

**EFFECTS OF HIGH COST IN THE ISSUANCE OF A BANK
GUARANTEE BY COMMERCIAL BANKS IN TANZANIA
THE CASE OF CRDB BANK PLC**

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THE CASE OF CRDB BANK PLC**

By

Eustadius Kalokola

**A Dissertation Submitted in Partial Fulfilment of the Requirements for Award of
the Degree of Master of Science in Accounting and Finance of Mzumbe University**

2013

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DEDICATION

This work is dedicated to my treasured late Grand Parents, The Late Mr & Mrs Laurent Kalokola, who insisted me to follow proper values in life and to stand alone when I am needed to stand. That is to say none can hinder my performance as long as I will be determined and focused in every sphere of life Politically, Economically, Socially, Technologically, Environmentally and Religiously (PESTER).

The lessons and values that were taught by them are the ones which took me through till the completion of this work. May their Soul rest in peace. Amen.

LIST OF ABBREVIATIONS AND ACRONYMS

BG	Bank Guarantee
BGH	Bank Guarantee Holder
CRDB	Co-operative and Rural Development Bank
FDR	Fixed Deposit Receipt
LC	Letter of Credit
MKUKUTA	Mkakati wa Kukuza Uchumi na Kupunguza Umasikini Tanzania.
NSGRP	National Strategy for Growth and Reduction of Poverty.
PESTER	Politically, Economically, Socially, Technologically, Environmentally and Religiously.
URT	United Republic of Tanzania

ABSTRACT

The study was mainly aimed at assessing the causes of high cost in the issuance of bank guarantee by commercial banks in Tanzania; CRDB Morogoro Branches were selected as being an appropriate representative. The study used a cross sectional study design which specifically deployed a diagnostic study in directing towards discovering what is happening, why is it happening and on what can be done on high costs pertaining to Bank Guarantees with Tanzanian Banks.

The sample size of the study comprised of 53 respondents. Objectives of the study were to determine the extent to which Bank Guarantees are preferred by customers, identify factors which are considered in establishing the issuance cost, establish components involved in coming up with issuance cost and lastly seek justification for including those components in coming up with issuance cost or cost of a bank guarantee.

The study found that majority of customers prefers bank guarantee since it assures their clients regarding completion of the contract. It was further found that banks consider factors such as value of the contract, asset pledged as collaterals, reputation of the customer (credit worthiness) and nature of his/ her business. More ever, it was found that banks when computing issuance cost they include components such as application fee, mortgage fee, legal fee and valuation fees.

The study concludes that bank guarantees are generally preferred by customers. It has further concluded that issuance costs are based on necessary procedures that banks must follow before issuing the guarantee. It is therefore concluded that, there is justification for the issuance cost to be high since they are based on necessary procedures that must be followed by the banks before providing guarantees to their customers.

The study recommends that costs which are not very necessary in providing guarantees be removed. These include the cost of mortgage and valuation fee.

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CHAPTER ONE

INTRODUCTION

1.1 Background Information

The growth of businesses and trading activities globally have seen transactions involving suppliers and vendors purchasing and selling goods and services to and from distant and or overseas customers with whom they don't have well established business relationships. This has brought about the need for the use of different forms of financial instruments designed to reduce the risk taken by each party involved in such transactions. Bank Guarantee is one of the mostly used among such instruments.

A Bank Guarantee is a pledge on the part of a bank to make someone's debt good in the event that he or she cannot pay it. Bank guarantees are essentially like agreements to stand as a consigner (an obligor) on a transaction. The bank becomes obligated by signing the instrument in conjunction with the original obligor, there by promising to pay it in full. In the event that the original party cannot follow through, the bank can be called upon to provide that particular payment (Gupta, 2010).

Many banks offer bank guarantees as a service to their customers for the purpose of facilitating large business operations and deals, and this particular banking tool is primarily used by big customers such as corporate bodies and governments. The growing needs of users of the different contracts to accomplish a certain objective such as construction contracts, paved a way for the development of a more sensitized way in the engagements of different undertakings. For many years the process of engaging into different contracts were actually undertaken in such a way which was not securing different interests of the pertinent parties. This arose to the situation which caused different squabbles between parties.

From the latter, different mechanisms in undertakings were decided to be designed in a manner which might try to deal with the said disputes in order for the contractual relationships to be designed in a way to satisfy every party which is involved in such a relationship. And the said satisfaction is merely based on the level which will provide a mechanism to compensate any party upon breach. This is to say, confidence will be attained when there is a satisfactory level of a security to be provided/ set at a necessary level so that to indemnify the required party upon unsatisfactory or complete loss which can arise due to the engagement of the specified contract.

Corporate undertaking can be defined as a guaranty, promise, or stipulation that creates an obligation to a particular corporation upon falling into the engagement with another party to establish, implement and accomplish the required task in the manner agreed between parties (Concise Oxford Dictionary, 2007). A corporation is one kind of company, which means an entity that has separate legal personality from the people who carry out its activities or have rights to its property. The relationship between parties concerned can be of a company and an individual or a company and another company or a company and the government or its agencies. Corporate undertaking is as old as a corporation because as corporations emerged also corporate undertakings were simultaneously taking place in 1772 in England, exactly 240 years ago today. The idea of the corporation was born, matured, over-extended, reined-in, refined, patched, updated, over-extended again, propped-up and finally widely declared to be obsolete (Venkat, 2008).

Most recent construction contracts require a Bank Guarantee as an appropriate security to be placed so that to insure the party in the contract (Mason, 1973). These financial instruments are often used in trade financing when suppliers, or vendors, are purchasing and selling goods to and from overseas customers with whom they don't have established business relationships (Grath, 2008).

The instruments are designed to reduce the risk taken by each party. The use of bank guarantee is now so wide spread that there very few operations which do not involve the direct applicability of it. That is to say, many engagements be it a constructions or maintenance all require the use of this facility. A bank guarantee may suit your business if you need to promise payment to a third party, (eg: to secure a business contract or leasing arrangement) or if you are in an industry such as property development, building, contracting or retailing (Grath, 2008).

In international trade, it has become increasingly common for either or both parties to demand separate undertakings usually in the forms of bonds, guarantees or standby letters of credit, covering the obligations of the buyer (Grath, 2008). When bank guarantee first became available on commercial basis, during the Bretton Woods era, many parties quickly develop a participation when a bank loan is made and investors contract with the bank for some part of the loan. This caused a question as to why the bank's guarantees of loans to government by private investors, which was intended to stimulate foreign portfolio lending, never developed instead the opposite was true (Mason, 1973: 915).

Letter of credit is a binding document that a buyer can request from his/ her bank in order to guarantee that the payment for goods will be transferred to the seller. Basically, a LC gives the seller reassurance that s/he will receive the payment for the goods. In order for the payment to occur the seller has to present the bank with the necessary shipping documents confirming the shipment of goods within a given timeframe (Venkat, 2008).

That is to say, bank guarantees on loans were only made available only when private investors were in need of it only but not when the government needs. When the government needs such a facility, it will be able to issue other types of securities like

bonds but not stocks because the government cannot sell its ownership. The primary purpose of bank guarantee was considered to be to put lenders in direct touch with borrowers or to bring borrowers into the market. In fact the bank has never guaranteed either a foreign loan of a private investor or a public offering of a foreign government. Initially the reason given for not using a guarantee was that the bank had still to test the market for its own securities. But after the successful sale of \$ 250 million in bank securities in July 1947, this reason was less tenable (Mason, 1973).

From July 1947, the bank guarantee was issued universally irrespective of the physical location of the applicant/ borrower for the reason that collateral must be put in consideration of a guarantee. From this juncture a bank guarantee allows different suppliers to offer customers, suppliers and other third parties a guarantee of payment to secure a contract or leasing arrangement without tying up your working capital or affecting your other business activities. In actual sense here, stronger business relationships will have been created with customers and suppliers and the security of knowing that payment has been guaranteed by one of the financial institutions will be developed. The cost to most borrowers would have been higher if they followed the guarantee route rather than borrowing directly from the bank. Guarantees were not very popular in the US market, and the legal complications involved in such issues were serious (Grath, 2008).

