review process .....	68

5.3.4	Improving the strategic plans for risk management .....	68
5.3.5	Updating and reviewing credit risk ratings .....	69
5.3.6	Strengthening the Credit Risk Department.....	69
5.3.7	Improving communication among the staff and customers .....	69
5.3.8	Considerations for eliminating risks at BBT .....	70
5.3	Areas for Further Study .....	70
<b>REFERENCES .....</b>		<b>71</b>
<b>APPENDICES .....</b>		<b>75</b>
Appendix 1: Questionnaire to Barclays Staff.....		75
Appendix 2: Questionnaire to Barclays Customers .....		77

## LIST OF TABLES

Table 3. 1	Study Population .....	27
Table 4. 1	BBT's implementation of the rules, polices and principles .....	35
Table 4. 2	The effectiveness of credit risk management in BBT .....	36
Table 4. 3	The implementation of the customers' suggestions on credit risk.....	37
Table 4. 4	Summary of BBT retail credit loans in bucket wise .....	39
Table 4. 5	The implementation of credit analysis process by the BBT's staff .....	40
Table 4. 6	The implementation of the credit analysis process by Barclays' staff.....	42
Table 4. 7	The process of credit analysis as followed by BBT .....	42
Table 4. 8	BBT Performance, 2007 – 2013 in million Tshs .....	48
Table 4. 9	The knowledgeable staffs are involved in BBT's decision making.....	50
Table 4. 10	The determinants of credit risk management (5Cs) in BBT .....	51
Table 4. 11	The BBT's implementation of the stake holders' suggestions .....	52
Table 4. 12	The use of collection agents when the internal ways have failed .....	54
Table 4. 13	The effectiveness of the use of external collectors instead of internal .....	55
Table 4. 14	The improvement of the shortcoming in recoveries .....	56
Table 4. 15	The use of collection agents when the internal ways have failed .....	57
Table 4. 16	Assessment of the effectiveness of using external agents.....	58
Table 4. 17	The analysis of customers' general questions, Part 2 .....	59
Table 4. 18	Findings from questionnaires Vs the specific Research objectives .....	61
Table 4. 19	Credit risk rating from year 2008-2014 .....	63

## LIST OF FIGURES

Figure 4. 1	BBT's retail credit risk level against classes .....	45
Figure 4. 2	The chart which shows how customers rate BBT' services.....	60
Figure 4. 3	Feedback from respondents Vs the research objectives.....	62
Figure 4. 4	Trend analysis: Retail credit portfolio impairment level .....	64

## **CHAPTER ONE**

### **PROBLEM SETTING**

#### **1.0 Introduction**

This chapter presents a summary of the background to the problem, statement of the problem, objectives of the study and research questions that were investigated. It also includes the scope and significance of the study while keeping the focus into banking industry particularly commercial banks.

#### **1.1 Background to the Problem**

The growth in liquidity of credit markets and the active management of credit risk are among the most significant developments in commercial banking in the past 20 years. These developments hold the potential to permanently reduce the risk profile and improve the financial performance of commercial banks.

Credit portfolio management grew out of the need to improve the financial performance of the large corporate loan portfolios in commercial banks. It is paradoxical that these portfolios created the biggest problems for originators and investors in the marketplace. After all, large corporate loan portfolios typically are composed of loans, commitments, and other lending exposures to banks' most creditworthy customers. Lending is the backbone of commercial banking, so lending is what banks should do best. Yet these portfolios proved to be the source of recurring problems and the cause of failure for many commercial banks.

The source to these problems can mostly be grouped into three broad categories which include: unmeasured risk, misdirected incentives; and aversion to change.

Unmeasured risk: When credit managers assume credit risk, they know there will be defaults, but they generally assume the defaults won't occur in the positions they approve. This sense of denial exists because of the importance placed on personal judgment in the credit approval process. Statistics and modeling techniques can be combined with personal judgment to create a stronger credit decision, but that still doesn't eliminate the risk of default. The researcher does not know the future with

certainty, and defaults will happen. Ultimately, the management of credit risk requires an objective, scientific measure of credit risk, and such an objective measure is available only at the portfolio level.

**Misdirected incentives:** In the past, most banks compensated loan originators for the revenue streams they brought in, without proper regard for the associated risks. In credit environments, risks that were overlooked and allowed to accumulate came in many different forms, including single-name concentrations, sector concentrations, geographic concentrations, relaxed covenant protection, and less creditworthy obligors. Such risks remained largely unnoticed until there was a change in the market.

**Aversion to change:** The old tricks were rewarded in the past, and these rewards included position and reputation. Resistance to change is especially problematic for an industry that views itself as rock-solid and impenetrable. Thus, it is not surprising that most credit portfolio management units were created with the statement "Just fix it! Early attempts at credit portfolio management focused on influencing the loan approval process and selling loans. Loan originators considered these efforts a nuisance, and early practitioners frequently found themselves relegated to "geeky" research functions in their institutions (Bessis, 1998).

Credit risk arises whenever a borrower is expecting to use future cash flows to pay a current debt. The evaluation of credit risk is a regular and routine part of the everyday business process. The business of banking itself is mainly about borrowing from other sources with surplus and lending to individuals and institutions (Harvey, 1994). Above all, banks are financial intermediaries, similar to credit unions, insurance companies and other financial institutions selling financial services. The term financial intermediary simply means a business that interacts with two types of individuals and institutions in the economy (Peter, 1999). Deficit spending individuals and institutions, whose current expenditures for consumption and investment exceed their current receipts of income and who, therefore, need to raise funds externally through borrowing; and Surplus spending individuals and

institutions, whose current receipts of income exceeds their current expenditures on goods and services so they have surplus funds to save and invest. Therefore a lender should decide whether or not to advance loan to a particular prospective borrower, and if so how much, she/he necessary take account of the risks involved. Credit risk indeed, is one of the fundamental elements in the business of banking to success or failure of both lenders and borrowers. Banks perform the indispensable task of intermediating between these two groups offering convenient financial services to surplus-spending individuals and institutions in order attract funds and the loaning those funds to deficit spending individuals and institutions.

However as the bank carry out this primary and vital task in the economy together with other services, they take risk, they transform them and they embed them in their services. Additional to that (Carrio, 1996) insisted that, the practices, norms and techniques of banking have changed substantially in recent years with many institutions adopting more complex banking products designed to take risk in order to enhance income. These developments require that financial institutions adopt more logical and systematic method, of identifying, analyzing and mitigating risks associated with any activity, function or process in a way that will enable them take advantage of opportunities and minimize losses.

### **1.1.1 Evolution of Risk management**

The field of risk management emerged in the mid-1970s, evolving from the older field of insurance management. The term risk management was adopted because the new field has a much wider focus than simply insurance management. Risk management includes activities and responsibilities out-side of the general insurance domain, although insurance is an important part of it and insurance agents often serve as risk managers. Insurance management focused on protecting companies from natural disasters and basic kinds of exposures, such as fire, theft, and employee injuries, whereas risk management focuses on these kinds of risks as well as other kinds of costly losses, including those stemming from product liability, employment practices, environmental degradation, accounting compliance, offshore outsourcing, currency fluctuations, and electronic commerce. In the 1980s and 1990s, risk

management grew into vital part of company planning and strategy and risk management became integrated with more and more company functions as the field evolved. As the role of risk management has increased to encompass large-scale, banking industry, the field has become known as enterprise risk management.

Furthermore, companies face a number of risks that stem primarily from the nature of doing business. In *Beyond Value at Risk*, Kevin Dowd sums up these different types of risks companies face by placing them in five general categories:

- Business risks are those associated with an organization's particular market or industry;
- Market risks are those associated with changes in market conditions, such as fluctuations in prices, interest rates, and exchange rates;
- Credit risks are those associated with the potential for not receiving payments owed by debtors;
- Operational risks are those associated with internal system failures because of mechanical problems (e.g., machines malfunctioning) or human errors (e.g., poor allocation of resources); and
- Legal risks are those associated with the possibility of other parties not meeting their contractual obligations (Kevin, D. 1998).

This study was assessing the challenges of risk management of credit portfolio in commercial banks, and come up with necessary information, that could possibly help on overcoming those risks. I was assessing the performance of loan portfolio of Barclays Bank Tanzania (BBT) as the case study in credit risk management approach.

## **1.2 Background information of the Research Setting**

Barclays Bank Tanzania, part of the global Barclays Group, is one of the leading international commercial banks in Tanzania offering retail banking and corporate banking, merchant cards, small and medium term financing, wealth management products and services (BBT 2010). Employing more than 750 people, Barclays Bank Tanzania serves more than 92,750 customers and clients across the country through a

network of more than 46 ATMs and 24 branches and 8 sales centers. Barclays Bank Tanzania continues to expand its retail market since it started in 2002 and appeal to a new generation of customers, and for the past two years has been shoring up preparations to serve the variant needs of the marketplace. This has involved extending some of its product lines, introducing new product to make its services more attractive to a broader range of customers. This has included developing a concise branch network to bring banking closer to the people as part of Barclays Bank Tanzania's 'Launch Campaign Strategy' regarding new branch openings.

### **1.2.1 Barclays Vision**

The vision of Barclays Bank is to be the leading bank in the country. The move by Barclays is in line with its vision of being a leading contributor to this country's future. The intention is to make it easier for customers to obtain its services and make banking easily accessible to all (BBT 2010).

### **1.3 Statement of the Problem**

While financial institutions have faced challenges over the years for a multitude of reasons, the major cause of serious banking challenges or problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a commercial bank's counterparties.

In performing lending business, the lending banks are always keen on the rules, regulations, principles and procedures that should be followed before the loan is offered (Williams, 1998). Despite the development role of credit program and availability of principles, rules, regulations and procedures, the commercial banks in Tanzania and other African banks are facing different challenges or problems in their performance, and common to all is the problem of default in the loan repayment (Harvey, 1993). Moreover the Tanzanians' culture seems not to be good in repaying back the loan (interest plus principal). So without proper credit management the commercial banks in Tanzania will find themselves in serious losses.

Due to the challenges stated above, it shows that those rules, regulations, principles and procedures have failed to clear the challenges facing management of credit portfolio in commercial banks. This study is therefore geared towards assessing the challenges facing managers of commercial banks in undertaking risk management of their credit portfolio.

## **1.4 Research Objectives**

### **1.4.1 General Objective**

The main objective of this study was to assess the performance of credit portfolio and risk management at Barclays Bank.

### **1.4.2 Specific Objectives**

The specific objectives of this study were as follows:-

- i. To assess the weaknesses of policy and financial procedures dealing with credit risk.
- ii. To analyze the performance of BBT's loan portfolio in terms of underwriting process, growth and profitability
- iii. To identify the challenges that affects effective implementation of risk management process.

## **1.5 Research Questions**

### **1.5.1 General Question**

The general research question was; what is the performance of credit portfolio and risk management that Barclays bank is facing?

### **1.6.2 Specific Questions**

In the light of the research problem the specific research questions that were used to guide the assessment are as follows:

- i. What are the weaknesses of policy and financial procedures dealing with credit?
- ii. What is the performance of BBT's loan portfolio in terms of underwriting process, growth and profitability?

- iii. What are the challenges that affect effective implementation of risk management process?

### **1.7 Significance of the study**

Upon successful completion of this study, it was expected to be significant in the following ways to different stakeholders:

The findings may be relevant to the management of commercial banks particularly by exposing the challenges which impede effective risk management of loan portfolio. In this way, these Banks may come up with appropriate measures to overcome the challenges. Besides that, the findings may enable the researcher to integrate theoretical knowledge obtained in the class to the practical situations in the risk management areas.

Moreover, the study will enable the researcher fulfill partial requirement for an award of Master's Degree in Accounting and Finance.

### **1.8 Scope of the Study**

The scope of this study was to assess the challenges of risk management of credit portfolio in commercial banks, Barclays Bank Tanzania Ltd being a case study. It includes recovery manager, recovery officers, loan/credit officers and credit manager because these are the one who are dealing with loan disbursement and collection.

### **1.9 Limitation of the Study**

In conducting this study, the researcher comes across the following limitation;

Time constraints: since the period provided is somehow short, to gather sufficient and relevant information.

### **1.10 Delimitation of the Study**

In conducting this study, the researcher comes across the above limitation, therefore the researcher was collected his data from three departments only i.e. Credit, recovery and customer care.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter presents meaning of key terms and concepts used in this study and visit a number of previous studies that are related to this study. The aim was to visit a number of studies to see what had already been undertaken related to the challenges of risk management of credit portfolio in commercial Banks.

#### **2.2 Theoretical Literature Review**

This part specifically present meaning of concepts, variables and key terms involved in the study as they have been conceptualized by different authors/scholars in different contexts. The researcher went through different literatures and publications and come up with the following information:

##### **2.2.1 Theoretical definitions**

Lending in its most general sense is the temporary giving of money or property to another person with the expectation that it will be repaid. In a business and financial context, lending includes many different types of commercial loans (Comptroller, 2006). Lending is to provide (money) temporary on condition that the amount borrowed will be returned, usually with an interest fee.

##### **2.2.2 Meaning of risk in different perspectives**

**General:** Probability or threat of a damage, injury, liability, loss, or other negative occurrence, caused by external or internal vulnerabilities, and which may be neutralized through pre-mediated action.

**Finance:** Probability that an actual return on an investment will be lower than the expected return. Financial risk is divided into the following general categories:

**Basis risk:** Changes in interest rates will cause interest-bearing liabilities (deposits) to reprice at a rate higher than that of the interest-bearing assets (loans).

**Capital risk:** Losses from un-recovered loans will affect the financial institution's capital base and may necessitate floating of a new stock (share) issue.

**Country risk:** Economic and political changes in a foreign country will affect loan-repayments from debtors.

**Credit risk:** This refers to the risk that a borrower will default on any type of debt by failing to make required payments. This type of risk basically entails that of the lender and includes lost principal and interest, disruption to cash flows, and increased collection costs. The loss may be complete or partial and can arise in a number of circumstances.

**Default risk:** Borrowers will not be able to repay principal and interest as arranged (also called credit risk).

**Delivery risk:** Buyer or seller of a financial instrument or foreign currency will not be able to meet associated delivery obligations on their maturity.

**Economic risk:** Changes in the state of economy will impair the debtors' ability to pay or the potential borrower's ability to borrow.

**Exchange rate risk:** Appreciation or depreciation of a currency will result in a loss or a naked-position.

**Foreign exchange risk:** This can be defined as a financial risk that exists when a financial transaction is denominated in a currency other than that of the base currency of the company. This also takes place when the foreign subsidiary of a firm maintains financial statements in a currency other than the reporting currency of the consolidated entity.

**Interest rate risk:** Decline in net interest income will result from changes in relationship between interest income and interest expense.

**Liquidity:** In terms of the accounting world, liquidity (or accounting liquidity) is a degree of the capability of a borrower to pay their debts as and when they fall due. It is typically conveyed as a ratio or a percentage of current liabilities. Liquidity, in short, can be said to be the ability to pay short-term obligations.

**Liquidity risk:** There will not be enough cash and/or cash-equivalents to meet the needs of depositors and borrowers. In financial terms, it entails a risk that a given security or asset cannot be traded quickly enough in the market to prevent a loss (or make the required profit).

**Operations risk:** Failure of data processing equipment will prevent the bank from maintaining its critical operations to the customers' satisfaction.

**Payment system risk:** Payment system of a major bank will malfunction and will hinder its payments.

**Political risk:** Political changes in a debtor's country will jeopardize debt-service payments.

**Refinancing risk:** It will not be possible to refinance maturing liabilities (deposits) when they fall due, at economic cost and terms.

**Reinvestment risk:** It will not be possible to reinvest interest-earning assets (loans) at current market rates.

**Risk management:** In wider terms, this entails the identification, calculation, and arrangement of risks followed by harmonized and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events or to maximize the realization of opportunities.

**Settlement risk:** Failure of a major bank will result in a chain-reaction reducing other banks' ability to honour payment commitments.

**Sovereign risk:** Local or foreign debtor-government will refuse to honor its debt obligations on their due date.

**Underwriting risk:** New issue of securities underwritten by the institution will not be sold or its market price will drop.

**Insurance:** Situation where the probability distribution of a variable (such as burning down of a building) is known but its mode of occurrence or actual value (whether the fire will occur at a particular property) is not. A risk is not an uncertainty (where neither the probability nor the mode of the occurrence is known), a peril (cause of loss), or a hazard (agent or condition that makes the occurrence of a peril more likely or more severe).

**Securities trading:** Quantifiable likelihood (probability) of a loss or stagnation in value. Trading risk is divided into two general categories

**Systemic risk:** Affects all securities in the same class and is linked to the overall capital-market system and which, therefore, cannot be eliminated by diversification. Measured by beta coefficient, it is also called market risk or (erroneously) systematic risk.

**Non-systemic risk:** Any risk that is not market-related or is not systemic. Also called non-market risk, extra-market risk, (mistakenly) non-systematic risk, or un-systemic risk.

**Business Risk** – Risk of income that is caused by the business itself (firm’s industry). In other words, variability of sales due to its products, customers. For example, over the business cycle, income from fashion business is more volatile than income from foodstuff business (Joel B, 2001).

### **2.2.3 Theories and concept**

#### **2.2.3.1 Theory of Performance**

The Theory of Performance (ToP) develops and relates six foundational concepts (italicized) to form a framework that can be used to explain performance as well as performance improvements. To *perform* is to produce valued results. A *performer* can be an individual or a group of people engaging in a collaborative effort. Developing performance is a journey, and *level of performance* describes location in the journey. Current level of performance depends holistically on 6 components: context, level of knowledge, levels of skills, level of identity, personal factors, and fixed factors. Three axioms are proposed for effective performance improvements. These involve a performer’s mindset, immersion in an enriching environment, and engagement in reflective practice.

#### **2.2.3.2 Rationale for a Theory of Performance**

Humans are capable of extraordinary accomplishments. On September 12<sup>th</sup>, 1962, JFK challenged the country to “go to the moon in this decade and do the other things, not because they are easy, but because they are hard, because that goal will serve to organize and measure the best of our energies and skills...” Wonderful accomplishments also occur in day-to-day practice in commercial banks because people have been given targets to meet per individual as well as a team. A manager inspires subordinates to follow their dreams in order to be more creative in their work. A researcher continually asks the quintessential questions that lead to revolutions in thinking. Management inspires an entire bank to collaborate and attain wonderful outcomes.

#### **2.2.3.4 Modern Portfolio Theory: The Basics**

Many experienced investor's turn to **modern portfolio theory** when making investment decisions for their money. Modern portfolio theory is one of the most widely used theories in the investment world. Here are the basics of modern portfolio theory and how it applies to the decisions that an investor should make.

#### **2.2.3.5 Modern Portfolio Theory**

Modern portfolio theory has been around since 1952 when it was published in the *Journal of Finance* as "Portfolio Selection." Harry Markowitz invented this theory. He was one of the leading economists in the United States during his career.

#### **2.2.3.6 Diversification**

Markowitz was partly responsible for coming up with the idea of diversification in a portfolio. He theorized that it was not enough to simply look at the risk versus return of a single stock. You need to combine multiple stocks from many different sectors of the market. He noted that when an investor utilized this strategy, they could effectively lower the amount of risk that they are taking on and increase the returns at the same time. Each security that you invest in has a standard deviation which represents the possibility of it deviating from the mean. This is how the theory summarizes risk. By combining many different securities into the portfolio, you can effectively lower the standard deviation and protect your funds better. Therefore, as an investor, it is more important to be good at choosing the right combination of stocks rather than picking individual stocks.

#### **2.2.3.7 Types of Risk**

According to modern portfolio theory, there are two different types of risks that you should be aware of when investing in stocks. You have systematic and unsystematic risk. Systematic risk represents risk that you cannot control under any circumstances. This type of risk represents outside influences on your investment. For example, if inflation rate has changed in a country, which means all the loans that were already issued to customers will have impact in the banks' books. There is no way that you

could control this. Other factors that you cannot control include interest rate changes and recessions.

Unsystematic risk is a type of risk that you can actually do something about. With this type of risk, you can effectively eliminate it by purchasing many different stocks, or for loan lenders they can just introduce a tight control on how to reduce defaulters in commercial banks etc. The more stocks that you get in your portfolio, the lower this risk it becomes. This value is represented by the amount of change in a stock that has nothing to do with the movements of the market as a whole.

#### **2.2.3.8 Efficient Frontier**

Another important piece of modern portfolio theory is referred to as efficient frontier. This concept deals with the relation to risk and return of a particular portfolio. With every particular level of return, there are many different portfolio combinations that could get you there. However, you want to choose the one that has the lowest risk. When you plot this on a graph, you will be able to see where the efficient frontier line is for a particular group of portfolios. Smart investors/lenders will always choose a portfolio that has the lowest risk.

#### **2.2.3.9 Investment Decisions**

You should always strive to look at each investment decision in relation to your portfolio as a whole. Do not disburse loans just to disburse loans. You need to disburse them based on how they complement the portfolio that you already have in place. All pre- disbursement conditions must be fulfilled and proper documentation is done as per procedures.

#### **2.2.3.10 Theory of Constraint**

One of the most successful of these theories is Eli Goldratt's Theory of Constraints. Goldratt shows that the performance of a whole system/process is dictated by the performance of the slowest individual component of that system/department. It focuses its efforts, therefore, on identifying and alleviating that constrained resource or the bottleneck in the production process because the performance of the system is optimized whenever the performance of the constrained

resource is optimized. Every system must have at least one such constraint because, in the absence of such, a profit-making organization would make infinite profits. Constraints are seen as positive as their existence represents an opportunity for improvement. Consequently, a continual improvement in system constraints will result in a continual improvement in organizational results.

The Theory of Constraints has found broad support from service businesses including banks. However, as with all such theories its application has been limited to opportunities to increase the efficiency of the service delivery processes. A bank might, for example, use it to reduce the time it takes to process a loan application. However, even more value could be created if banks were to use it to improve their products too in this case the loan itself.

#### **2.2.3.11 Extreme Value Theory**

Extreme value theory is a branch of statistics dealing with the extreme deviations from the median of probability distributions. The general theory sets out to assess the type of probability distributions generated by processes. Extreme value theory is important for assessing risk for highly unusual events, such as the amount of large insurance losses, equity risks, day to day market risks etc.

Below are the research questions with some clarity;

##### **i. The Weaknesses Of Policy And Financial Procedures Dealing With Credit**

The credit culture and risk profile of the bank has led to a successful credit risk management. The staff members throughout the bank understand the bank's credit culture and risk profile. A bank's credit culture is the sum of its credit values, beliefs, and behaviours. The credit culture exerts a strong influence on a bank's credit risk management. Values and behaviours that are rewarded become the standards and will take precedence over written policies and procedures.

A commercial bank's risk profile describes the various levels and types of risk in the credits. The profile evolves from the credit culture, strategic planning, and the day-

to-day activities of making and collecting loans. Credit culture varies from bank to bank. Some of them approach credit very conservatively, lending only to financially strong, well-established borrowers. Growth-oriented banks may approach lending more aggressively, lending to borrowers who pose a higher repayment risk. These cultural differences are grounded in bank's objectives for asset quality, growth, and earnings. Emphasizing one of these objectives over another does not itself preclude achieving satisfactory performance in all three.

**ii. The Performance Of BBT's Loan Portfolio In Terms Of Underwriting Process, Growth And Profitability**

Banking is both a risk taking and profit making business, and bank loan portfolio should return profits commensurate with their risk. Although this concept is intellectually sound and almost universally accepted by bankers and examiners alike, banks have difficulty in implementing it. Over the years, volatility in banks, earnings usually have been linked to credit management. While there are many contributing factors including market forces, anxiety for income, poor risk measurement, and weak risk management, a common underlying factor has been the banks' tendency to underestimate or under-price credit risk.

The assessment of credit pricing decision of BBT revealed that some of the personal loans are overpriced. For example, the interest of 20% per annum for most of the personal loans like Barclay loans and scheme loans is too high which result to some of the customers to run away from their obligation of repaying back. Generally, the price charged for an individual credit should cover funding costs, overhead or administrative expenses, the required profit margin and risk. Apart from these, other component of credit risk is the pricing dilemma. The methods used in pricing depend much on the nature of the organisation where customers come from and the background on repayment rate, risk rate and nature of the business. Some of the development measures in credit performance and risk measurement should be taken for further improvement of the credit pricing more precisely, though these requires accurate risk measurement at the beginning of the loan circle. The important thing is

that, BBT should continue developing systems to measure and price risk credits and portfolio accordingly (BBT 2012).

### **iii. The Challenges That Affect Effective Implementation Of Risk Management Process**

This is a third research question which needs clear elaborations to be used to improve BBT's risk management process as a whole. Hereunder are some of the challenges obtained from the observations and others from respondents (customers and BBT staffs)

- Lack of credit reference bureau (or institutions for credit ratings) in Tanzanians commercial banks
- Low sharing of information between banks - someone who defaulted at NMB, NBC can still get a loan at BBT and other commercial banks in Tanzania because there is no common database for all commercial banks in the country.
- Most of collaterals are informal – that means it is difficult to realize those securities when a customer default.
- Purpose of the loan – most of our customers have no clear focus or target on how they could spend their loan, so they diverge the funds into something that was not planned and that is not sustainable. They take a loan only because they qualify.
- Lack of professional management team especially those at credit risk and collection departments.
- Lack of knowledge regarding risk management and credit/finance related
- Transparency – whereby borrowers do not disclose all information or right information and are not honest about their businesses and practices.
- Lack of risk mitigation tools and customers bad attitude towards repaying their loans.

## **2.3 Empirical Literature Review**

In this section, the researcher tried to look at how other researchers described the challenges facing risk management of credit portfolio in commercial banks and the analysis in lending processes.

### **2.3.1 Emerging Trends**

In an empirical study conducted in the UK, Felix and Claudine (2008) examined the link between bank performance and credit risk management. From the findings, could be concluded that return on equity (ROE) and return on assets (ROA) both calculating profitability were inversely related to the ratio of non-performing loan to total loan of financial institutions thereby leading to a weakening in profitability.

In a similar study, Ahmad and Ariff (2007) looked at the key elements of credit risk of commercial banks on emerging economy banking systems compared with the developed economies. Findings from the study found that regulation is significant for banking systems that offer multi-products and services; management quality is critical in the cases of loan-dominant banks in emerging economies. The study further showed that an upsurge in loan loss provision is also considered to be a significant determinant of potential credit risk. The study also highlighted that credit risk in emerging economy banks is higher than that in developed economies.

Not only has the banking sector changed in the United Kingdom, but empirical studies show that the services in banking industry have changed dramatically in recent years across the globe resulting in the diversification of bank products and portfolio. This diversification has put new challenges to risk management and efficiency of banks. The sophistication of financial technology coupled with deregulation and liberalization has made the risk profiles of financial institutions even more complex (Cebenoyan and Strahan, 2004, Becher and Cambell II, 2005).

Empirical literature conducted years ago shows that credit risk is related to the traditional bank lending activities, while it also comes from holding bonds and other securities. For ample, according to Basel (1999a)'s empirical literature, many banks,

loans are the largest and most obvious source of credit risk; nevertheless, during the activities of a bank, which include in the banking book as well as in the trading book, and both on and off the balance sheet, there are also other sources of credit risk. Various financial instruments including acceptances, interbank transactions, financial futures, guarantees, etc increase banks' credit risk. Therefore, it is indispensable to identify all the credit exposures—the possible sources of credit risk for most banks, which can also serve as a starting point for the following parts of this work.

In terms of empirical results from previous studies, Bourke (1989) reports the effect of credit risk on productivity appears obviously negative. This study may be clarified by taking into account the fact that the more financial institutions are exposed to high-risk loans, the higher is the accumulation of unpaid loans, implying that these loan losses have produced lower returns to many commercial banks (Miller and Noulas, 1997).

To gain a better understanding on the nature of credit risk, it is necessary to introduce the types of credit risk involved in financial activities before any further discussion. Concerning the categorizing of credit risk, different authors have expressed various criteria. For example, in an empirical study by Hennie (2003), it points out in his book that the three main types of credit risk are consumer risk, corporate risk and sovereign or country risk, while Culp and Neves (1998) consider realized default risk and resale risk to be the two types of credit risk. What is adopted here is part of the views from Heffernan's study (2005), who defines six types of credit risk, including default risk, counterparty pre-settlement risk, counterparty settlement risk, legal risk, country or sovereign risk and concentration risk.

However, since legal risk is more likely to be considered as independent or belonging to operational risk nowadays (HSBC 2006 annual report, Casu, Girardone and Molyneux 2006, etc) and concentration risk, together with adverse selection as well as moral hazard, is more reasonably to be thought of as an important issue in managing credit risk rather than a type of the risk itself (see Duffie and Singleton

2003), in the following illustration, only the rest four kinds of credit risk mentioned by Horcher (2005) will be touched upon.