The situation of bank guarantees in Tanzania is a bit not flowing in a smooth way because of the stumbling blocks or obstacles set in acquiring such a security. This is due to the fact that the number of SMEs participating in this facility are not displaying the initial intention of instigating this facility and this can be clearly seen from the BOT Publication by The Director of Financial Markets that, During the financial year 2004/05 the Government of Tanzania decided to establish the Small and Medium Enterprise Credit Guarantee Scheme (SME-CGS). The scheme was geared towards promoting and

supporting SMEs by creating and enabling environment for expansion and facilitating access to financial resources, thereby accelerating economic growth and job creation. This initiative is in line with the National Policy on SME Development and Poverty Reduction Strategy (BOT, 2013).

1.2 Statement of the Problem

There are various types of securities which can be used to cover the contractual relationship which exists between the concerned parties. Construction contracts usually provide for stage payments against architects' or engineers' certificates and for a specified percentage of the amount certified in each certificate to be retained by the employer for a specified period of time as a safeguard against defects. The interim payments will enable the contractor to improve his cash flow position. Due to the said interim payments made by the client for the proposed work to start that's where arose a need for the provision of a security. These securities are normally issued in form of a bank guarantee in order to facilitate the arrangement established. These guarantees are commonly issued with regard to the type of the contract or work to be engaged.

Most clients prefer a bank guarantee (Advance Payment Bond/Guarantee) to act as a security towards the payment made to the contractor because it is the one which has the ability to satisfy the terms of the engaged undertakings. It is important to note that these bank guarantees apply only whenever the issuing bank's guarantee is not contingent on the existence, validity and enforceability of its customer's obligation. This is called an "abstract" guarantee (i.e. the bank's obligation is to pay regardless of any disputes between its customer and the beneficiary) (Eagle Golden Investment, 2012).

Despite of the mentioned features above, these Bank Guarantees are normally issued at a relatively higher cost compared to other types of securities (i.e. the cost of servicing guarantees is significantly less than the cost of bank lending).

The reasons for these high costs are not well established. This study therefore intended to assess factors making banks in Tanzania to charge high guarantee costs to customers. The high cost frustrates them to undertake projects whose owners demand guarantee. CRDB Bank PLC was taken as a case study.

1.3 Objectives of the Study

The overall objective the study was to assess factors which contribute to high cost in issuing Bank Guarantees.

Specifically, the study intended to:

- i) Determine the extent to which Bank Guarantees are preferred by customers.
- ii) Identify factors considered in establishing the issuance cost.
- iii) Establish the components involved in coming up with the issuance cost.
- iv) Seek justification for including those components in coming up with issuance cost or cost of a bank guarantee.

1.4 Research Questions

- i) What are customers' preferences on Bank Guarantees?
- ii) Which factors are considered in establishing the issuance cost?
- iii) Which components are considered in making up the issuance cost?
- iv) What are justifications for including all the components in coming up with the issuance cost?

1.5 Significance of the study

Despite the fact that, the study will extend the researchers understanding on costs associated with Bank Guarantee, the study will also be significant to Financial Institutions dealing with secured instruments in understanding and put into practice the preventive and control measures which will be suggested upon researcher's findings, as

a result the Banks will increase effort to reduce the costs associated with bank guarantees and become more confident in providing more guarantees, thus boasting the vicious liquidity spiral (As costs on bank guarantee decreases, Banks confidence of providing more guarantees tend to increase, leading to increase in aggregate demand) this will lead to the achievement of the 2025 goal of National Strategy for Growth and Reduction of Poverty (NSGRP) in Kiswahili known as MKUKUTA. And if the implementation will be achieved properly, then the strategy will be in line with the second paragraph of page two of the NSGRP. The findings will also be of core directions to other researchers conducting research studies in the same field or related topic either in Tanzania or any part of the world, without forgetting different users of bank guarantees to be aware of the genuine factors resulting into high costs of these instruments and be able to avoid the factors where necessary.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The first part of this chapter mainly dealt with the Definition of Key Concepts of the study such as Bank Guarantee, Factors and Evaluation. The second section discusses the structure of a bank guarantee for instance Direct Guarantee and Indirect Guarantee. The third part of the chapter describes types of Bank Guarantees which are Tender Guarantee; Performance Guarantee, Advance-payment Guarantee and Maintenance or warranty guarantee. The fourth section discusses similar studies conducted on Bank Guarantee. The fifth part of the chapter talks about the causes of a bank guarantee. The sixth section describes the processing of a bank guarantee. The seventh part discusses on the effects of bank guarantee. The eighth section talks about the duties of banks with respect to BG to its parties. The ninth section elaborates the situation of BG in Tanzania. The tenth part of the chapter distinguishes between BG and LC. The eleventh section elaborates on the principle of independence of bank guarantee. The mechanisms of payment of a bank guarantee are detailed in section twelve of this chapter. The last part of this chapter provides the conceptual framework of the study.

2.2 Definition of Key Concepts

i) Bank Guarantee

A Bank Guarantee is a written obligation by the issuing bank to pay a sum to a beneficiary on behalf of their customer in the event that the customer does not pay the beneficiary (Golden Eagle Investment, 2012).

Bank Guarantee means a comfort, which is being given by issuing bank, to a party (Beneficiary in whose favour the guarantee is issued) of losses or damages if the client

(on whose behalf the guarantee is being issued) fails to complete or conform to the terms of agreement (Gupta, 2010).

ii) Factors

A factor can be defined as a circumstance, fact, or influence that contributes to a result (Concise Oxford Dictionary, 2007).

iii) Evaluation

An Evaluation can be said to be as an act of forming an idea of the amount, number, or value of any concept under study (Concise Oxford Dictionary, 2007).

2.3 Structure: Direct and Indirect Guarantee

2.3.1 Direct Bank Guarantee

This involves the act of the issuing bank guarantee the obligation of its customers (i.e. Obligor) to its third part (i.e. beneficiary). A guarantee is a casuistic contract. It always derived from a relationship between the principal debtor and the creditor (beneficiary). This relationship is referred to as the underlying relationship or contract.

In order to safeguard the employer or buyer (referred therein as “creditor”) against non-performance or late or defective performance by the supplier or contractor (referred therein as “debtor”) international contracts usually contain a clause that demands the debtor to provide a guarantee in favour of the creditor (This occurs mainly when it is a first time contract and that the two parties have not yet built a relationship of trust) (Goode, 2000). Pursuant to this clause, the debtor instructs his bank to issue a guarantee

with the terms and conditions as specified by him. The relationship between the debtor and the bank embodies thus an internal mandate.

Of course, the bank is not obliged to carry out this instruction unless it has agreed to do so, and it will in any event require to be put in funds or to have other provision made to cover its prospective liability under the guarantee. Under this relationship, the debtor becomes the principal, the bank the guarantor and the creditor the beneficiary. Should the bank be called to pay under the guarantee, the bank must pay provided that the demand and other documents (if any) conform to the terms and provisions of the guarantee and in the absence of fraud or other exculpatory ground. The bank will then claim reimbursement from the principal under its counter-indemnity contract (Goode, 2000).

2.3.2 Indirect Bank Guarantee

This issued in favour of the second bank which has issued a guarantee on behalf of the original's bank's customer. The beneficiary may require the guarantee to be issued by a bank in his own country instead of relying on the principal's bank. This is common practice since it gives many advantages to the beneficiary on several counts. Firstly, the risk of currency exchange restriction is limited. Secondly, that bank can be the house bank of the beneficiary this means that it will be more inclined to pay under the guarantee and any problems will solve more smoothly than if it was with a foreign bank. Thirdly and finally, the national law of the beneficiary will govern the relationship between the beneficiary and the bank (Bertrams, 2004).