Hennie (2003) states that despite innovations in the financial services sector over the years, credit risk is still the major single cause of bank failures, for the reason that “more than 80 percent of a bank’s balance sheet generally relates to this aspect of risk management”. The consultative paper issued by Basel (1999a) also points out that the major cause of serious banking problems continues to be directly due to the loose credit standards for borrowers and counterparties, poor portfolio risk management and so on. All such evidence proves the extremely vital role credit risk management plays in the whole banking risk management approach as well as the sustainable success of the organization. In this section, the goal and principles of banking credit risk management will be summarized briefly, which together with the above part on the identification of the existing credit risk in banking activities, will provide a basic framework for the understanding and discussion of banks’ credit risk management practices.

### **2.3.2 Subjective Analysis in lending (5 C’s)**

This is the analysis, which ascertains whether the borrower is worth to be granted the loan or not (Joel, 2001). Commercial banks use information on various borrowers’ characteristics such as borrower Character (reputation), Capital (leverage), Capacity (ability to service the loan to maturity), Collateral (amount, quality, and liquidity of the asset) and Condition (economical and environmental forces). This system also called “expert system” and is used to assess the credit risk on corporate loans (Ansell, 2003). The credit manager(s) should consider the five C’s of credit evaluation as follows:

#### **i. Character**

A manager has to do with the probability that a customer will honor the obligations by looking at the history and, or his/her general behavior in loan repayment. This is important factor because every credit transaction implies a promise to pay. The character is the most important issue in a credit evaluation.

**ii. Capital**

This factor is measured by the general financial position of the firm as indicated by a financial ratio analysis with special emphasis on the tangible net worth of the company.

**iii. Capacity**

This describes the ability of customer to repay the principal plus the interest on time. It is gauged by the customer's past business performance record, supplemented by physical observation of the plant or store and business method.

**iv. Collateral**

This factor is represented by assets offered by the customer as a pledged for security of the credit extended.

**v. Conditions**

This factor has to do with the impact of general economic trends on the firm or special developments in certain areas of the economy that may affect the customer's ability to meet the obligation.

The loan documentation refers broadly to the documents needed to legally enforce the loan agreement and properly analyze the borrower's financial capacity. When a document is missing, stale, or improperly executed, it becomes an exception. Common loan documents are promissory notes, note guarantees, financial statements, collateral agreement and appraisals. The promissory note, guarantee, and financial statement must be properly prepared and signed; the financial statement must be received and analyzed in a timely manner by the bank; and the collateral agreement must be recorded in the appropriate jurisdiction. In most banks, loan administration is the control point for loan documentation. A commercial bank should systematically identify document exceptions, initiate timely resolution, and ensure that documentation remains current and valid throughout the credit period. The effectiveness of this control function should be reviewed by audit and loan review.

In a study conducted in Tanzania (Kaaya et al) Conclusively it has been witnessed that the increase in credit risk tends to lower firm performance, both indicators have

produced the negative coefficients which tends to lower profit level. Credit risk is not a bad situation as it is related to bank return, from empirical theory it has been stated that the higher the risk the higher the bank return due to the bank ability to increase portfolio, but the bank need to balance and foresee the return.

Further Chijoriga (1997) suggested that the assessment of borrowers should be carried by employing of qualitative as well as quantitative techniques. One major challenge of using qualitative models is their subjective nature. However, borrowers attributes assessed through qualitative models can be assigned numbers with the sum of the values compared to a threshold. This technique is termed as “credit scoring” (Heffernan, 1996; Uyemura and Deventer, 1993).

According to the Tanzania Risk Management Guidelines for Banks and Financial Institutions (2010), despite the fact that banks assume risks in order to realize returns on their investments. They (banks) are called upon to take into consideration the fact that credits have the potential to wipe out expected returns and may result into losses to the institutions. These losses could be either expected or unexpected. Expected losses are those that an institution knows with reasonable certainty will occur (e.g. the expected default rate of loan portfolio) and are typically reserved for in some manner. Unexpected losses are those associated with unforeseen events (e.g. losses due to a sudden downturn in economy, falling interest rates, natural disasters, or human action such as terrorism). Institutions rely on their capital as a buffer to absorb such losses.

According to Kileo (2012) credit risk management Risk Management is not a new concept in the banking business. It does goes up to the extent of risks taken by banks. Even in Tanzania, due to pressure from various stakeholders such as regulators, shareholders, depositors, the need for a well-defined risk management framework cannot be overemphasized.

In another empirical study by Chijoriga (1997), it was recommended that Tanzanian banks need to maintain substantial amount of capital reserve to absorb credit risk in

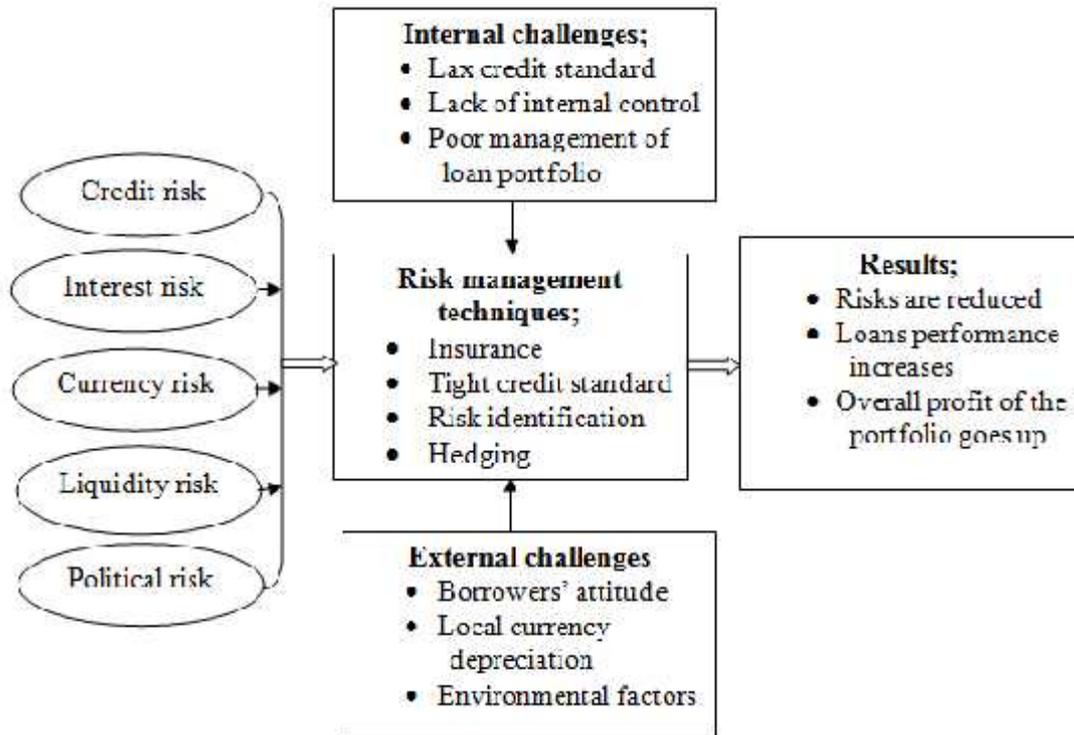
event of failure, moreover the bank need to enhance lending criteria, portfolio grading and credit mitigation techniques to reduce chance of default. Meanwhile the adoption of sound management practices and corporate governance will reduce credit risk.

Banks and Non-Bank Financial Institutions (NBFIs) have, since the mid-1980s, gained a significant share of banking and financial markets in the world, particularly in African countries. The commercial banks provided important benefits to the economy, and facilitated the objectives of financial liberalization, by boosting competition in banking markets, stimulating improvements in services to customers and expanding access to credit, especially to domestic small- and medium-scale businesses (Kariuki, 2000).

Some degree of structural weakness may be found in virtually any aspect of a loan arrangement or type of loan, and the presence of one or more need not be indicative of an overall credit weakness deserving criticism. Instead, the examiner must evaluate the relative important of such factors in the context of the borrowers overall financial strength, the condition of the borrower's industry or market, and the borrower's total relationship with the bank (Peter, 2007). The most prevalent structural weaknesses include; speculative purpose, none existent, or weak covenants, in adequate debt service coverage, in adequate financial analysis and in sufficient collateral support. Tanzania researchers have touched few areas on the scope of this research compared with abroad researchers who touches almost all the areas.

## 2.4 Conceptual framework

In this part, the researcher is linking the possible cause of the research problem and what other researchers have done in relation to this problem, thereafter the researcher outlined the possible outcome derived from different sources of challenges.



Source: Research field data, 2014.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter specifically gives the picture on how data was collected, analyzed and combined in relation to the objective of the study. The chapter provides information on the methodology and procedures in data collection, the population sample and sampling techniques, data collection and research instruments.

#### **3.2 Research Design**

Research design implies the strategy adopted in planning, selecting participants, area of study, and how data is treated to fulfill the research objectives (Oborn, 2011). It is therefore a general plan of the study. Research designs range from experimental, semi-experimental, to non-experimental. The choice of research design depends on the aim and nature of the problem that has to be studied. As it is explained by Kothari (1985), the most relevant design for studies aiming at getting detailed insights is case study design.

This study adopted a case study research design. The aim of the study is to examine the performance of credit portfolio and risk management at Barclays Bank Tanzania Limited. Therefore, to have a detailed analysis of mechanisms and factors governing credit portfolio and risk management in Tanzania, the case study design is the most useful compared to surveys and other probability studies. The study shall use a single case of Barclays Bank where within case analysis shall be used. According to Eisenhardt (1989), case studies are analyses of persons, events, decisions, periods, projects, policies, institutions, or other systems that are studied holistically by one or more methods.

The study employs a descriptive design after the problem being clearly defined. In this case, descriptive studies were used because they are usually the best methods for gathering information that will prove relationships and describe the world as it exists. These types of studies are often done before an experiment to know what specific

things to manipulate and include in an experiment. Bickman and Rog (1998) suggest that descriptive studies can answer questions such as “what is” or “what was.” Experiments can typically answer “why” or “how.”

### **3.2.1 Area of study**

The main area where the study takes place is Dar es Salaam region, specifically at Head office located at Ohio Street. This is because BBT has wide network in terms of branches therefore it enables the availability of detailed data of credit operations. Several credit risk measures and trend analysis were used in assessing the challenges facing risk management of credit portfolio. The researcher also reviewed the policies and procedures on how the loans are processed and managed.

### **3.3 Target population**

A population in the context of research methodology is defined as a group of individuals units, objects, or items from which samples are taken for the purpose of measurement (Chambers, et al (2003)).The theoretical population for this study is the banks.

The targeted population was depending on the number of employees working on those particular areas or respective departments where the study was to cover, especially those working in the credit, recovery and customer care departments. It was also includes the top management who are part of credit approving committee. The employees from these departments are well knowledgeable in credit overall process (from application to collection).

This study was conducted at Barclays Bank headquarters along Ohio Street Tanzania and two branches in the outskirts of Dar es Salaam, within Kinodoni, Ilala and Temeke districts in Dar es Salaam; It involved all staff who deal with credit disbursement and credit department of the headquarters, SMEs department and the staff of these branches who handles credit issues. In total, 80 respondents were interviewed, at both the headquarters and these branches, within Dar es Salaam region.

### **3.4 Sampling**

The study applied nonprobability sampling. This is more accurate because the study aims at targeting a specific group, in case the BBT clients and staff; therefore the answers were almost similar to what the rest of the clients and staff in other banks generally usually go through.

Non-probability sampling was used because the procedures used to select units for inclusion in a sample are much easier, quicker and cheaper when compared with probability sampling.

In this case, only 50 respondents that composed of both clients and staff bank were selected. During the interview process, the respondents were easy to get, especially bank clients, as those clients that were presents during the day of conducting the interview were interviewed. As for the staff, the researcher was able to choose only those staffs that were deemed informative, experienced and knowledgeable about the study subject; hence it was easier for the researcher to select few staffs who meet the requirement of the study.

#### **3.4.1 Sampling Procedure**

The study involved few staff and clients of Barclays Bank Tanzania. Due to time and financial constraints, a small but representative sample was used, which included a total of 50 respondents, with 25 clients for Barclays Bank Tanzania, while 25 of the respondents were the staff from the credit department who specifically deal with SMEs, drawn from the head office of Barclays along Ohio street, and others from the rest of the two branches found in Temeke, Ilala and Kinondoni districts within Dar es Salaam. All these respondents were selected randomly. The researcher believes that this sample is small enough to be studied and representative of the whole population.

#### **3.4.2 Sample Size**

The sample size of this study was the number of BBTs' staffs who are responsible for credit appraisal, analysis, approval, control and collection or recovery. A sample

size of 50 staffs was selected. Categorically, the selection will including; one Director, two senior managers, five managers and 42 officers.

**Table 3.1 Study Population**

Business Unit		Population
Ohio Street Branch	SMEs clients	6
	Staff	10
Kariakoo Branch 1-Uhuru Street, SMEs department	Staff	8
	Clients	5
Buguruni Branch-Credit department	Staff	11
	Clients	10
Total		50

### 3.5 Methods of Data Collection

Both primary and secondary data were collected in order to support the findings of this study. Primary data are those collected for the first time while secondary data are those already been collected and analyzed, which was used in obtaining necessary information which assisted the researcher in preparation of the report.

Methods employed in data collection were:-

#### 3.5.1 Interview

This involves presentation of oral-verbal stimuli and reply in terms of oral-verbal responses. It involves the Researcher asking a set of questions to the respondent(s). The set of question could be rigidly, pre-set or unstructured.

#### 3.5.2 Questionnaire

This includes a schedule of questions in which the respondents fill in answers. It was both closes ended and open ended, clear and untentious. Close ended questionnaire will be prepared in form of multiple choices where respondents were asked to

encircle or put “v” or to fill in appropriate letter. While open ended, the respondents were required to fill in the empty space by giving their opinion.

### **3.5.3 Observation**

Through this method, the Researcher was looking at a processor procedure being performed by the employees. It involves sight or visual data gathering. For example the researcher was observing how and where a transaction is recorded and processed in various books of accounts. The researcher uses both participatory observations where he was required to participate in the activities being observed and non-participatory observation where the researcher does not participate in-group activities.

### **3.5.4 Documentation**

This technique refers to acquisition of data through various documents. Such documents include internal audit reports, Management account reports and credit manuals, past research report, magazines, newspapers and published book. Moreover, the findings were based on the data provided. Therefore conclusion was made on the facts.