In such a situation, the principal asks his bank (here called the instructing bank) to arrange for the issue of the guarantee by a bank in the country of the beneficiary. Instructions are then given to the local bank, the issuing bank, by the instructing bank to issue a guarantee in favour of the beneficiary against a counter-guarantee from it. The

instructing bank will be then entitled to an indemnity from its customer, the principal. The adjective “indirect” refers to the structure of two links, notably mandate and counter-guarantee between the principal and the instructing bank, and instructions, mandate and counter-guarantee between the instructing bank and the issuing bank. This structure encompasses four contracts: The first contract is the underlying contract; the second contract reflects the relationship between the principal and the instructing bank (indemnity contract); the third contract is the relationship between the instructing bank and the issuing bank (counter-guarantee contract) and the last contract is the most fragile in the entire structure and relates to the guarantee itself which is issued by the issuing bank to the beneficiary (Goode, 2000).

2.4 Types of Bank Guarantee

The variety of risks which attend the conclusion and execution of contracts or which result from advance and interim payments has engendered various types of guarantee. All guarantees serve basically the same overall purpose namely the protection against non-performance, however it has been deemed appropriate to have separate guarantees for particular phases of performance rather than to have a single guarantee covering all the stages of performance. This has the advantage to limit the liability of the principal to the amount corresponding to a single phase of performance. Among the range of demand guarantee are: the tender guarantee, performance guarantee, advance payment guarantee, retention guarantee, maintenance guarantee e.t.c.

For the purpose of this study, only these types of guarantee will be reviewed although there are others forms of guarantee such as the judicial guarantees and the customs guarantee (Kayembe, 2008). That is to say, all the said guarantees fall between performance guarantee and financial guarantee which are the main types of guarantees.

2.4.1 Tender Guarantee

Construction contracts and major contracts for the supply of goods are often awarded through tender procedures. The buyer or employer favours this form of trading because it allows them to ascertain the best price for the goods and the best available service for the order. Furthermore, tender guarantees are usually used when the contract is of high value or when the project being tendered is time critical. Where tenders are invited it is often a condition of consideration of the tender that the tenderer provides a tender guarantee as assurance for the employer or buyer of his intention to sign the contract and comply with the terms of such contract in the event of his tender being accepted (Penn, 1987).

Indeed, it is not unknown for a supplier to submit a tender for a contract and then refuse to proceed with the contract when the contract is awarded to him. The purpose of such guarantee is to compensate the beneficiary of the guarantee for the additional costs he may incur in re-awarding the contract to another party. Once the tender has been accepted, and assuming that the customer is willing to proceed, it will normally be necessary to replace the tender guarantee with a suitable performance guarantee. Some tender guarantees, however, are drafted in such a way that they automatically become performance guarantee once the tender is accepted.

2.4.2 Performance Guarantee

Performance guarantees are the instruments most frequently used in international trade. They can be characterized as the counterpart of a documentary credit. Indeed, while a documentary credit assures payment in anticipation of proper performance by the seller, a performance guarantee assures payment in the event that the seller has not fulfilled his

obligation under the contract (Bertrams, 2004). For instance, if the buyer is uncertain that the seller will supply the goods sold, he will require a performance guarantee in order to safeguard his position. Accordingly, if the seller does not perform his obligation under the contract of sale the buyer will simply have to make a demand. The performance guarantee is the guarantee of the central performance of the contract from commencement to completion.

Indeed, unless otherwise expressly stated in the contract, the ambit of the performance guarantee extends not only to the delivery of the goods but includes the installation, contractual warranty obligations, and all other obligations that form part of the principal contract. Performance guarantees are usually requested within a few weeks of the contract being awarded, however in some cases they can be a prerequisite for the formation of the contract. In such an event, the guarantor should give its commitment in order for the contract to be effective.

2.4.3 Repayment or Advance-payment Guarantee

Advance payment guarantees are issued in circumstances where the seller negotiates for an advance payment. The repayment guarantee seeks to ensure the buyer that the money advanced will be returned in case of non-performance of the contract by the seller. They are particularly common in construction contracts, where the constructor needs a certain amount of money in order to enable him to start with the first phase of construction (Bertrams, 2004).

Generally, repayment guarantees contain a reduction clause by virtue of which a mechanism of reduction of the maximum amount is provided upon evidence of progressive performance. Consequently, the maximum amount is reduced to zero once the performance has been completely completed. It should be noted that the ambit of the repayment guarantee is broader than that of the performance guarantee. Indeed, while a

repayment guarantee should be considered as a “loan” being reimbursable even in the event of force majeure or voidance of the contract, a performance guarantee is only provided to secure any losses that the buyer may incur because of a breach of contract.

2.4.4 Maintenance or Warranty Guarantee

Maintenance guarantees are issued to ensure the employer or buyer of compensation in the event any defects or malfunctions become manifest after delivery of the goods or after provisional or substantial completion of the plant, during the maintenance or defects liability period (Bertrams, 2004). A maintenance guarantee serves the same purpose as a performance guarantee even if the maximum amount of maintenance guarantee tends to be considerably lower than a performance guarantee. A maintenance guarantee can also be furnished in order to persuade the employer to release the last instalment of the contract price, which he would otherwise have withheld as security for repairs or supplemental works by the contractor during the maintenance period (Goode, 2000).

2.4.5 Retention guarantee

Construction contracts usually provide for stage payments against architects’ or engineers’ certificates and for a specified percentage of the amount certified in each certificate to be retained by the employer for a specified period of time as a safeguard against defects. The interim payments will enable the contractor to improve his cash flow position. The purpose of the retention guarantee is similar to repayment guarantee in that it ensures to the employer a refund of the interim payments made and like performance guarantee, it indemnifies the employer if the contractor fails to meet his contractual obligations. The employer may be willing to release the retained money against a retention guarantee securing repayment of the released retention moneys if defects later occur or if the contractor fails to perform under the contract. The amount of

the retention guarantee usually varies between five and ten percent of the stage payments (Goode, 2000).

2.5 Studies Conducted on Bank Guarantees

A similar study on a Bank Guarantee titled “**Fraud Exception in Bank Guarantee**”, this study tried to evaluate the bank guarantee on the concept of Fraud and it supposed that, the bank guarantee is a device, which provides certainty of payment for the beneficiary.

However, the increased certainty for the beneficiary amounts to an increased risk of loss for the principal. Consequently, the balance of risk is considerably tipped in favour of the beneficiary, especially in the case of first demand guarantee. However, while the principle of independence achieves the desired commercial result in the majority of cases and the principal is willing to be exposed to the risk of loss for the eventual gains effected by a successful deal, the principle may give rise ---if applied too rigidly--- to inequitable results in one recurring situation: when the transaction is tainted by fraud. Indeed, fraud does attack the basic principles of every law of equity and justice. Therefore, protecting the bank's obligation of payment in the fields of demand guarantee without exception, when documents are in accordance with their terms and conditions, would lead to unpermissible protection of fraud. The courts have thus attempted to establish a balance between the commercial utility of bank guarantees and the desire to prevent unlawful result that may result from fraudulent actions on the part of the beneficiary. The balance has been achieved through the fraud exception. The study went further displaying the position of the pertinent bank in the whole engagement of the bank guarantee in the sense that it tried to explain what course of action will be applied during the life of the undersigned contract between the bank and its client (Kayembe, 2008).

The study aforesaid, if fraud on the part of the beneficiary is evident to the bank at the time of payment, the bank owes a duty to the principal to reject the demand and to refrain from payment. If the bank disregards this duty, it incurs liability towards the principal, which implies the forfeiture of its right of reimbursement under the contract of indemnity. The liability that the bank incurred derives from its duty to perform the contract of mandate between him and the principal in good faith and due care. Indeed, no one is entitled to assist in fraudulent practices by third parties. Without forgetting, the act of examining documents were explained in this study and it said that for the examination of documents presented under a demand guarantee, the globally accepted principle of strict compliance applies. The meaning of this principle is that the duty of the bank is to make payment only against documents that comply strictly with the terms of the guarantee.

Accordingly, if there are discrepancies between the documents, the bank is under a duty to reject them even though their material adequacy for the purposes of the underlying contract can be proven through evidence outside the documents. Also the bank will always have to ascertain whether the demand has been made in correct form and by the proper person and whether the beneficiary has submitted the statement of default (if so required by the guarantee). Additionally, the bank will have to verify if the demand has been made on or before the expiry date. Failure by the bank to comply with these requirements will unravel its right of reimbursement under the counter indemnity and may expose it to a claim of damage from the principal (Kayembe, 2008).

The study concluded by postulating the following findings, that the problem that appears throughout the study is, it seems that only limited protection is available to the principal under the fraud rule not only because of the different standards of evidence of fraud but also because of the stringent test of balance of convenience. A way of filling that

protection gap is for the courts to adopt a more interventionist position by shifting from the fraud exception to the possibility of having further ground of injunction. To this effect, Enonchong suggests the recognition of two more devices to combat the problem of abusive call, namely: “the underlying contract exception” and “the unconscionability exception” (The Researcher, 2013).

2.6 Causes of a Bank Guarantee

Bank guarantees are widespread and the scope of their usage is very increasing. It could be said with confidence that all major international economic transactions are conducted with at least some kind of bank guarantee. Furthermore, they are also commonly used in contracts within national borders. The guarantees are not only issued just in trades; it also given to government authorities for bidding of land, some project say hydropower or mines etc. For example when a company bid for mines (ore or coal), it needs to furnish the guarantee to the local authorities in which state it is going to bid. Also suppose one needs bid for road project, it is required to furnish the guarantee to the government authorities or the main contractor in case the company wishes to work as sub-contractor (Gupta, 2010).

This swift growth is related with the possibility to use bank guarantees as an appropriate back up to all kinds of transactions, both non-financial and purely financial obligations. Indeed, they are frequently used as security for default in connection with contracts for supply of goods, construction and shipbuilding contracts, mergers and acquisitions, technology transfers, as well as to secure obligations resulting from loans, leases, bond issues, commercial paper and other financial transactions. In addition, bank guarantees can provide security to both the party which is entitled to payment and the party which is entitled to receive goods or services (Mason, 1973).

By issuing the guarantee, the issuing bank is assuring payment of the certain amount of money (as specified in the bank guarantee) to the beneficiary in case of non-performance of a certain contract according to the terms and conditions contained in the same. By furnishing the Bank Guarantee, the buyer binds itself with the seller that it has an implied commitment to fulfill the terms and conditions of the agreed contract. If it fails to comply with the same, the bank will honor it. The party to whom the BG is given cannot go to its bank and en-cash. It is just a comfort that if we do business with some unknown party, we might not be on loss as we are not aware honesty, sincerity and authenticity of that party (Gupta, 2010).

2.7 Processing a Bank Guarantee

Processing of a bank guarantee is a mere act of designing the facility on how it can help to provide or shield any effect of the occurring loss when the contract engaged fail to be accomplished as planned. This processing of a bank guarantee is done by the bank issuing its bailment to his/her customer through bank's credit officer in order for the customer to be entrusted by his/her client and be able to be provided with the a certain lamp sum of money as a prepayment for the job to be done as it has been agreed by the parties. As processing is a way or method of manufacturing things, and in order for things to be manufactured fully, manufacturing costs are to be attached to the finished good. This is why a bank charge must be attached as a processing cost to a bank guarantee. A bank processing charge is an expense for a bank service that is included in processing costs of a bank guarantee (Libby, 2007).

That is to say, a bank guarantee is processed merely as any other security which has to be processed and issued by a credit officer, who has the authority of making such a contract viable. The issuance of a bank guarantee is a secured transaction as the client needs to mortgage the properties and cash in the form of FDR for issuing of same. The

bank cannot give a security without securing itself (Ms. Pendo Assey; Branch Director-CRDB Morogoro Branch, 2013).

2.8 Effects of Bank Guarantee

The guarantor bank is not obliged to supply goods or perform work on the principal's behalf. It will not, for instance, undertake to go on with the project itself if its client fails to do so, neither will it manufacture or supply anything in connection to the contract entered if the client falls behind with deliveries. The bank's commitment is solely a financial one, as its obligation as a guarantor is limited to the payment of a sum of money as a substitute for performance that has not been rendered (Credit Suisse, 2010).

A bank guarantee provides protection against non-performance in three ways:

2.8.1 Legitimation

A bank guarantee testifies to the principal's ability to carry out the contract. Since the issuance of a guarantee constitutes an irrevocable payment undertaking, a bank will not enter into such a commitment without first thoroughly examining the principal's financial status and technical capability (Credit Suisse, 2010).

2.8.2 Motivation

The principal stands to lose the guarantee amount if it fails to fulfil the contract terms. This is a strong incentive to complete the contract, even if the transaction has lost its appeal in the meantime (Credit Suisse, 2010).

The completion of the said contract, considering the factor of avoiding losing the guarantee due to not fulfilling the terms of the contract, may motivate the contractor of the to accomplish the contract nicely which in long run gear a business growth to the

extent of creating more employment and attract a significant interest among business stakeholders due to its contribution in economic growth and development (Nyello, 2012).

2.8.3 Compensation

If the principal fails to fulfil its obligations, the buyer is entitled to demand payment of the guarantee sum, which will compensate fully or partly for the financial consequences of the breach of the contract (Credit Suisse, 2010).

2.9 Bank duties

Apart from the protection provided by the bank guarantee, there are also duties which are supposed to be fulfilled by a particular bank with respect to a bank guarantee. The following are the said:

2.9.1 Duty of examination with respect to compliance with the terms and conditions of the guarantee

For the examination of documents presented under an international demand guarantee, the globally accepted principle of strict compliance applies. The meaning of this principle is that the duty of the bank is to make payment only against documents that comply strictly with the terms of the guarantee. Accordingly, if there are discrepancies between the documents, the bank is under a duty to reject them even though their material adequacy for the purposes of the underlying contract can be proven through evidence outside the documents. The bank will always have to ascertain whether the demand has been made in correct form and by the proper person and whether the beneficiary has submitted the statement of default (if so required by the guarantee). Additionally, the bank will have to verify if the demand has been made on or before the expiry date. Failure by the bank to comply with these requirements will unravel its right

of reimbursement under the counter indemnity and may expose it to a claim of damage from the principal (Bertram, 2004).

It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorized to accept are in the matter of the accompanying documents strictly observed. There is no room for documents which are almost the same, or which will do just as well. However, a mere visual inspection of the documents by the bank will suffice to determine that the documents are compliant. The bank is neither required to look beyond the documents to ascertain their compliance nor to check their authenticity (Nielsen, 2007).

Thus, all a bank is to do is to determine, based on the documents alone, whether they appear on their face to comply with the terms and conditions of the guarantee. In determining whether the documents comply, the bank will have no regard to trade custom. The reason to narrowly bind the bank to the terms of the guarantee is based in the fact that the bank has no visibility of the relation between the parties in the underlying contract and due to lack of industry; experience cannot foresee what the results of a deviation to the order will have (Nielsen, 2007).

However, at present the principle of strict compliance is somewhat softened. Consequently, bank does not have to insist on the rigid and meticulous fulfillment on the wording. A word-by-word compliance is only necessary if stipulated in the guarantee. Consequently, a one digit error in the number of a credit does not justify dishonor of the demand where the mistake is an obvious typographical or clerical error. Therefore, banks are not strictly liable if they fail to uncover discrepancies in the documents as long as they were acting with reasonable care. This means in other words that if the credit is ambiguous or unclear, the bank may need to clarify the matter with its customer, but if it does not see the need to, it commits no breach by adopting a reasonable interpretation.