## **3.6 Data Analysis techniques**

The data were carefully organized and presented so as to make them to meet the objectives of the study in terms of drawing up the study’s conclusions and recommendations. The research involved both qualitative and quantitative data analysis techniques which involved drawing and interpreting tables, graphs, bar charts and percentages. In quantitative research, the information obtained from the participants is expressed in numerical form. Studies in which we record the numbers of item recalled, reaction times, or the numbers of aggressive acts are all examples of quantitative research. In qualitative research, on the other hand, the information obtained from participants is not expressed in numerical form. The emphasis is on the stated expression of the participants and on the stated meanings they attach to themselves, to other people, and to their environment. Those carrying out qualitative

research sometimes make use of direct computer program like Excel and Minitab were used in analyzing data.

### **3.6.1 Reliability**

According to (Saunders et al., 2000), reliability refers to the degree to which data collection method(s) yield consistent findings, similar observations would be made or conclusions reached by other researchers or there is transparency in how sense was made from the raw data. In this study, I was cross-checking the answers from respondents and observations made during the study and realize that the findings are consistent and reliable to the great extent.

### **3.6.2 Validity**

Validity defined as the extent to which data collection method or methods accurately measure what they were intent to measure (Saunders et al., 2000). In this study I want to fulfill the research questions requirements, so validity was paid/given more attention and I can conclude that the data collected using different methods can yield good results due to their validity.

## **CHAPTER FOUR**

### **PRESENTATION OF FINDINGS, ANALYSIS AND DISCUSSION**

#### **4.1 Introduction**

In this chapter primary and secondary data have been analyzed and presented from both questionnaires and documentaries like the credit operations manual, audited financial reports and annual general meeting reports. The specific objectives of the study have been discussed and presented in this chapter too (i.e. assessment of challenges of risk management of credit portfolio in commercial banks), financial procedures and loan performance, analysis of underwriting process, growth and profitability, the policy on credit risk and the credit administration and recovering process of BBT. The analysis and discussion will help the study to come up with relevant recommendations for facing the challenges of risk management of credit portfolio in commercial banks effectively and overcoming any shortcomings.

#### **4.2 Response Rate**

This study envisaged to cover a total population of 50 respondents drawn from credit and risk departments. However, due to the fact that some of the expected interviews were busy, only 49 respondents were able to be interviewed, giving a response rate of 98%.

#### **4.3 Demographic Characteristics of Respondents**

Before delving deep into the real discussions of each of the objectives, it is first and foremost important to first look at the socio-demographic features of the interviewees as illustrated in Table 4.1 below.

**Table 4.1: Demographics of Respondents**

<b>Socio-demographic characteristic %</b>	<b>(n=50)</b>	<b>Percentage (%)</b>
<b>Age group (years)</b>		
20 – 35	28	56%
>36	22	44%
	50	
<b>Education</b>		
Completed Secondary Education	3	6%
Post Secondary Education	45	90%
Tertiary Level	2	4%
<b>Work experience (years)</b>		
< 10	32	64%
10-20	16	32%
> 20 years	2	4%
<b>Designation</b>		
Semi skilled worker	5	10%
Skilled Credit worker	13	26%
Highly skilled credit worker	21	42%
Office Support Staff	3	6%
Branch manager	5	10%
Senior Manager	2	4%
Director	1	2%

Majority of the respondents were in the age brackets of 20-35, representing 44% of the respondents. This clearly corresponds with the fact that majority of the working force in Tanzania. These respondents were mostly workers at Barclays Bank Tanzania.

In terms of education, majority of the respondents (90%) had received post secondary education, which includes degree and masters degrees. This means that at least the most of the respondents were very informed from an intellectual point of view, lending the study more credibility, given that the topic itself requires serious analysis.

As for the experience at their respective work stations, 64% of the respondents, equivalent to 32 of the respondents had at least 10 years experience, while 32 % had more than 10 years of experience and 4% of the respondents equivalent to 2 of the respondents had more than 20 years of experience.

#### **4.4 The BBT Financial Procedures and Loan Performance**

The financial procedures and loan performance of BBT have been discussed here by looking at the credit risk unit (which deals direct with credit risk management), credit culture and risk profile. Also the data from Questionnaires feedback which relates to these particular objectives have been analyzed.

##### **4.4.1 BBT Credit Risk Unit**

The credit risk unit, particularly in collection subunit has played a central role in successful credit risk management due to its being essential in managing the credit risks arising from different defaulters. The unit carries out its daily activities according to the policy given which insists that all Barclays bank's customers, including those who are late in paying or in default, must be treated with respect, dignity, courtesy and fairness in debt collection efforts. Barclays bank believes that, this is not only the ethical thing to do, but also the most effective way of recovering overdue payments. All collection officers must abide by the collection policy which is the code of conduct in managing credit risk with respect to Barclays bank (BBT's, 2012).

The study learned that collection officers have their principles and ethical values form the cornerstone of all collection and recovery activities at the bank; which are:

- i. Customers deserve to be treated with dignity. Collection officers always remain professional during telephone conversations and visits. No written or

verbal threats, abuse or rudeness is permitted. Staffs use only acceptable business language, even if the other party does not.

- ii. Collection officers deserve to be treated with dignity. They may refer the customer to management, or end calls when a customer becomes abusive or threatening. Customers are informed prior to termination of such calls. All calls where the customer becomes abusive or threatening are appropriately documented.
- iii. Customers are entitled to privacy. Privacy policies apply to all conversation with third parties.
- iv. Any request from Customer for stopping calls or visits to place of work are honored if he or she provides a suitable alternate address where he or she may be contacted during collection working hours. Such customers are asked to provide an alternate address/ phone number where they could be reached.
- v. Customer's questions should be answered fully and accurately. Customers are provided with information requested, given assistance and issues, are resolved. Accounts with unresolved issues are referred to management.
- vi. If a customer or a third party requests to speak to a supervisor or manager or seeks the contact details of the supervisor, the collections officer does honour such requests.

#### **4.4.2 BBT's Credit Culture and Risk Profile**

The credit culture and risk profile of the bank has led to a successful credit risk management. The staff members throughout the bank understand the bank's credit culture and risk profile. A bank's credit culture is the sum of its credit values, beliefs, and behaviours. The credit culture exerts a strong influence on a bank's credit risk management. Values and behaviours that are rewarded become the standards and will take precedence over written policies and procedures.

A commercial bank's risk profile describes the various levels and types of risk in the credits. The profile evolves from the credit culture, strategic planning, and the day-to-day activities of making and collecting loans. Credit culture varies from bank to bank. Some of them approach credit very conservatively, lending only to financially

strong, well-established borrowers. Growth-oriented banks may approach lending more aggressively, lending to borrowers who pose a higher repayment risk. These cultural differences are grounded in bank's objectives for asset quality, growth, and earnings. Emphasizing one of these objectives over another does not itself preclude achieving satisfactory performance in all three.

#### **4.4.3 Analysis of Data from Questionnaires Feedback**

Questionnaires were distributed to both 70 staff of BBT in the Credit Department and 100 customers who were willing to receive questionnaires and fill them. 80 customers and 50 staff filled them.

#### **Analysis of the feedback from Barclay's Staff:**

The meanings of answers were:

1 = strongly disagree,

2 = disagree,

3 = agree,

4 = strongly agree,

5 = I don't know

After distributing the questionnaires, the following were the observations from 50 staff of Barclays:

#### **4.5 What are the weaknesses of policy and financial procedures dealing with Credit risks?**

In order to come up with reliable and strong answers, the researcher asked few sub-questions through questionnaire which yield good answers and conclusion of the first research question 4.3 above. The following are the sub-questions and their response/answers from BBT staffs and customers:-

##### **4.5.1 Is there adherence to rules, polices and principles of credit risk management in BBT during credit appraisal?**

From Table 4.1 below, the feedback obtained shows that 10% of the staff disagreed that rules, polices and principles of credit risk management are applied during credit appraisal. 70% of them agreed and 20% of them strongly agreed that rules, polices

and principles of credit risk management are applied during credit appraisal. The fact that a total of 90% of the staff respondents are of the opinion that rules, policies and principles of the Bank is indicative of how serious the Bank is with adherence to its laid down rules, policies and principles during loan application and approvals. From the findings presented here, the researcher concluded policies and procedures of credit risk management are well known and included during appraisal. Therefore, rules, policies and principals are not compromised on credit appraisal processes.

**Table 4. 2 BBT’s implementation of the rules, polices and principles**

Question	Statement		Answer					Total
			1	2	3	4	5	
2	In BBT the rules, polices and principles of credit risk management are applied.	Scale						---
		Frequency	0	5	35	10	0	50
		Percent	0%	10%	70%	20%	0%	100%

Source: Research Data, 2014

#### 4.5.2 The effectiveness of credit risk management in BBT

The paper highlights that effective credit risk management is a critical component of a bank's overall risk management strategy and is essential to the long-term success of any banking organization. Overall, the components of effective credit risk management comprise active board and senior management oversight; sufficient policies, procedures and limits; adequate risk measurement, monitoring and management information systems; and comprehensive internal controls.

Table 4.2 below shows that at least 30% of the staff disagreed that the credit risk management is effective in Tanzanian commercial banks, 60% agreed and 10% of them strongly agreed that the credit risk management is effective in Tanzanian commercial banks. These results from the respondents imply that only 70% of them

agreed and strongly agreed that in BBT the credit risk management is very effective. From the findings presented here, the researcher concluded that credit risk management in BBT are effective. Therefore, there is no challenge/doubt on this item.

**Table 4. 1 The effectiveness of credit risk management in BBT**

Question	Statement		Answer	Total				
4	The credit risk management is effective in BBT	Scale	1	2	3	4	5	
		Frequency	0	15	30	5	0	50
		Percent	0%	30%	60%	10%	0%	100%

Source: Research Data, 2014

### **Analysis of the Feed Back From Customers**

The meaning of answers for general questions part 1 (i.e. 1 to 5) is as explained above:

After distributing questionnaires, the following were the observations from 80 customers of Barclays Bank Tanzania who positively responded.

#### **4.3.3 Are the suggestions on credit risk management from customers implemented by BBT?**

From Table 4.3 below, the feedback from customers' shows that 20% disagreed that the comments/ opinions on credit risk management from them are implemented by BBT, 60% agreed and 20% of them said they do not know if the comments/opinions on credit risk management from them are implemented by BBT. This means 60% of them agree that their comments/opinions on credit risk management are implemented by BBT and the remaining 40% need to be taken care by BBT through improving the implementation of the customers' comments/opinion in various areas of credit operation.

From the findings presented here, the researcher concluded customers' comments on credit risk management are well implemented. Therefore, credit processes will be improved as expected.

**Table 4. 2 The implementation of the customers' suggestions on credit risk**

Question	Statement		Answer					Total
			1	2	3	4	5	
3	The comments/opinions on credit risk management from customers are implemented by the BBT	<b>Scale</b>						---
		<b>Frequency</b>	0	16	48	0	16	80
		<b>Percent</b>	0%	20%	60%	0%	20%	100%

Source: Research Data, 2014

#### 4.4 What is the performance of BBT's loan portfolio in terms of underwriting process, growth and profitability?

In order to come up with valid and reliable data as per research second question 4.4 above, the researcher starts by the analysis that will give us clear knowledge of underwriting process, growth and profitability.

##### 4.4.1 The Analysis of Underwriting Process, Growth and Profitability

Banking is both a risk taking and profit making business, and bank loan portfolio should return profits commensurate with their risk. Although this concept is intellectually sound and almost universally accepted by bankers and examiners alike, banks have difficulty in implementing it. Over the years, volatility in banks, earnings usually have been linked to credit management. While there are many contributing factors including market forces, anxiety for income, poor risk measurement, and weak risk management, a common underlying factor has been the banks' tendency to underestimate or under-priced credit risk.

In this study, the assessment of credit pricing decision of BBT revealed that some of the personal loans are overpriced. For example, the interest of 20% per annum for most of the personal loans like Barclay loans and scheme loans is too high which result to some of the customers to run away from their obligation of repaying back. Generally, the price charged for an individual credit should cover funding costs, overhead or administrative expenses, the required profit margin and risk. Apart from these, other component of credit risk is the pricing dilemma. The methods used in pricing depend much on the nature of the organisation where customers come from and the background on repayment rate, risk rate and nature of the business. Some of the development measures in credit performance and risk measurement should be taken for further improvement of the credit pricing more precisely, though these requires accurate risk measurement at the beginning of the loan circle. The important thing is that, BBT should continue developing systems to measure and price risk credits and portfolio accordingly.

The primary data of loans and its repayments from the year 2008 to 2014 was extracted and computation in percentage for each risk category for respective years was done as shown in the table 4.4 bellow.

The computation based on the following formula;

$$\text{Risk} = \frac{\text{The amount under each category}}{\text{Total portfolio amount under the respective year}} \times 100$$

The results obtained are summarized in table 6.

**Table 4.3 Summary of BBT retail credit loans in bucket wise**

Period	BUCKET-1 (Risk A)	BUCKET-2 (Risk B)	BUCKET-3 (Risk C)	BUCKET-4 (Risk D)	WRITTEN OFF (Risk E)
2008	70.2%	14.5%	15.0%	0.3%	0%
2009	85.9%	1.7%	12%	0.4%	0%
2010	82.12%	4.4%	10%	0.8%	2.68%
2011	83.6%	9.7%	2.3%	1.4%	3%
2012	86.1%	4.2%	1.8%	4 %	3.9%
2013	81.6%	6.4%	0.5%	7.3%	4.2%
2014	77.1%	4.8%	3.3%	9%	5.8%

Source: Research Data and BBT's Financial Statements 2008 - 2014

The risks ranging from A to E are ranging from a best performing loan portfolio to a worst performing loan portfolio. There was a poor performance of the loan portfolio from 2012, 2013 and 2014, whereby the written off book grew from 3%, 4.2% to 5.8% respectively. The same trend happened in the charge off book where it grew from 2012 to 2014 from 4% to 9%. These impacted the core capital of the bank from 7.9% of core capital in year 2012, 11.5% of core capital in year 2013 and 14.8% in year 2014. Although there was significant improvement in year 2011 to 2012 where the amount under bucket 1 improved from 83.6% of the best performing loans to 86.1% it however decreased further to 77.1% in the year 2014. This shows that there was a poor monitoring of loan performance especially from year 2012 to 2014. This requires all the staff in retail credit department to launch an aggressive follow-up of borrowers to repay the amounts due in time. In general, the performance of BBT's retail loan portfolio for the research period (i.e. 2008 to 2014) is not certain because

in 2009 it improved to 85.9% from 70.2% in 2008 but worsen from 86.1% to 77% in 2012 to 2014 respectively (based on Bucket 1 portfolio (Risk A)).