2.9.2 Bank's duty to examine within a reasonable time

Banks must examine the documents within a reasonable time. The length of the reasonable time depends on e.g. the need for urgency or the complexity and language of the documents. Normally, it takes two to three banking days to examine the documents submitted under the guarantee. Exceeding this time limit, the bank does not trigger any disadvantages, as it is not liable since there is not a fixed date for the payment under the guarantee. However, the lack of any sanctions when exceeding the standard examination time does not entitle the bank to postpone a refusal for payment when there are discrepancies in the document until the day of expiration. It is common practice in the banking area, for the bank to notify the beneficiary immediately, to permit this latter to take further measures (Nielsen, 2007).

Consequently, failure for the bank to act within a reasonable time will seriously damage its international reputation.

2.9.3 Bank's duty of notification of the demand for payment

The main purpose of the notification is the announcement of the bank to the principal that the beneficiary has placed a demand under the guarantee and that consequently the claim for reimbursement of the guarantee now becomes due. So, the applicant shall have the time to attune to the imminent debit to his account or advise the bank which funds to use to honor the guarantee (Nielsen, 2007). However, in a case of plausible fraud the importance of notification has a side effect. It is common ground that the only possibility for the principal to obtain a preliminary stop-payment order is his ability to establish fraud on the part of the beneficiary. Should, however, payment by the bank already have been effected, his chances of reimbursement of the money debited from his account will be if he can prove not only fraud by the beneficiary but also knowledge of such fraud by the bank at the time of payment. As already discussed above, in such situation his chances of success are very small due to the high standard of proof. Consequently, it is crucial for the principal to be aware of a demand so that he can take the required steps for an interlocutory relief (Bertrams, 2004).

The question of whether the bank has a legal duty of notification towards its customer, the principal, has been long debated in the legal environment but still a unanimous view on the subject has not emerged. A general duty of notification has been rejected. Although it has been a long standing practice for the bank to give prior notification to their customer for the safeguard of their relationship it was found that this custom does not amount to a legal obligation on the part of the bank (Nielsen, 2007). The position would obviously be different if, according to the terms of the mandate, the bank had expressly agreed to inform its customer before making payment. Indeed, in such a case the bank would be exposed to liability if it breaches its contractual obligation. In Germany, however, the position is different from the one in the United Kingdom. Indeed, according to the BGH adjudicating a surety ship payable on first demand the notification serves to give the applicant to present facts, which would prevent the bank from payment. Accordingly, the BGH did not negate the bank's duty to notify. The bank however, does not have to insist or wait for a response from the applicant. The position is the same in the United States as well, where there exists a so-called "notice injunction" requiring the bank to inform the account party of the demand for payment and to allow a period of ten days before honoring the demand (Bertrams, 2004).

2.10 Bank Guarantee v Letter of Credit

Bank guarantee and Letter of Credit are financial instruments often used in inland or international trade when suppliers or vendors do not have established business relationship with their counterparts. The difference between the two instruments is the position of the bank relative to the buyer and seller of goods and services. The differences are explained as follow:

- 1) A letter of credit is a bank's direct undertaking to the supplier (called the beneficiary) to pay. When the letter of credit is in use, the issuing bank does not wait for the buyer to default, and for the seller to invoke the undertaking. In contrast, a guarantee is a written contract stating that in the event the primary

party (the buyer) is unable or unwilling to pay its dues to the supplier, the bank as guarantor to the transaction and the issuer of the BG, would pay (the client's debt) to the supplier. In other words bank guarantee is an undertaking on behalf of its customer. But this comes into play only when the principal party (the buyer) has failed to pay its supplier (Bose, 2010).

- 2) Essentially, the bank becomes a co-signer for its customer's purchases. Hence, in a BG the initial claim is still settled primarily against the bank's client, and not the bank itself. Should the client default, only then would the bank (which has issued the BG) agree to pay for its client's debts on behalf of its client. This is a type of a contingent guarantee. A bank guarantee, therefore, is more risky for the merchant and less risky for the bank. But this is not the case with a letter of credit (Bose, 2010).
- 3) With a bank guarantee, if a client defaults the bank assumes liability. With a letter of credit, liability rests solely with the issuing bank (this is being the key difference and the key advantage in an LC) which then must collect the money from client. Therefore, the principal character of an LC is that it is a potential claim against the bank, rather than a bank's client. An LC substitutes the bank's credit for its client's. The seller's risk is mitigated from the risk that the buyer will not pay to the risk that the bank will be unable to pay, which is unlikely. A letter of credit is less risky for the merchant, but more risky for a bank, though banks accept full liability in both cases. An LC is a direct responsibility of the issuing bank. The buyer does not at all come into the picture (his relation is with the issuing bank and no further). The LC is the primary instrument in a transaction. In contrast, a BG comes into operation (is invoked) only when the buyer has failed to perform his bit. The BG issuing bank is therefore the second line of defence; it is not the primary party.

2.11 Principle of independence

A demand guarantee generates the creation of various contracts (three when it is a direct bank guarantee and a total of four when it is an indirect bank guarantee) which are totally correlated to such an extent that the existence of one is only possible through the existence of the other. However, although the various contracts are functionally and commercially interdependent in some aspects, they are at the same time totally independent from each other.

The principle of independence or autonomy is an essential feature of the structure and operation of bank guarantees. It is trite knowledge that the autonomy principle gives the bank guarantee its unique attraction as a method of finance in international commerce.

The meaning of this principle as well as the underlying explanation varies according to the selected point of reference.

2.11.1 Between the bank and the beneficiary

In this relationship, the principle of independence comprises two facets. Firstly, that relationship is not affected by the mandate relationship between the bank and the principal; secondly, the payment obligations of the bank and the beneficiary's right to payment are a very different transaction from the underlying relationship. In respect of the first facet, independence means that the guarantor is not entitled to invoke a breach of the contract between him and the principal in order to refuse payment to the beneficiary. As a result, circumstances such as avoidance, repudiation of the mandate or insolvency of the principal as well as prior notice of refusal to repay the bank have no bearing in the obligation of the bank to pay the beneficiary. Indeed, the bank obligation to pay is an absolute undertaking and consequently it must meet its obligations whatever is the state of its relationship with the principal. In the same way, the bank cannot invoke

any defenses available under the underlying contract to refuse to fulfill its obligation under the guarantee. This facet is one of the most important under the principle of independence (Bertrams, 2004).

2.11.2 Between account party and bank, indirect guarantee and counter guarantee

The notion of independence between account party and bank as far as direct guarantees are concerned means that the obligations and right to reimbursement are not affected by the underlying relationship. The bank cannot be affected by the disputes that may divide the principal and the beneficiary.

When a counter- guarantee is issued - that is in an indirect guarantee, the counter guarantee possesses the same independence from the guarantee as the latter from the underlying contract. The counter-guarantee is payable under its own terms. Consequently, once the guarantor meets all the requirements under the counter guarantee, the guarantor is entitled to payment whether or not the guarantor has paid the beneficiary or has received a demand for payment or is legally liable to pay a demand received.

2.11.3 Between parties to the underlying contract

Here the notion of independence finds its application in the principle “pay first, argue later”, i.e. their agreement that payment by way of compensation is to be effected once the agreed conditions of the guarantee have been complied with, for instance a simple demand for payment with or without a statement of default or presentation of third party. This is one of the differences between a bank guarantee and a surety. Indeed, under a surety the guarantor is able to invoke the defenses in the underlying contract since its obligation to pay is conditional on the default of the principal in the underlying contract. That is why a surety is said to be a secondary obligation on the part of the guarantor (Goode, 2004).

The principle of independence is of particular interest especially for banks. Indeed, in accordance to the principle the duty of the bank is confined to verifying whether the terms of the guarantee have been complied with. The bank is thus expected merely to compare the documents presented to it by the beneficiary with the documents prescribed in the guarantee. However, this principle should not be too rigid and inflexible to the extent of undermining other important policy concerns of the law. Thus, it is now widely accepted that the autonomy principle may be breached in certain exceptional circumstances in order to give effect to other important policy considerations, such as the need to combat fraud. While the fraud exception in the autonomy principle is well established, it is unclear to what extent illegality can provide the basis for a defense to a claim under a bank guarantee. This principle of independence of a BG arises into mechanism of payment of a BG.

2.12 Mechanism of payment

The payment mechanism forms the heart of the guarantee; it determines the actual benefits of the beneficiary and the risk exposure for the principal. There are three mechanisms of payment: payment on first demand, which does not require any proof of default from the principal; payment upon submission of an arbitral or court decision, which hardly differs from a surety ship, and finally; payment upon submission of third-party document, which occupies an intermediary position between the two first. (Bertrams, 2004).

Consequently, the duty of the bank is confined to pay when the documents presented to it are correct. Indeed, the general rule is that banks in bank guarantee are obliged to pay upon the presentation of the conforming documents by the beneficiary. The documents

presented under the bank guarantee must strictly comply with the terms and conditions contained in the bank guarantee. If the documents do not comply with the terms of the guarantee and the bank nevertheless makes a payment, it will not be entitled to reimbursement from the principal as it will have exceeded its mandate (Hillman, 1991).

However, if the documents do comply with the guarantee then payment must be made. This principle is generally known as “the doctrine of strict compliance”. It seems thus, that the apparent intention is that the standard of compliance in relation should be the same as for a documentary letter of credit. Accordingly, all a bank is to do is to determine, based on the documents alone, whether they appear on their face to comply with the terms and conditions of the guarantee without consideration whatsoever to the underlying contract (Bertrams, 2004).

2.12.1 Payment on first demand

This form of payment is the most used in international trade as it offers to the beneficiary a considerable advantage. It is known by many as the “suicide” form of payment. Under this form, the obligation of the bank to make payment is not subject to any forms of proof or conditions. The advantage of such a guarantee is obvious, since the beneficiary can call it without any evidence or corroboration concerning the principal’s default or any entitlement of payment under the guarantee (Warne, 2005).

All the beneficiary is to do is to adduce a written demand of payment. There are two variants of first demand guarantee: The one that does require only a simple written demand without any others additional documents from the beneficiary characterized as the “simple demand guarantee” and the one that requires a statement of default by the principal. The idea is to establish a balance between the liquidity of payment that renders the guarantee attractive and the need to protect the principal from unfair calling by the beneficiary. Demand must be accompanied by a unilateral declaration of the principal’s default specifying the nature of the default. Because of the lack of requirement of other

documents, the first demand guarantee is also referred to as the “unconditional” demand guarantee as opposed to the kind of guarantees which require the submission of documents others than a unilateral statement by the beneficiary, known in international trade as “conditional” demand guarantees. These kinds of guarantees encompass the guarantee paid upon submission of third party documents and the guarantee paid upon submission of an arbitral or court decision (Penn, 1987).

2.12.2 Payment upon submission of third party documents

The principal has no protection against unilateral, unfair, and /or capricious demand by the beneficiary under a first demand guarantee, especially under a simple demand guarantee. This has led to financial catastrophe for many contractors in recent years, and in order to mitigate the harsher implications of this form of payment, it is becoming increasingly common to see clauses giving a degree of protection against an unscrupulous beneficiary. One of the ways of limiting the risks of an unfair call is the requirement of submission of third party documents before the bank makes any payment under the guarantee (Hillman, 1991).

By definition, guarantees payable upon submission of third party documents are independent guarantees. Accordingly, the beneficiary is entitled to payment forthwith if he submits the documents required by the guarantee. There is no need for him to adduce any other evidence of the principal's default. This is in line with the principle of autonomy governing all independent guarantees (Bertrams, 2004).

There is a variety of documents suitable as conditions of payment demanding of the type of guarantee. For instance, a guarantee may require the presentation of a statement from a notary public confirming that the beneficiary has accepted the principal's tender and that the latter has failed to perform (this in case of a tender guarantee). As for a performance guarantee, the guarantee could call for certificates from an independent expert or surveyor, which indicates non-performance of the contract by the principal. It

is noteworthy to remark that the presentation of the required documents does not automatically imply that the principal is liable under the law. For instance, in the case of occurrence of case of force majeure, the surveyor will still certify the non-performance of the principal even though force majeure is a legal exception that frees the principal for performance under the contract (Goode, 2000).

2.12.3 Payment upon submission of an arbitral or court decision

A third type of payment mechanism involves the submission by the beneficiary of an arbitral or court decision, which affirms the principal's liability to the beneficiary as a condition of payment. This kind of payment is particularly frequent in the case of judicial guarantees, furnished in order to have a conservatory attachment lifted. Otherwise, a guarantee upon submission of an award or judgment is believed to be rare in international trade (Bertrams, 2004).

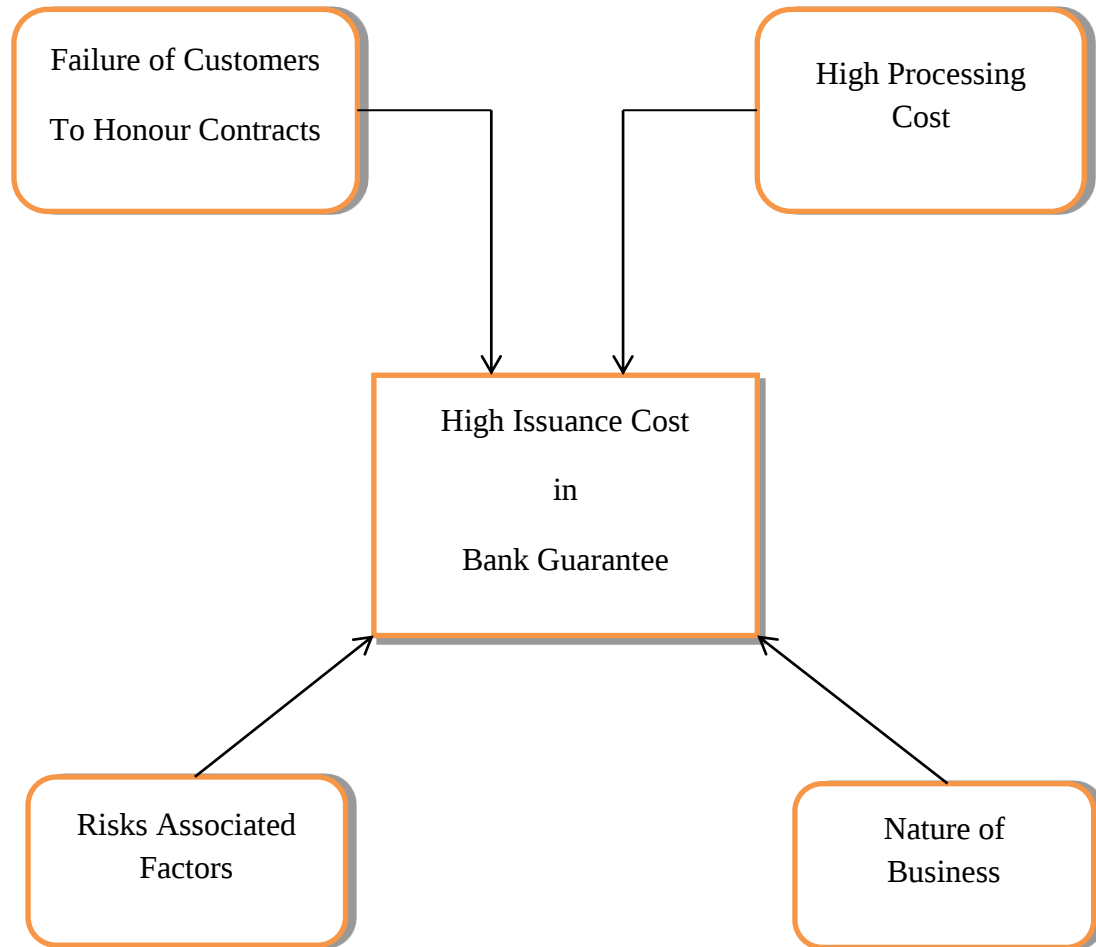
This type of payment mechanism is often compared to a surety ship as all the defenses available under the underlying contract are already considered before the court or the arbitral tribunal. However, they are conceptually different. In the case of this type of guarantee, the bank's duty is confined to the examination of the arbitral or court decision in order to determine if they comply on their face to the requirement of the guarantee while, in a case of a surety ship the bank becomes involved in the underlying contract in raising personally all possible defenses that the principal could have raised (Penn, 1987).