Analysis of the Feedback from Barclays Staff

The meaning of answers is as defined above:

#### 4.4.2 The implementation of the credit analysis process

From Table 4.5 below, the feedback obtained shows that 30% of the Barclays staff disagreed that the process of credit analysis in relation to services deliverance is clearly followed by both staff and customers. 60% of them agreed and 10% of them strongly agreed that the process of credit analysis in relation to services deliverance is clearly followed by both staff and customers. 30% of those who disagreed are a quite significant number which BBT should take into account by making sure that both staff and customers follow the process.

**Table4. 4 The implementation of credit analysis process by the BBT's staff**

Question	Statement		Answer					Total
			1	2	3	4	5	
3	The process of credit analysis in relation to services deliverance is clearly followed by both staff and customers	Scale	1	2	3	4	5	---
		Frequency	0	15	30	5	0	50
		Percent	0%	30%	60%	10%	0%	100%

Source: Research Data, 2014

#### 4.4.3 The positive effects of the credit analysis and approval procedures to the customers and BBT

The findings on Table 4.6 below shows that, 40% of the Barclays staff disagreed that the credit analysis and approval procedures are affecting positively both BBT and customers, 20% of them agreed, 30% of them strongly agreed and only 10% of them

did not know if the credit analysis and approval procedures are affecting positively both BBT and customers.

The effects of the credit analysis and approval procedures to BBT

Question	Statement		Answer					Total
			1	2	3	4	5	
7	The credit analysis and approval procedures are affecting positively both banks and customers.	Scale	1	2	3	4	5	---
		Frequency	0	20	10	15	5	50
		Percent	0%	40%	20%	30%	10%	100%

Source: Research Data, 2014

Analysis of the Feedback from Customers

The meaning of answers for general questions part 1 (i.e. 1 to 5) is as defined above:

#### 4.4.4 The implementation of the credit analysis process

From Table 4.7 below, the feedback obtained shows that 10% of customers strongly disagreed that during credit appraisal process, Barclays' staffs are following its rules, policies and principles, 60% of them agreed and 10% strongly agreed that during credit appraisal process, Barclays' staffs are following its rules, policies and principles. However, 20% of the staffs said they did not know if during credit appraisal process, Barclays' staffs are following its rules, policies and principles. The fact that a total of 70% of customers responded that during credit appraisal process, BBT is following its rules, policies and principles indicates how serious the Bank is in adherence to its laid down rules, policies and principles. For the 20% of them said they did not know, challenges BBT to work in transparency form in order to make customers to be comfortable on how it follows its rules, policies and principles.

**Table 4.5 The implementation of the credit analysis process by Barclays' staff**

Question	Statement		Answer					Total
			1	2	3	4	5	
1	During credit appraisal process, Barclays' staffs are following its rules, policies and principles.	Scale	1	2	3	4	5	---
		Frequency	8	0	48	8	16	80
		Percent	10%	0%	60%	10%	20%	100%

Source: Research Data, 2014

**4.4.5 The effects of the credit analysis and approval procedures in relation to services deliverance to the customers**

Table 4.8 below, the feedback obtained shows that 10% of customers who were asked disagreed that the process of credit analysis in relation to service deliverance is clearly followed by both staff and themselves. 70% agreed, 10% strongly agreed and 10% of them said they did not know if the process of credit analysis in relation to service deliverance is clearly followed by both staff and themselves. As far as 80% of customers agreed (and strongly agreed) that the process of credit analysis in relation to service deliverance is clearly followed by both staff and themselves, BBT should continue in improving the process of credit analysis in relation to service deliverance. The remaining 20% is still significant.

**Table 4.6 The process of credit analysis as followed by BBT**

Question	Statement		Answer					Total
			1	2	3	4	5	
2	The process of credit analysis in relation to service deliverance is clearly followed by both staff and customers.	Scale	1	2	3	4	5	---
		Frequency	0	8	56	8	8	80
		Percent	0%	10%	70%	10%	10%	100%

Source: Research Data, 2014

#### **4.4.6 BBT Policy on Credit Risk**

The BBT policy on credit risk was assessed on BBT's credit operations manual which deals with BBT's lending process and other regulatory documents which are used in credit risk management by the bank. The credit operations manual was developed in year 2002 and the latest review was carried out in September 2007. The manual contains credit approval authorities, types of credit facilities that BBT offers, credit approval process, risks, annual reviews and monitoring requirements. It also contains documentation requirement, type of security of collateral required, legal actions, credit administration, outsourcing procedures and control and credit cycle guideline procedures. The comparison between the practices and the credit policy assisted to observe some of the policies and procedures if they are not followed. For example, the credit approval process requires the loan application, after being received by DST/LGs or any other sales personnel to go to the policy and underwriting department for in-depth analysis. Then it should go to the head of collection unit and final approval from country credit director. In case of commercial businesses, which borrow very huge amounts of money, their applications have to be discussed by CMC members for final approval. It should be noted that retail loans range from Tsh 1,000,000/= to 30,000,000/=, business solution loans (SMEs) range from Tsh 31,000,000/= to 500,000,000/= and corporate loans or commercial loans and are range from 501,000,000/= to any amount above that. However, it was observed that some of the loan applications, after being received by the sales personnel, are submitted directly to KYC/LPC for appraisal ignoring the policy and underwriting department first for in-depth analysis (BBT, 2012).

##### **4.4.6.1 BBT's Five Risk Classes on Credit Portfolio**

The BBT credit manual classifies the risk into five (5) classes and each class has direct implication to the bank's core capital. The researcher reviewed the credit manual and analyzed its impacts on the bank's core capital. Figure1 bellow illustrates clearly the implications to the bank (BBT 2012):

**Bucket 1:** One month loan in arrears. This is a loan which has been defaulted for the period of one day to a maximum of one month (i.e. 1 to 30days). The bank classifies the loan in risk from day one of not submitting payments without prior notice. The risk rate for bucket one loans is 20% of BBT's core capital.

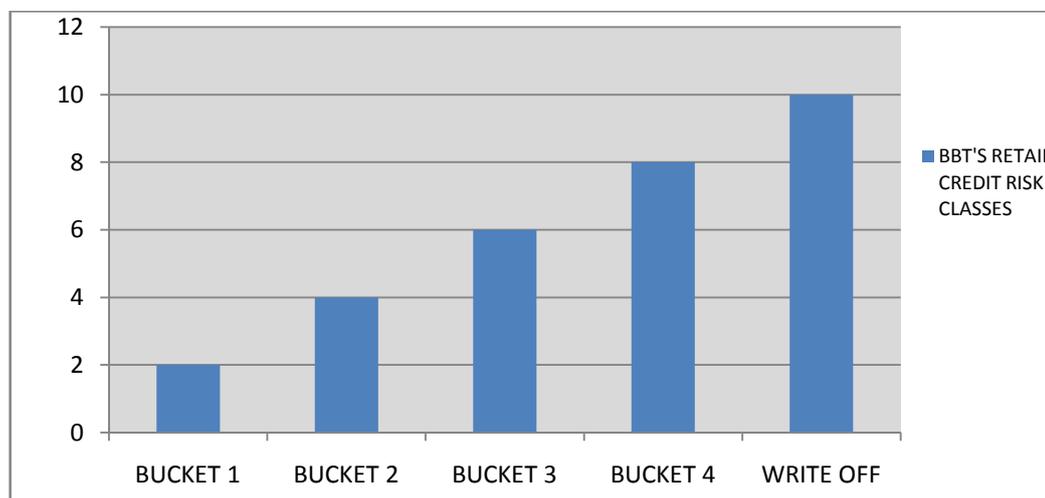
**Bucket 2:** Two months loan in arrears. This is a loan which has missed payments for a maximum of two months period (i.e. 31 to 60 days). The bank classifies the loan in risk after day one of the second month of not submitting payments without prior notice. The risk rate for bucket two loans is 40% of BBT's core capital.

**Bucket 3:** Three months loan in arrears. This is a loan which has been defaulted for a maximum of three months period (i.e. 61 to 90 days). The bank classifies the loan in risk after day one of the third month of not submitting payments without prior notice. The risk rate for bucket three loans is 60% of BBT's core capital.

**Bucket 4 (Charge off book):** Four months loan in arrears. This is a loan which has been missed payments for a maximum of four months period (i.e. 4months to 12 months). The bank classifies the loan in risk after day one of the fourth month of not submitting payments without prior notice. The risk rate for bucket four loans is 80% of BBT's core capital.

**Write Off Account (Bad book):** Twelve months loan in arrears. This is a loan which has been missed payments for the period of twelve months, consecutively. A bank writes off the loan in its book when the customer has missed payments for twelve months without formal notice. The risk rate for this type of bucket loans is 100% of BBT's core capital.

**Figure 4.1 BBT's retail credit risk level against classes**



Source: Research Data, 2014

The bar chart above shows the level of credit risk to its core capital increases when the number of months in default increases, so the impairment level is 100% of the BBT's core capital from the write off portfolio, and 80% in all loans which are in charge off book, 60% in all loans which are defaulted in a total of three months and 40% impairment in loans which are in bucket two. Lastly, there is an impairment of 20% in all those loans which have not been serviced for up to one month from the day of repayment.

#### **4.4.6.2 Regulatory Classifications of Credit Risk Rating**

The regulatory authorities such as BOT use a common risk rating scale to identify credits performance. The regulatory classification is based on the borrower's repayment performance, which shows the degree of credit weakness. The regulatory authority classifies the portfolio risk rating as follows (BOT, 2012).

##### **Pass Loans [Risk A]**

Loans classified as 'pass' in the portfolio are fully secured and the borrower is servicing his obligations in accordance with the items of the loans. Normally the

amount due is paid on the due date or in one month from the due date. BBT classify the loan as pass if the borrower is one of the strongest financial institutions, or government supported agencies with substantial capital, liquidity, and reputation. If a commercial business has a substantial tangible net worth and available cash flow throughout the year or at the specified period of time or has consistent earnings and grows in a stable industry, and operates in a favorable business and political environment, it will be given a pass class. The private individual who is well known to BBT and has got verifiable wealth liquid assets that exceed the liabilities is included in this class of pass.

#### Special Mentioned Loans [Risk B]

This loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan. This is designed to identify a specific level of risk and concern about loan quality. Although the loan has a higher probability of default than a pass loan, its default is not imminent. So, this requires closer management's attention. BBT considers the loan as a special mentioned loan if the borrower is:-

- i. A small or privately owned bank with a good reputation and the ability to honor its obligations, although its capital base may be relatively small.
- ii. A private individual whose assets are financed with significant leverage, but who has the ability to repay interest and principals.
- iii. A commercial business whose financial condition may show a significant increase in leverage and or decrease in cash and other liquid assets, may be vulnerable to volatile business or economic conditions, but has adequate cash flow to make required interest or principal payments and credit facility structured to mitigate some risk by security such as against assets, or by an unsecured guarantee from a parent or principal whose financial strength is judged to be satisfactory.

#### Substandard Loans [Risk C]

The substandard loans are those which are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any.

Loans classified must have a well-defined weakness(s) that jeopardize the liquidation of the debt. The loans have high probability of payment default, so they need more intensive supervision by the management of the bank. Although substandard loans in the aggregate will have a distinct potential for loss, an individual loans' loss does not have to be distinct for the loan to be rated as substandard. BBT considers the loan as substandard if the borrower is:-

- i. A bank or financial institution experiencing a deteriorating financial condition, or unfavorable political or regulatory conditions that indicate that new or increased exposure is not desirable.
- ii. A commercial business with high leverage and an unsure earning record, where asset quality and debt paying ability are marginal but meeting BBT's minimum credit standards.
- iii. A private individual whose real financial condition cannot be determined, or who exhibits a marginal ability to repay debt without resorting to sale of collateral, or whose ability to obtain other financing is extremely limited and is vulnerable to the extent that external economic or political factors alone may cause problems with otherwise satisfactory borrowers or credit facilities.

#### Doubtful Loans [Risk D]

A loan classified as 'doubtful' has all the weaknesses inherent in one classified substandard with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improvable. A doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the loan, its classification as loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidation or capital, and the resources necessary to remain an operating entity.

#### Loss Loans [Risk E]

The loss loans are the ones which exhibit the same weakness as doubtful loans, and where collection in full is highly questionable. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or

desirable to defer writing off this basically worthless loan even though partial recovery may be affected in the future.

#### 4.4.7 BBT Loan Portfolio Strategic Planning, Growth and Profitability

Also it was observed that BBT is following a relaxed culture with an objective of high retail expansion campaign and financial growth. This also was observed from the annual financial reports whereby the average annual loan portfolio growth of BBT is about 60% (see table 5 below). This is an aggressive growth which requires the bank to review its credit policies and risk control programme

**Table 4.7 BBT Performance, 2007 – 2013 in million Tshs**

<b>Period</b>	<b>Balance Sheet Loans</b>	<b>% Growth in Loans</b>	<b>Total Assets</b>	<b>Deposits</b>	<b>Profit</b>
2007	1,898	-	17,710	4,421	224
2008	4,487	136.4%	23,823	10,607	114
2009	4,571	1.9%	29,707	17,045	110
2010	9,889	116.3%	44,792	32,515	252
2011	16,550	67%	44,226	32,688	914
2012	25,067	51.5%	52,449	39,627	1,449
2013	96,300	180%	250,340	60,230	4,942

Source: BBT annual report, 2013

The retail credit lending level of BBT under the research period (i.e. year 2007 to 2013) increased by almost fifty times from 1.9 billion in year 2007 to 96.3 billion in year, 2013 as shown in table 5. The observation was that BBT's business plan should be detailed and more focussed on the financial goods for the loan portfolio. The current annual average portfolio growth is about 79%. The most aggressive loan growth was from year 2012 to 2013 with about 180%. The study also observed that the strategic planning on loan portfolio should set other key factors such as loan quality, portfolio diversification and loan product mix to minimise the associated risks.

#### **4.5 What are the challenges that affect effective implementation of risk management process?**

This is a third research question which needs clear elaborations to be used to improve BBT's risk management process as a whole. Hereunder are some of the challenges obtained from the observations and others from respondents (customers and BBT staffs)

- Lack of credit reference bureau (or institutions for credit ratings) in Tanzanians commercial banks
- Low sharing of information between banks - someone who defaulted at NMB, NBC can still get a loan at BBT and other commercial banks in Tanzania because there is no common database for all commercial banks in the country.
- Most of collaterals are informal – that means it is difficult to realize those securities when a customer default.
- Purpose of the loan – most of our customers have no clear focus or target on how they could spend their loan, so they diverge the funds into something that was not planned and that is not sustainable. They take a loan only because they qualify.
- Lack of professional management team especially those at credit risk and collection departments.
- Lack of knowledge regarding risk management and credit/finance related
- Transparency – whereby borrowers do not disclose all information or right information and are not honest about their businesses and practices.
- Lack of risk mitigation tools and customers bad attitude towards repaying their loans.