2.13 Conceptual Framework

The study assumes that banks are worried that some of the customers may fail to honour their contract. It further assumed that the bank does not recognise bank guarantee as one of their main source of revenue. Moreover, it assumed that majority of Tanzanians' business persons are not faithful enough to honour their contracts. Lastly, It assumed that, high issuance cost deters a good number of Tanzanians' business community from seeking bank guarantees.

These assumptions (variables) are summarised in Figure 1.

Figure 1Figure 1: Conceptual Framework



Source: Author's Own Construct, 2013

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The first section of this chapter pinpoints the study area. The second chapter describes the research design and the reason for using the selected design is well explained in the third part of this chapter, the study population, the sample size and sampling procedure, the data collection methods and data analysis methods are presented in part four, five, six and seven respectively of this chapter.

In a nutshell, this chapter entails the methods and procedures which have been used by the researcher in the study while collecting, evaluating and analysing information relating to causes of high costs associated with bank guarantee in Tanzania.

3.2 Study Area

The study was conducted in Morogoro region; this is due to the fact that Morogoro is very close to Dar es Salaam which is the business city in Tanzania, so most business people from Dar es Salaam have invested as well in Morogoro. That is to say, Morogoro CRDB's Branches acted as a good representative of all other CRDB Branches in Tanzania. This is said because, the procedures applied in the preparation and issuing of a Bank Guarantee as per CRDB Bank are locally alike.

3.3 Research Design

The study deployed a case study, because it explores and analyse the life of a social unit, be that unit a person, a family, an institution, a cultural group, or even a community (Bharadwaj, 1989: 2) Since the type of study was explanatory study and particularly based on diagnostic study which was to be directed toward discovering what is happening, why is it happening and what can be done on high costs pertaining to Bank

Guarantees with Tanzanian Banks.(Hangai & Kothari, 2004) suggests this type of study(diagnostic study) to use the case study design because it investigated the unit across the variety of features or characteristics. A case study is characterized by a thorough investigation of a unit over a range of variables. The aim is to investigate the selected factors (variables) on the entire banking Industry in Tanzania. In view of the fact the study looked on the causes of high cost in issuing Bank Guarantees and the problem is well known.

3.4 Study Population

The population encompasses the total collection of all items, units, cases, or element from which the research conclusion is to be made. This is the total items about which the information is desired (Kothari, 2006).

The population for this study embraced all the issuers of Bank Guarantees within CRDB together with all guarantees been issued in Tanzania that have been in existence in the last three years to December 31st 2011. This therefore excluded any transaction or any arrangement to a transaction which might have taken place beyond this period.

3.5 Sampling Size and Sampling Procedures

The sample size of the study comprised of 53 respondents in selecting the sample of the study used. The set of objects, technically called the universe, to be studied are all events pertaining with Bank Guarantee at CRDB Bank and their relevant Branches. Since the field of inquiry is large Morogoro region branches were selected to represent a sampling unit. It should however be clear that the source list for all CRDB Branches in Morogoro is attached as an appendix.

A sample of six branches from Morogoro and were selected based on their location (Morogoro Municipality) as it is shown in (appendix 4). Thus from the selected sample, each respective selected CRDB Branch in Morogoro were visited and the senior personnel officer in each branch was approached to direct the researcher to relevant credit manager. Each credit manager was asked to direct the researcher to other two (2) credit officers and analysts of each branch. Thus the respondents comprised the credit manager, and 2 credit analysts of each bank together with 35 customers and hence a total of 53 respondents. The respondents were informed about the intended study through a personal visit.

3.6 Data Collection Methods

The various method of data gathering involves the use of appropriate recording form. These are called tools or instruments of data collection (Krishnaswami, 2006). They consist of observation schedule, interview guide, interview schedule, Mailed questionnaire; Rating scale, check list document schedule and schedule for institutions. In this study the researcher used both closed ended and open ended questions in the questionnaire, however, respondents' telephone numbers were used for the telephone interview. As it has already been noted both secondary and primary data were collected as stipulated in part one and two below as way of determining causes of high costs in issuing Bank Guarantee in Tanzania.

3.6.1 Primary data

Primary data are original data from which the researcher directly collects and that have not been previously collected (Krishnaswami et al, 2006). However Kothari (2006) stated that primary data are those which are collected afresh and for the first time, and thus happen to be original in character. These two definitions elaborate clearly the meaning of primary data. Basing on the above definitions, the primary data were

obtained from bank customers who obtained a Bank Guarantee within the year 2009-2011 and bank officers of the selected commercial banks. Primary data of this study were collected through questionnaires given out to the respondents, and in-depth interview.

3.6.1.1 Questionnaire

The researcher also used questionnaire to beseech data from staffs and customers of the selected branches. The conceptual framework suggested variables which assumed to cause Bank Guarantee to be of a high cost. Thus the Questionnaires have been developed to identify Bank factors (consider Appendix I) and questionnaires to customers (consider Appendix II) to identify customers' factors.

The questionnaire included both open and closed ended questions; the researcher used questionnaire because, questionnaires can cover extensive geographical areas and are free from the interviewers' bias, as there is no personal contact between the respondents and the investigator. Questionnaires can be used contacting persons such as senior business executives who are difficult to reach in any other way, the respondents can complete the questionnaires at their conveniences and certain personal and economic data may be given more accurately in an unsigned mail questionnaire.

3.6.1.2 In-depth Interview

Interview to customer was conducted in their respective places of work. However, the interview can be classified into; structured or directive interview, unstructured or non-directive interview, focused interview, clinical interview and depth interview. The researcher used telephone interview as it is possible due to the fact the bank keep customers profiles such as telephone number and postal boxes, (consider Appendix III) for the customers interview guide. The researcher adopted this method due to the

following advantages pertaining to it; the method is more flexible and faster than any other method meaning that it's a quick way of obtaining information, it is cheaper than personal interview method and high rate of response, interview can explain requirements more easily and there is no field staff required, representative and wider distribution of sample is possible, at times, access can be gained to respondents who otherwise cannot be contacted for one reason or the other, recall is easy and the replies can be recorded for one reason or the other, recall is easy than the replies can be recorded without causing embarrassment to respondents.

3.6.2 Secondary data

Secondary data were collected using documentary sources such as books, journals, reports, security assessment forms and any relevant financial and non-financial data that were available in the selected banks while determining the causes and therapies of high costs in issuing bank guarantee in Tanzanian banks. Secondary data are those which were collected by someone else and have already passed through the statistical process (Kothari, 2006).

3.7 Data Processing and Analysis

Raw data obtained from the field were edited, typed, transcribed and then coded ready for analysis. Data were analyzed using the SPSS (Statistical Package for Social Science) software package. SPSS produced the frequencies, total scores, means and percentages. These enabled the researcher to present frequencies, total scores, means and percentages. Spreadsheets (MS Excel) were also used in order to come up with appropriate charts and tables for data presentation.

CHAPTER FOUR

PRESENTATION OF FINDINGS AND DISCUSSION

4.1 Introduction

This study examined the causes of high costs with respect to bank guarantees issued by various banks in Tanzania picking up CRDB as an appropriate representative. The presentation of findings and discussion has been given out as from what the study found. The first section of this study explained the extent to which Bank Guarantee is preferred by customers. Second section identified factors which are considered in establishing the issuance cost. Third section gave out the components involved in coming up with the issuance cost and the fourth section sought justification for including the components in coming up with the issuance cost or cost of a bank guarantee. Generally, this chapter involves an analysis and presentation of major findings of the study. As a clue, this chapter is committed on answering the objectives and the research questions formulated in chapter one.