#### **Analysis of the Feedback from Barclays Staff**

The meaning of answers is as defined above:

#### 4.5.1 Are knowledgeable staffs in credit department incorporated in Bank's decisions and implementation?

From Table 4.9 below, the feedback obtained shows that 20% of the knowledgeable staff in credit department disagreed with the statement they are incorporated in Bank's decisions and implementation. 60% agreed and 20% strongly agreed with the statement they are incorporated in the Bank's decisions and implementation. However there were 10% of them who strongly disagreed with the statement that they are incorporated in the Bank's decisions and implementation. This reflects one thing that in the bank there are variations of perception of the staff when it comes to the decision making and implementation exercise. All the same it concluded that most respondents (80%) feel the Bank involves knowledgeable people when it comes to the exercise of decision making and its implementation.

**Table 4.8 The knowledgeable staffs are involved in BBT's decision making**

Question	Statement		Answer					Total
			1	2	3	4	5	
1	Knowledgeable staffs in credit department are incorporated in Bank's decisions and implementation.	Scale						---
		Frequency	5	5	30	10	0	50
		Percent	10%	10%	60%	20%	0%	100%

Source: Research Data, 2014

#### 4.5.2 The application of the determinants of credit risk management (5Cs) in BBT

Table 4.10 below shows that 10% of the Barclays staff strongly disagreed that the determinants of credit risk management (5Cs) in BBT are well known and applied, 20% of them disagree, 30% of them agree and 40% they do not know if the determinants of credit risk management (5Cs) in Tanzanian commercial banks are well known and applied. This mean that the 5Cs (i.e. Character, Capital, Capacity, Collateral and Condition) is still not known very well by BBTs' staff and as the

results the possibility of appraising loans to the un appropriate customers will remain very high and the risk keeps increasing. Since 5Cs is the analysis which ascertains whether the borrower is worth of being granted a loan or not (Joel, 1998) and commercial banks has to use information on various borrowers' characteristics such as borrower character (reputation), capital (leverage), capacity (ability to service the loan to maturity), collateral (amount, quality, and liquidity of the asset) and condition (economical and environmental forces). This system is also called ``expert system`` and is used to assess the credit risk on corporate loans (Ansell, 1992). Overall, 70% of the respondents disagree or the do not know if the 5Cs are applicable in BBT's credit risk management and simply because the mare customers have no reason to know these rather than staff themselves who control the risks in credit.

**Table 4. 9 The determinants of credit risk management (5Cs) in BBT**

Question	Statement		Answer					Total
			1	2	3	4	5	
5	The determinants of credit risk management (5Cs) in Tanzanian commercial banks are well known and applied	Scale	1	2	3	4	5	---
		Frequency	5	10	15	0	20	50
		Percent	10%	20%	30%	0%	40%	100%

Source: Research Data, 2014

#### **4.5.3 The implementation of the suggestions on credit risk management from various stake holders by Tanzanian commercial Banks**

The findings on Table 4.11 below show that 20% of the staff disagree that the suggestions on credit risk management from various stake holders are implemented by BBT, 50% of them agrees, 20% they are strongly agree and only 10% of the staff they do not know if the suggestions on credit risk management from various stake

holders are implemented by BBT. So BBT's management need to continue implementing those suggestions which helps on credit risk management as 30% of the respondents said they do not know or they disagree that the suggestions on credit risk management from various stake holders are implemented by BBT.

**Table 4. 10 The BBT's implementation of the stake holders' suggestions**

Question	Statement		Answer					Total
			1	2	3	4	5	
6	The suggestions on credit risk management from various stake holders are implemented by Tanzanian Banks.	Scale						---
		Frequency	0	10	25	10	5	50
		Percent	0%	20%	50%	20%	10%	100%

Source: Research Data, 2014

### **The Credit Administration and Recovering Process of BBT**

The BBT's effective credit management system and, analysis of the Feedback from Barclays staff has been discussed and presented here

#### **4.5.4 BBT's Effective Credit Management System**

Barclays has established eight key features which are applied to make sure that all loan applications are clean and will result in profit making these key features are (BBT, 2012):

- i. Loans must be in commercial basis.
- ii. The bank obliges all loan applications to follow the business practices and abide by government laws and regulations as well as its credit policy.
- iii. Its credit strategy

The bank has a credit strategy which articulates clearly the type of customers to deal with and deals with all employee customers, business men and women, and other special groups like politicians and students.

- i. Credit policy
- ii. This is the centre of reference in lending practice and it covers all the key aspects of credit business. It includes the policies with respect to credit, concentration and exposure limits, business or sector limits and all the criteria for assessment, pricing and acceptable amount.
- iii. Credit operational manual
- iv. This is the tool used by the bank staff in underwritings the loan applications, loan disbursements as well monitoring.
- v. Structure and accountability
- vi. Barclays bank has developed its own organisation structure which directs the level of decision making in all areas. Credit risk management is one of the key areas.
- vii. Proper record keeping
- viii. The bank has a very good system of keeping its records and through that it is very easier to retrieve any information down to very personal information, when needed within very reasonable time. Moreover the records are kept at a place which any unauthorised people cannot access. This makes the bank to protect the customer's information and maintain a strong image of it. Documents like a copy of the contract entered into by a customer during loan application can easily be retrieved any time it is needed.
- ix. Suitable systems,
- x. Barclays bank uses various systems to manage loan applications, disbursements, repayments, monitoring and control, collections and recovery etc. For instance, it is uses collection and control system (C.C.S) to monitor all customer accounts and once a customer has overdrawn his/her account the system provides a daily report which shows the exact status of the account which is in debit balance and the bank staff make a close follow up with the

respective customer in order him/her to deposit money into it to bring the account back to normal position.

- xi. Qualified staff
- xii. The system for employing staff is very open, honest and fair for the purpose of getting highly qualified staff, competent and trustable. This helps the bank to appraise loans well and establish the relationship with customers

**4.5.5 The use of collection agents when the internal ways have failed is encouraged by BBT**

Table 4.12 below shows that, 10% of the Barclays’s staff disagrees that the uses of collection agents when the internal ways have failed is strongly encouraged by the bank, 70% of them agrees and 20% of them are strongly agree. This means that BBT should continue using its external agents in collecting debtors because the findings show that, 90% of the staff suggests doing so for the better collection of defaulters.

**Table 4. 11 The use of collection agents when the internal ways have failed**

Question	Statement		Answer					Total
			1	2	3	4	5	
8	The use of collection agents when the internal ways have failed are strongly encouraged by BBT.	Scale	1	2	3	4	5	---
		Frequency	0	5	35	10	0	50
		Percent	0%	10%	70%	20%	0%	100%

Source: Research Data, 2014

**4.5.6 The use of external agents instead of bank’s staff to collect debts has been more effectively**

Also the findings on Table 4.13 below show that 30% of the Barclays staff strongly disagrees that the advantages of outsourcing to external collectors are very big as compared to the use of internal collectors, 50% of them they are disagrees and only 20% agree that the advantages of outsourcing to external collectors are very big as compared to the use of internal collectors. From this point of view, 80% disagree (and strongly disagree) that the advantages of outsourcing to external collectors are very big as compared to the use of internal collectors, so BBT should encourage more the use of internal staff (employees) in collecting debts than outsourcing to the external collection agents like CAL and Majembe, and it should only do so to those debts which became very bad in servicing and the internal ways have failed to deliver the positive results. This reflected in the respondents.

**Table 4. 12 The effectiveness of the use of external collectors instead of internal**

Question	Statement		Answer					Total
			1	2	3	4	5	
9	The use of external agents instead of internal collectors to collect debts has been more effectively.	Scale						---
		Frequency	15	25	10	0	0	50
		Percent	30%	50%	20%	0%	0%	100%

Source: Research Data, 2014

**4.5.7 The improvement of the weak points in recovering the bank’s money**

Table 4.14 below shows that 20% of the Barclays staff disagree that when the weaknesses are revealed in recovering the bank’s money they are always rectified in order to improve collections and minimize the rate of defaulters in BBT, 30% of

them agree and 50% they were strongly agreed that when the weaknesses are revealed in recovering the bank's money are always rectified in order to improve collections and minimize the rate of defaulters in the Tanzanian commercial banks and Barclays bank Tanzania in particular. The fact that a total of 80% of the staff respondents are of the opinion that when the weaknesses are revealed in recovering the bank's money are always rectified in order to improve collections and minimize the rate of defaulters in BBT.

**Table 4. 13 The improvement of the shortcoming in recoveries**

Question	Statement		Answer					Total
			1	2	3	4	5	
10	The weak points in recovering the bank's money are always rectified in order to improve collections and minimize the rate of defaulters in the Tanzanian Banks and Barclays bank Tanzania in particular.	Scale						---
		Frequency	15	25	10	0	0	50
		Percent	0%	20%	30%	50%	0%	100%

Source: Research Data, 2014

#### **Analysis of the Feedback from Customers**

The meaning of answers for general questions part 1 (i.e. 1 to 5) is as defined above:

#### **4.5.8 The use of collection agents when the internal ways have failed**

Table 4.15 below shows that 60% of customers they disagreed that the use of collection agents when the internal ways have failed are strongly encouraged by BBT, 10% agreed and 10% of them strongly agreed. But there were 20% of them who did not know if the use of collection agents when the internal ways have failed

should strongly be encouraged by BBT. This reflects the fact that some borrowers do not like the use of debt collection agents for a number of reasons, including the agents being harsh and using unacceptable language or the borrowers simply not being happy with their debts status being known/ disclosed to a third party.

**Table 4. 14 The use of collection agents when the internal ways have failed**

Question	Statement		Answer					Total
			1	2	3	4	5	
4	The use of collection agents when the internal ways have failed are strongly encouraged by BBT.	Scale	1	2	3	4	5	---
		Frequency	0	48	8	8	16	80
		Percent	0%	60%	10%	10%	20%	100%

Source: Research Data, 2014

#### **4.5.9 The use of external agents instead of bank's staff to collect debts has been more effective**

Table 4.16 below shows that 50% of the customers disagreed that the use of external agents instead of internal collectors to collect debts has been more effective, 20% of them agreed and only 10% they strongly agreed but 20% they did not know if the use of external agents instead of internal collectors to collect debts has been more effective. This also reflects the bad picture of the use of external agents like CAL and Majembe Auction Mart which Barclays outsource its difficult defaulters and it might be the way they treat the bank's customers.

**Table 4. 15 Assessment of the effectiveness of using external agents**

Question	Statement		Answer					Total
			1	2	3	4	5	
4	The use of external agents instead of internal collectors to collect debts has been more effectively.	Scale						---
		Frequency	0	40	16	8	16	80
		Percent	0%	50%	20%	10%	20%	100%

Source: Research Data, 2014

#### 4.5.10 Unemployment of BBT's Customers

The impairment level kept increasing was caused also by the number of its potential customers to lose job. Since Barclays offers most of the retail loans without security and the only security is the employment they have which guarantee them to pay back loans through their monthly salaries. So once customers loose job or change from one organisation to another they stop paying back loans and when the credit officers try to make follow up become very difficult to trace them since the address of the majority of the country is not traceable. A good example is the mining companies which terminated many of their employees during the period of economic meltdown that affected the world in year 2008/2009, and most of their employees were Barclays' customers and as a result they default their loans.

#### 4.5.11 BBT Credit Risk Diversification

Risk diversification is a basic tenet of portfolio management. Concentration of credit occurs within a portfolio when otherwise unrelated loans linked by common characteristics. If this common characteristic becomes a common source of weakness for the loan in concentration, the loans could pose considerable risk to earnings and capital. For many Tanzanian commercial banks, portfolio segmentation has customarily meant dividing the loan portfolio into broad categories by the loan types. BBT has three major loans types, retail loans which ranging from Tshs 1,000,000/= to 30,000,000/=, business solution loans (SMEs) ranging from Tshs 31,000,000/= to 500,000,000/=, and corporate loans or commercial loans which start from Tshs

501,000,000/= and above). In the year 2008 to 2013 BBT concentrated much more on commercial loans and low capital was given to retail and SMEs lending. Under this period there was little portfolio segmentation, especially, the retail market was left with very low capital. As a result the bank did not use the wide range of market and left the majority away without its services.

#### 4.6 The analysis of general questions, part 2 (i.e. questions 6 to 10)

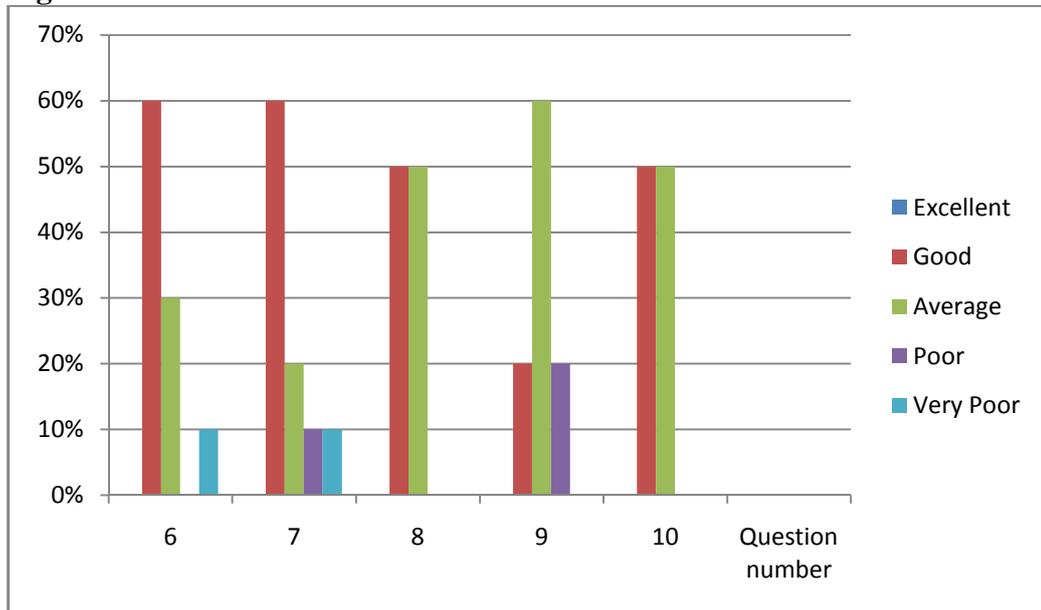
The Table 4.17 bellow, followed by the bar chart summarizes the analysis of the feedback from the customers in regards with questions 6 to 10.

**Table 4. 16 The analysis of customers’ general questions, Part 2**

S/N	QUESTION	CUSTOMER’S FEEDBACK				
		Excellent	Good	Average	Poor	Very poor
6	The quality of Barclay’s customer care services	0%	60%	30%	0%	10%
7	Barclay’s policies, procedures, and process of loans approvals and collections.	0%	60%	20%	10%	10%
8	BBT credit analysis and approvals procedures.	0%	50%	50%	0%	0%
9	The effectiveness of credit risk management by BBT	0%	20%	60%	20%	0%
10	The level of applying the 5Cs in lending process by BBT.	0%	50%	50%	0%	0%

Source: Research Data, 2014

**Figure 4.2 The chart which shows how customers rate BBT' services**



Source: Research Data, 2014

Table 4.17 and figure 4.2 above show the quality of Barclay's customer care services. Almost 60% of the customers said that it is good, 30% of them said it is average and there were no one who said it is excellent, poor or very poor. Also 60% of the customers who responded rated the bank's policies, procedures and process of loans approvals and collections as good, and there were almost 20% who rated them as average while the rest 20% rated them as poor or very poor The study learned also that 50% of customers who responded rated as good and average the credit analysis and approvals procedures, respectively. There were only 20% of customers who said the effectiveness of credit risk management at BBT is good, while 60% rated it as average and the rest 20% said it is poor. 50% of the customers who responded rated as good and average that the level of applying the 5Cs in lending process by Barclays Bank Tanzania.

After the above analysis, the researcher summarized the findings by relating with the specific research objectives of the study. Table 4.18 bellow shows the research objectives against the feedback from the respondents both staff and customers.

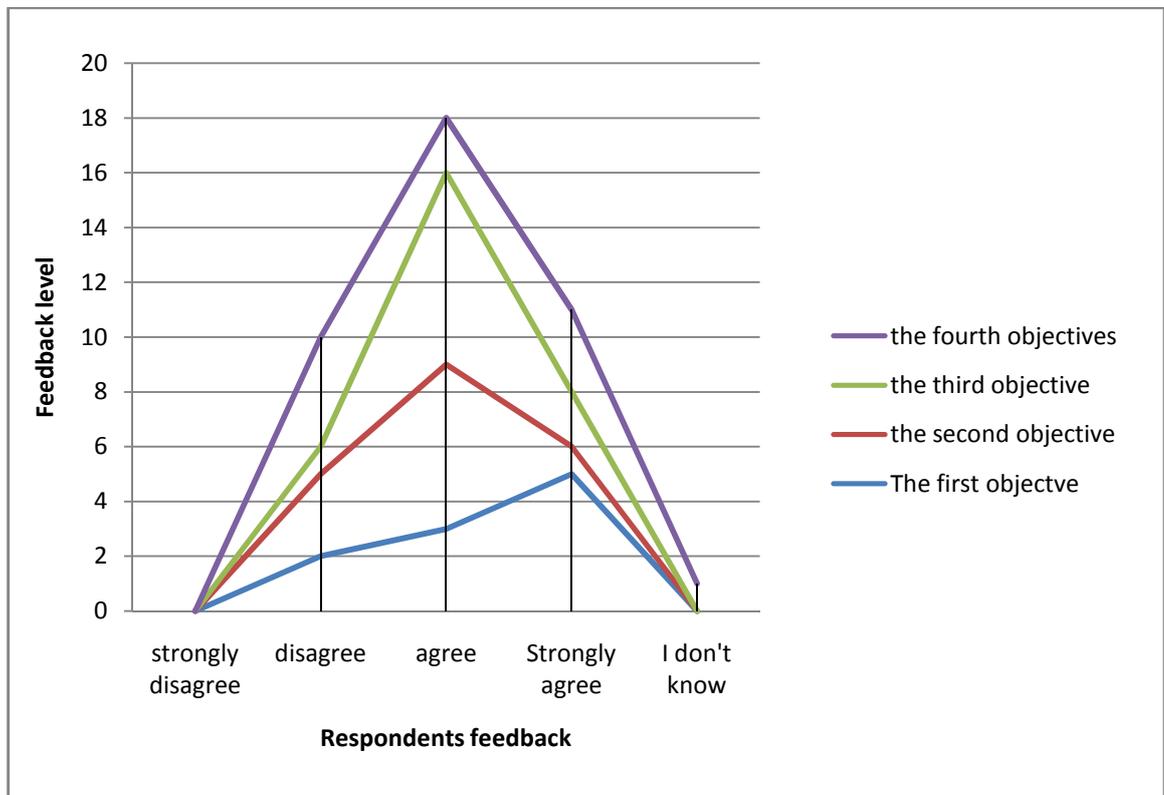
The main objective of this study is to assess the challenges of risk management of credit portfolio in commercial banks, the second objective stands for examining the policy of BBT on dealing with credit risk, the third objective stands for the aim of analyzing the performance of BBT's loan portfolio in terms of underwriting process, growth and profitability and the fourth objective stands for the aim of analyzing the loans recovering and credit administration process which BBT undertake and to identify the challenges that affects effective implementation of risk management process or exercise.

**Table 4. 17 Findings from questionnaires Vs the specific Research objectives**

<b>Respondent feedback/ Research objectives</b>	<b>Strong disagree</b>	<b>Disagree</b>	<b>Agree</b>	<b>Strong agree</b>	<b>I don't know</b>
The first objective	0%	40%	20%	30%	10%
The second objective	0%	10%	70%	20%	0%
The third objective	0%	30%	60%	10%	0%
The fourth objective	0%	20%	30%	50%	0%

Source: Research Data, 2014

**Figure 4.3 Feedback from respondents Vs the research objectives.**



Source: Research Data, 2014

Figure 4.3 above shows that most of the respondents, approximately 60% of them, agreed that the financial procedures of BBT that govern credit are followed very well by both bank staff and customers which makes the loan performance to be good, the credit policy is well understood and used appropriately by the bank, the performance of BBT's loan portfolio in terms of underwriting process, growth and profitability is also so strong as well as the recovering and credit administration process which BBT undertake still very good. Also there were few respondents ranging from 10% to 20% who disagreed with that and other 20% strongly agreed. This means that the majority of the respondents agreed that BBT is doing well in terms of credit risk management.

Generally, BBT needs to keep on improving its policy and building the culture which will ensure the effectiveness of credit risk management remains the key element of the organisation in lending business. Otherwise the impairment will keep increasing

significantly. So far, the level of impairment keeps increasing year by year which shows that there are still some weaknesses in monitoring and following up loan repayments. Therefore improving the credit risk control measures faster and implementing them will remain important factors for its sustainability and portfolio growth. If these factors are not maintained, the bank will experience further loss in loan provisions from its core capital.

#### 4.6.1 Measuring of BBT Credit Risk by Using Ratios

The analysis was based on the primary data provided and the risks assessed by using three ratios (i.e. Exposure Ratio, Doubt Ratio and Provision Ratio).

- i. Exposure ratio is the ratio of total retail credit performance to total assets.
- ii. Doubt ratio is the risk A, B and C to total assets
- iii. Provision ratio is the relationship of risk D and E to total assets.

**Table 4. 18 Credit risk rating from year 2008-2014**

<b>Research Period</b>	<b>Exposure Ratio</b>	<b>Doubt Ratio</b>	<b>Provision Ratio</b>
2008	11%	2.7%	0.01%
2009	19%	2.7%	0.17%
2010	15%	3.4%	0.52%
2011	22%	5%	1.0%
2012	37%	5.7 %	1.3%
2013	48%	6.2%	1.5%
2014	52%	8.0%	2.3

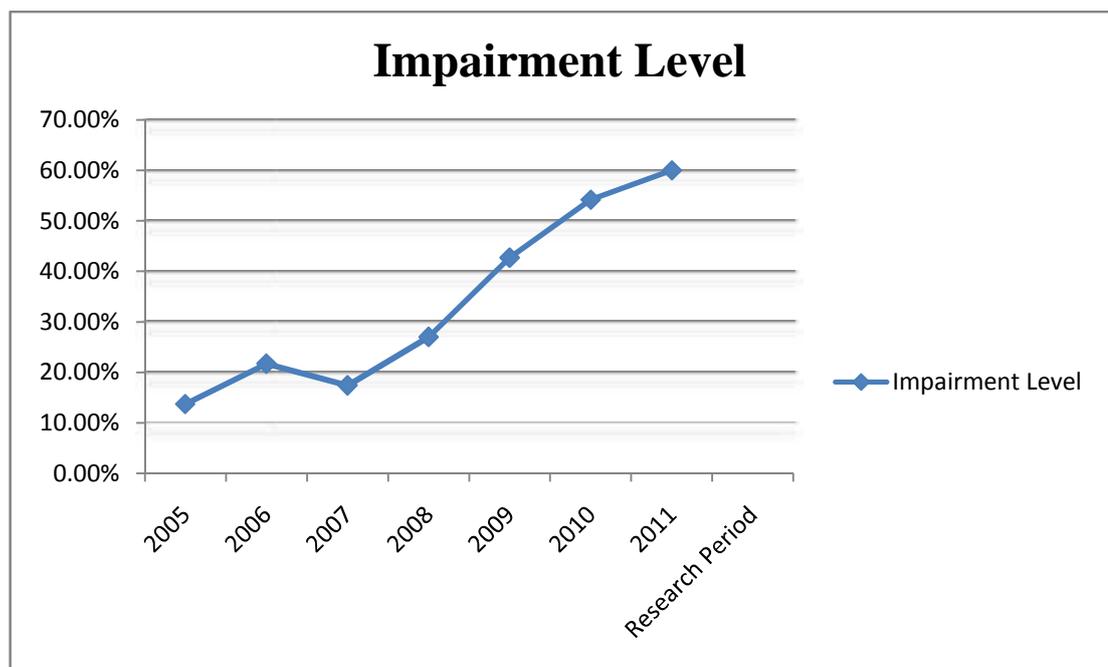
Source: Research Analysis

The exposure ratio shows how the loan portfolio covered by total assets or what amount of credit is at risk. The higher the exposure ratios refer the higher the risk. The trend shows that there is steep increase of exposure ratio from 11% in year 2008 to 52% in 2014. This requires BBT to develop policies and procedures, which would

ensure effective credit risk management, otherwise the Doubt Provision loss will increase significantly. So far there is an increase of Doubt ratio from 2.7% to 8.0% showing that there was poor loans disbursement and monitoring or follow-up on loan repayments, also there was an increase of provision ratio from 0.01% in 2008 to 2.3% in 2014, so BBT should establish the risk mitigation mechanism faster otherwise the bank will experience a poor credit risk management further.

The Figure 4.4 below refers that, the impairment level is the combination of the exposure ratio, doubt and the provision ratios for the period of study.

**Figure 4.4 Trend analysis: Retail credit portfolio impairment level**



Source: Research Data, 2014

The graph shows how the impairment level in loan portfolio increased from 13.71% in 2005 to 62.3% in 2014. Since the higher the impairment is the higher the risk toward the total portfolio, so the management and staff of BBT should be very sensitive in managing risk in order to maintain the safety and soundness of the bank

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Summary of Findings**

The researcher studied in detail the challenges of risk management of credit portfolio in commercial banks by analyzing the primary data which were collected and reviewed the secondary information. Specifically the study focused on the assessment of challenges of risk management of credit portfolio in BBT as a case study. The objective was to find out whether the BBT's policies, rules and procedures are linked to the practices. From previous chapter, the researcher has presented his findings in different formats and analyzes them accordingly.

The study mainly focused on the assessment of challenges of risk management of credit portfolio in BBT as a case study. The study was centered on three specific objectives which sought to:

- i. To assess the weaknesses of policy and financial procedures dealing with credit risk.
- ii. To analyze the performance of BBT's loan portfolio in terms of underwriting process, growth and profitability
- iii. To identify the challenges that affects effective implementation of risk management process.

The results obtained show that the financial procedures of BBT that govern credit are followed very well by both bank staff and customers which makes the loan performance to be good, the credit policy is well understood and used appropriately by the bank, the performance of BBT's loan portfolio in terms of underwriting process, growth and profitability is also so strong as well as the recovering and credit administration process which BBT undertake still very good. However, there are still a few grey areas that still need to be worked upon. For example, there a need to work on the exposure ratio in order to shield the bank from any possible risks as a result of high level of exposure to risks. Further, there is a need to ensure that at least all the staffs in credit department acquire up-to-date training in order to solve emerging challenges in era of technology.

## **5.2 Conclusions**

In light of the key problems and challenges that the study found out, it is paramount that in order to ensure the smooth operation of the credit department, and hence maintain profitability, the following issues need to be taken into serious consideration:

Basing on the findings and the specific research objectives, the researcher learned the following in these areas:

### **5.2.1 The BBT financial procedures and loan performance**

The bank is very serious in following its laid down financial procedures especially during loan application and approval process. It also implements almost all the customers' comments/opinion in various areas of credit operation. So the financial procedures and loan performance of BBT are good though some improvements are required. The suggested improvements are shown in section 5.2 of recommendations.

### **5.2.2 The analysis of underwriting process, growth and profitability**

The majority of the respondents agreed that BBT is doing well in terms of underwriting process, growth and profitability. This shows that the bank has a very strong underwriting process and is clearly following it. However, BBT should continue improving the process of credit analysis in relation to underwriting process, growth and profitability.

### **5.2.3 BBT policy on credit risk.**

The BBT policy on credit risk is well understood and used appropriately by the bank. Further training to its staff is needed because it was observed that some of the loan applications are submitted directly to KYC/LPC for appraisal after being received by the sales personnel, ignoring the policy and underwriting department for in-depth analysis.

#### **5.2.4 BBT credit administration and recovering process**

So far the level of impairment keeps increasing year by year which shows that there are still some weaknesses in monitoring and follow-up on loan repayments. Therefore, BBT is needed to keep improving its policy in relation to credit risk management as well as building the culture which will ensure that the effectiveness of credit risk management will remain the key element of the organization.

### **5.2 Recommendations**

After conclusion the researcher came up with some of the key recommendations which BBT needs to implement for better growth and stability of the business particularly the lending business (credit portfolio).

#### **5.3.1 Familiarity with credit policy and risk profile of the bank**

The staff of Barclays, especially those who are in credit department, should understand precisely the credit policy and risk profile of the bank because this is central to successful credit risk management. Therefore the management should emphasize the staff to often read and understand the credit policy and its culture and risk profile. Also the policy, risk profile, and credit practices of a bank must be linked with all process starting with the stage of acquiring initial information from customers.

Also, BBT needs to review its credit policies and risk control programs regularly and make them familiar to its staff because the bank is on the campaign of high retail expansion and financial growth.

#### **5.3.2 Improving the loan structure and pricing**

Credit risk can be well managed by improving the loan structure of the bank. The use of securities like collateral, guarantees, and insurance during and after the loan underwritten will cover the loss at a point of default. It was discussed earlier that some of the personal loans are overpriced by BBT. For example, the interest per annum for most of the personal loans is too high which result to some of the customers to run away from their obligation of paying back their loans. The

important thing is that, BBT should continue developing systems to measure and price risk credits and portfolio accordingly.

### **5.3.3 Improving loan review process**

Loan review is a main stay of internal control of the loan portfolio. Periodic objective reviews of credit risk levels and risk management processes are essential to effective portfolio risk management. The BBT management should focus on the role and effectiveness of loan review as part of a comprehensive credit risk management process. Assessment of the loan review function should also include evaluation of its role in assuring the effectiveness of the loan portfolio management process.

Moreover the bank should empower the credit department staff by establishing a system which will make the staff independent and able to take ownership on reviewing rules, procedures and policies. This will assist in improving the whole loan review process. The management should also implement them whenever necessary.

### **5.3.4 Improving the strategic plans for risk management**

It was observed that the strategic planning practice for retail credit risk management at BBT focuses on what proportion of the balance sheet the credit should compromise. However, more components such as loan quality, portfolio diversification, loan product mix, targeted industries and market share should be considered on credit risk management. The loan portfolio growth is very aggressive. Therefore the management of BBT should set and follow the risk limits on the bank's lending activities. Risk limits should take into consideration the bank's historical loss experience, its ability to absorb future losses, and the bank's desired level of return. Limits may be set in various ways, individually and in combination. Limits should be based on the interrelationship of risk and reward and on the risk to banks core capital or both. The management of BBT should adopt financial performance measures that consider the relationship between risk and return as well as assessing the risk-return relationship at both the individual loans and portfolio levels. Therefore BBT should incorporate more risk return analysis into loan underwriting decisions and portfolio management practices.

### **5.3.5 Updating and reviewing credit risk ratings**

The benefits of rating risk are more fully realized if they are dynamic. So the BBT management and the whole staff team should keep updating and reviewing the risk ratings whenever relevant new information is received. The credit operation manual should be reviewed at least annually to ensure that risk ratings are accurate and up-to-date. This will make the bank to gain efficiency in retail loans at retail credit department.

### **5.3.6 Strengthening the Credit Risk Department**

The credit risk unit, particularly in collections, has played a central role in successful credit risk management due to its essential responsibilities in managing the credit risks that arises from different defaulters. The department does its daily activities basing on the policy given which insists ethics and effectiveness in their duties in order to recover overdue payments efficiently and maintain customers. So, the bank needs to strengthen this department by hiring more highly qualified staff, competent and trustable. This will help the bank to appraisal good loans and to have clean loans which result in profit making and risk minimization profile. It will also encourage the best relationship with the potential customers.

Apart from hiring best staff also the bank is supposed to set good payment package to the credit staff by improving their monthly salaries and introducing incentives based on performance. All of these will result in better management of the credit risk.

### **5.3.7 Improving communication among the staff and customers**

The BBT staff should provide clear, concise, and timely information to the customers regarding price rate (i.e. loan interest on a specific product), due date, and its policy amendment whenever necessary to make their customers familiar with the service and its implication. The findings show that most of the customers lack information on how the bank deals with credit risk. This reflects the perception of customers on how banks manage its credit risk. When information improved some of the

customers will be very keen to pay back their loan installments at the time due to avoid being blacklisted.

### **5.3.8 Considerations for eliminating risks at BBT**

- Lack of credit reference bureau (or institutions for credit ratings) in Tanzanians commercial banks
- Low sharing of information between banks - someone who defaulted at NMB, NBC can still get a loan at BBT and other commercial banks in Tanzania because there is no common database for all commercial banks in the country.
- Most of collaterals are informal – that means it is difficult to realize those securities when a customer default.
- Purpose of the loan – most of our customers have no clear focus or target on how they could spend their loan, so they diverge the funds into something that was not planned and that is not sustainable. They take a loan only because they qualify.
- Lack of professional management team especially those at credit risk and collection departments.
- Lack of knowledge regarding risk management and credit/finance related
- Transparency – whereby borrowers do not disclose all information or right information and are not honest about their businesses and practices.
- Lack of risk mitigation tools and customers bad attitude towards repaying their loans.

### **5.3 Areas for Further Study**

The researcher ended up by suggesting further areas of study. Other methods of collecting data can be used in future for further research, in other Tanzanian commercial banks like CRDB, Standard Chartered Bank, NBC etc. This is important in order to establish further risks which they face in lending businesses. In case of BBT, other studies are required on Commercial Loans (i.e. big loans) and, Business Solution loans (SMEs or Medium loans) instead of retail credit loans (small loans) only.

## REFERENCES

- Ahmad, N.H. and Ariff, M. (2007). Multi-country Study of Bank Credit Risk Determinants, *International Journal of Banking and Finance*, 5(1), 135-152.
- Altman, E and Sounders. "Credit Risk Measurement and Developments over the last 20 years". *Journal of Banking and Finance*, Vol.21 page 1721-1742. 1998.
- Ansell, J and Wharton, F (1992). *Risk Analysis, Assessment and Management*. John Wiley & Sons Ltd, New Jersey.
- Augustine, C. (1995), *Banking industry Survey*. August & Co, Lagos.
- Barclays Bank, Board Meeting Report, 2012. BBT Head Office, Dar es Salaam.
- Barclays Bank, Credit Risk Manual of 2012. BBT Head Office, Dar es Salaam.
- Basel Committee, 1999a. Principles for the Management of Credit Risk. Basel Committee on Banking Supervision, July.
- Becher A., D., Cambell II, L., T. (2005). Interstate Banking Deregulation and the Changing Nature of Bank Mergers, *Journal of Financial Research*, 28:2, 1-20
- BOT, (2010), Banking and Financial Institutions Act. The Management of Risk Assets Regulations. BOT Head Office, Dar es Salaam.
- BOT. (2008), Risk Management Report Guidelines for Banks and Financial Institutions. BOT Head Office, Dar es Salaam.
- Bourke, P., (1989). "Concentration and other determinants of bank profitability in

- Cebenoyan, Sinan A., Strahan, E. P. (2004). Risk Management, Capital Structure and Lending at Banks, *Journal of Banking & Finance*, 28, 19–43
- Central Bank of Kenya (2009). Risk Management Survey on Kenya’s Banking Sector. Nairobi.
- Chambers, R L, and Skinner, C J (editors) (2003), *Analysis of Survey Data*, Wiley
- Chijoriga M. M. (1997): An Application of Credit Scoring and Financial Distress prediction Models to commercial Bank Lending: The case of Tanzania. PhD Dissertation Wirtschafts Universitatwien (WU) Vienna.
- Chijoriga, M.M (1997). An application of credit scoring and financial distress prediction models to commercial bank lending: The case of Tanzania. Unpublished PhD. Thesis, University of Vienna.
- Comptroller, S (1998). *Loan Portfolio Management*. Comptroller & Sons, New Delhi.
- Comptroller, S (2009). *Rating Credit Risk*. Comptroller & Sons, New Delhi.
- Culp, C. L. and Neves, A. M. P., 1998. Credit and Interest Rate Risk in the Business of Banking. *Derivatives Quarterly*, 4(4), pp. 19-35.
- Demsetz, R. S and Philip E. (2011), Agency problem and Risk taking at banks, Federal Reserve Bank of New York, New York.
- Eisenhardt, K. M. (1989) "Building theories from case study research", in *The Academy of Management Review*.
- Europe, North America and Australia’’. *Journal of Banking and Finance* 13, 65- 79.

- Felix, A.T and Claudine, T.N (2008). Bank Performance and Credit Risk Management, Unpublished Masters Dissertation in Finance, University of Skovde.
- Gerald, C. Jr. (2006), Bank regulation, Policy Research Working Paper, No. 1171, Washington, DC: World Bank.
- Harvey C. (2007), The role of commercial banking in recovery from financial disaster in Ghana, Tanzania and Uganda, Paper No.DP.325, Brighton: IDS, University of Sussex.
- Harvey, C. and Carolyn J. (2009), *Interest rate policy, Taxation and Risk Control*, Prentice Hall, New Jersey.
- Heffernan, S. (1996), *Modern Banking in Theory and Practice*, Wiley, New York, NY.
- Hennie, V. G., 2003. *Analyzing and Managing Banking Risk: A Framework for Assessing Corporate Governance and Financial Risk*, 2nd edition. Washington DC: World Bank Publications.
- Holliwell, J. (2008). *The Financial Risk Manual: A Systematic Guide to Identifying and Managing Financial Risk*. Pitman Publishing, London.
- HSBC 2006 Annual Report: <http://www.hsbc.com>
- Joel, B. (2007). *Risk Management in Banking*, 2<sup>nd</sup> Edition. John Wiley & Sons Ltd, New Jersey.
- Kaaya et al (2013), Credit Risk and Commercial Banks Performance in Tanzania: a Panel Data Analysis, *Research Journal of Finance and Accounting*

www.iiste.org ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online) Vol.4,  
No.16, 2013.

Kariuki, W.P. (2006). Interest rate liberalization and the locative efficient of credit,  
Ph.D. thesis, Brighton IDS, University of Sussex.

Kileo, K. (2012). Risk Management in Tanzania Experience & Challenges. Dar es  
Salaam. Tanzania Risk Management Guidelines for Banks and Financial  
Institutions, 2010

Kothari, C.R.,1985, Research Methodology- Methods and Techniques, New Delhi,

Miller, S.M., Noulas, A.G., (1997). ‘‘Portfolio mix and large-bank profitability i

Oborn, E; Barrett, M; and Exworthy, M (2011), Policy Entrepreneurship in  
Development of Public Sector Strategy: The Case of London Health  
Reform, Public Administration, Vol. 89 (2), pp. 325-344 USA’’. Applied  
Economics 29 (4), 505-512.Wiley Eastern Limited.

Williams, C. A Jr. et al (2005). Risk Management and Insurance 8<sup>th</sup> ed. Irwin  
McGraw-Hill New York City.

Williams, S (2008). *Small Business Guide*, 11<sup>th</sup> Edition. Lloyds Bank Press, London.

## APPENDICES

### Appendix 1: Questionnaire to Barclays Staff

**Dear Sir/Madam,**

I am **Jeremia Henry Msuya** doing a research on “The Performance of Credit Portfolio and Risk Management at Barclays Banks”. I am collecting different data from bank’s employees and customers. In order to fulfill the objective of this research, I kindly request you to assist in this finding by responding to the following questions. Thank you very much for participating in this research:

#### **Respondent’s Particulars:**

Date .....

Name ..... (Optional)

Position ..... (Optional)

Organization .....

#### **Professional Questions**

Cycle any of the number that reflects to your experience and understanding on credit risk management at BBT.

#### **The meaning of answers:**

1 = strongly disagree,  
2 = disagree,  
3 = agree,  
4 = strongly agree,  
5 = I don’t know

Questions	Statement	Answer				
1	Knowledgeable staff in credit department are incorporated in Bank's decisions and implementation	1	2	3	4	5
2	In BBT during credit appraisal the rules, polices and principles of credit risk management are applied.	1	2	3	4	5
3	The process of credit analysis in relation to services deliverance is clearly followed by both staff and customers	1	2	3	4	5
4	The credit risk management is effective in BBT	1	2	3	4	5
5	The determinants of credit risk management (5Cs) in Barclays Bank Tanzanian are well known and applied	1	2	3	4	5
6	The suggestions on credit risk management from various stake holders are implemented by BBT.	1	2	3	4	5
7	The credit analysis and approval procedures are affecting positively both banks and customers.	1	2	3	4	5
8	The use of collection agents when the internal ways have failed are strongly encouraged by BBT.	1	2	3	4	5
9	The advantages of outsourcing to external collectors are very big as compared to the use of internal collectors only.	1	2	3	4	5
10	The weak points in recovering the bank's money are always rectified in order to improve collections and minimize the rate of defaulters in Barclays bank Tanzania.	1	2	3	4	5

\*\*\*\*\* **Thanks for your faithful participation** \*\*\*\*\*

## **Appendix 2: Questionnaire to Barclays Customers**

**Dear Sir/Madam,**

I am **Jeremia Msuya** doing a research on “The Performance of Credit Portfolio and Risk Management at Barclays Banks”. I am collecting different data from bank’s employees and customers. In order to fulfill the objective of this research; I kindly request you to assist in this findings by responding to the following questions. Thank you very much for participating in this research:

### **Respondent’s Particulars:**

Date .....

Name of respondent ..... (Optional)

Title/Position (if employed) ..... (Optional)

Organization .....

### **General Questions (part 1)**

Cycle any of the number that reflects to your experience and understanding on credit risk management at Barclays Bank Tanzania Ltd.

### **The meaning of answers:**

- 1 = strongly disagree,
- 2 = disagree,
- 3 = agree,
- 4 = strongly agree,
- 5 = I don’t know

Questions	Statement	Answer				
1	During credit appraisal process, Barclays staff are following its rules, polices and principles.	1	2	3	4	5
2	The process of credit analysis in relation to services deliverance is clearly followed by both staff and customers	1	2	3	4	5
3	The comments/opinions on credit risk management from customers are implemented by BBT	1	2	3	4	5
4	The use of collection agents when the internal ways have failed are strongly encouraged by BBT.	1	2	3	4	5
5	The use of external agents instead of themselves to collect debts from defaulters, the banks have been able to collect debts more effectively	1	2	3	4	5

### General Questions (part 2)

Cycle any of a letter that reflects to your experience and understanding on credit risk management at Barclays Bank Tanzania Ltd.

6. Please rate the quality of Barclay's customer care services

- a) Excellent
- b) Good
- c) Average
- d) Poor
- e) Very poor

7. Please rate the quality of Barclay's procedures, policies, performances of loan application, approval and collection

- a) Excellent
- b) Good

- c) Average
- d) Poor
- e) Very poor

8. Please rate the credit analysis and approval procedures by Tanzanian commercial banks like Barclays Bank Tanzania.

- a) Excellent
- b) Good
- c) Average
- d) Poor
- e) Very poor

9. Please rate the effectiveness of credit risk management in Tanzanian commercial banks like Barclays Bank Tanzania.

- a) Excellent
- b) Good
- c) Average
- d) Poor
- e) Very poor

10. Please rate the level of applying the subjective analysis (5Cs) in lending process in Tanzanian commercial banks like Barclays Bank Tanzania.

- a) Excellent
- b) Good
- c) Average
- d) Poor
- e) Very poor

\*\*\*\*\* **Thanks for your Faithful participation** \*\*\*\*\*