4.2 Customers' Preference on Bank Guarantee

The study here looked on the coverage/ outreach of a bank guarantee to its customers. When talking about an extent, here it means the area or length to which something extends. This extent developed key actors/players (contractors, engineers, wholesalers and retailers) which enabled the researcher to collect data from the latter. This extent aimed at digging out what would be the actual performance of bank guarantees as compared to other securities.

To establish the extent to which bank guarantees are preferred by customers, the study was first interested to know whether respondents are aware concerning the availability of bank guarantees. In their reply to this question, all of them (100%) indicated that they are aware of it as shown in Table 4.1.

Table 4.1: Customers' Awareness on Bank Guarantee

Responses	Frequency	Percentage %
I am aware	53	100
I am not aware	0	0
TOTAL	53	100

Source: Study Findings, 2013

Since all the respondents are aware regarding availability of bank guarantees, the study was further interested in establishing whether they have ever applied for a bank guarantee this aspect goes in a parallel way with the aspect of the application of the same. In their reply to this question, majority of them (66%) indicated to have applied for a bank guarantee as shown in Table 4.2 and Figure 2.

Table 4.2: Application of a Bank Guarantee

Responses	Frequency	Percentage (%)
Yes	35	66.0
No	18	34.0
Total	53	100.0

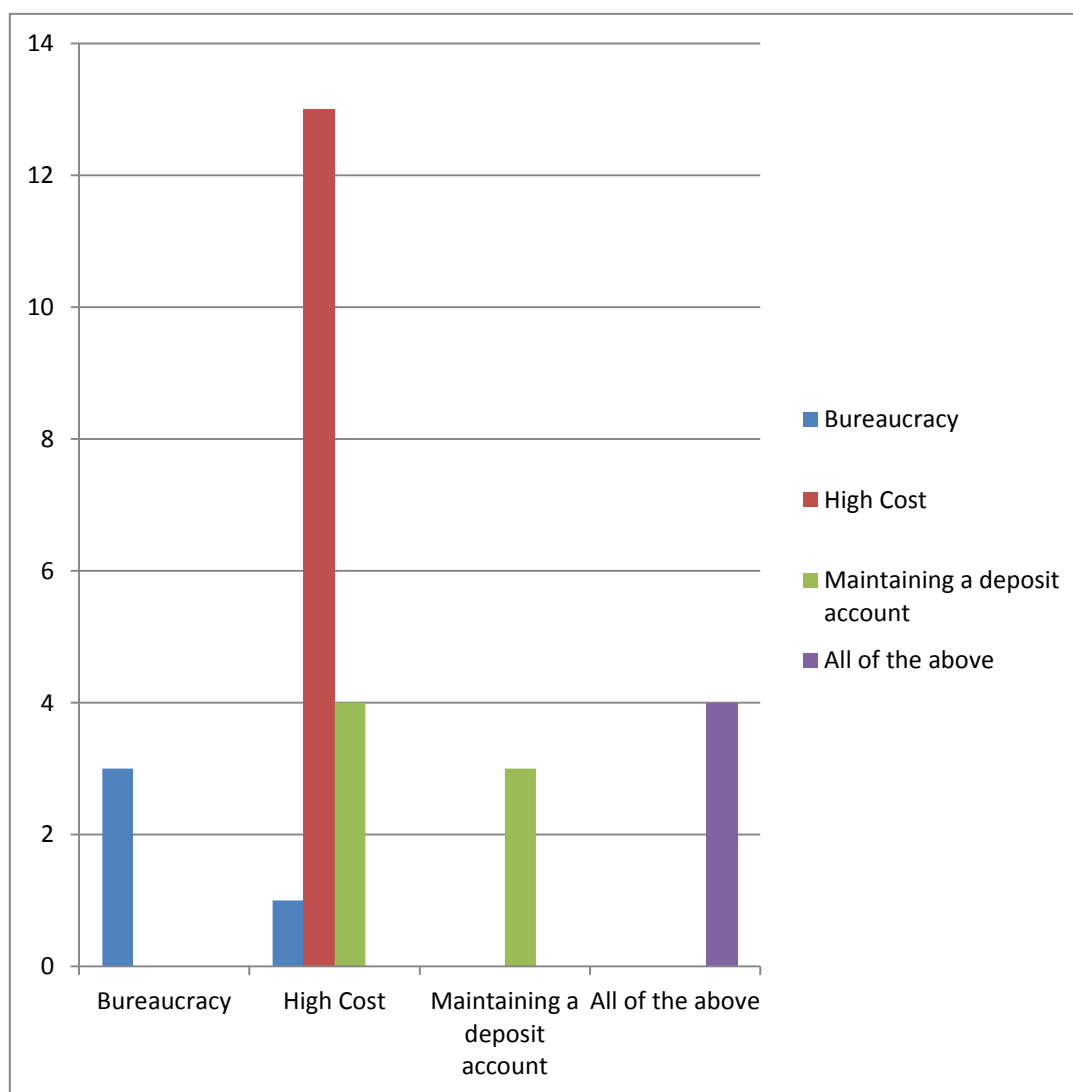
Source: Study Findings, 2013

From the findings above, respondents showed that their applications for a bank guarantee were mainly for their daily activities, either for personal/ private use or for business use when engaging into different contracts or purchases. This question developed another question seeking reasons as to why one did not apply for bank guarantee and if applied what were the main problems faced. In replying to this question, bureaucracy during the application of a bank guarantee was a factor in the sense that most applicants remarked that, their requests were not granted accordingly despite of fulfilling all the material requirements of the bank in order to be exposed to the facility. The amount of respondents who supported this point were only three (n=3) (5.7%).

Another point which the study came through is, applicants of bank guarantee are required to have a deposit account, (as per the case of CRDB), with CRDB and to maintain a certain amount with respect to the Guarantee amount to be provided. The amount of respondents who supported this point were only two (n=2), (3.8%)

Also the study discovered another significant point which also contributed to the problems which faced applicants during the use of a bank guarantee, this is high cost, thirteen respondents supported this point which marks (n=13), (25%) of all respondents. Together with other reasons which also have certain occupancy, this can be seen graphically in Figure 2.

Figure 2: Reasons causing problems to application of bank guarantee



Source: Study Findings, 2013

From the above findings, the study found that, Bank Guarantees are also preferred by customers but not as much as other kind of securities because most bank guarantee applicants are those people who are mainly engaging themselves into activities such as construction, farming and other personal activities such as importation and exportation and they are forced by conditions to shield their contracts by this facility. This objective resulted into a research question and the outcome as well:

Thus, these findings enabled the study to test on the aspect of what actually convinced customers to apply for a bank guarantee. This means those who applied for a bank guarantee, were only intending at either providing assurance to their clients for the work to be performed, or private individuals were only intending at securing their benefits. In their reply majority (n=44) (83%) said they applied for bank guarantee due to the requirement of the contracts and 9 responded that a guarantee were sought so that to cover their benefits in events like importing and exporting. This can be seen in Table 4.3

Table 4.3 Reasons for seeking bank guarantee

Responses	Frequency	Percentage %
Contract Requirement	44	83.0
Personal Benefit	9	17.0
Total	53	100.0

Source: *Study Findings, 2013*

The above responses resulted into another question to those who once applied for a bank guarantee and what actually faced the respondents during the whole exercise. This requirement was a close-ended which required respondents to respond with regard to the supplied reasons. In reply to this, the study deployed Likert scale and the discussion was on the manner that those who are either **strongly disagreeing** or **disagreeing** are in the side of a reject and those who are either **strongly agreeing** or **agreeing** are in the side of accept. **Neither agreeing nor disagreeing** was regarded as been neutral.

The results on Table 4.4 and Figure 4 show that, 11 respondents (21%) rejected that bank conditions on bank guarantee to be tight and 24 respondents (45%) accepted that bank conditions are tight; again 18 respondents (34%) were neutral on this point. This marks that the conditions on bank guarantee provision are tight in sense that most customers are nervous/ disappointed to apply for this facility despite of having a great need of it.

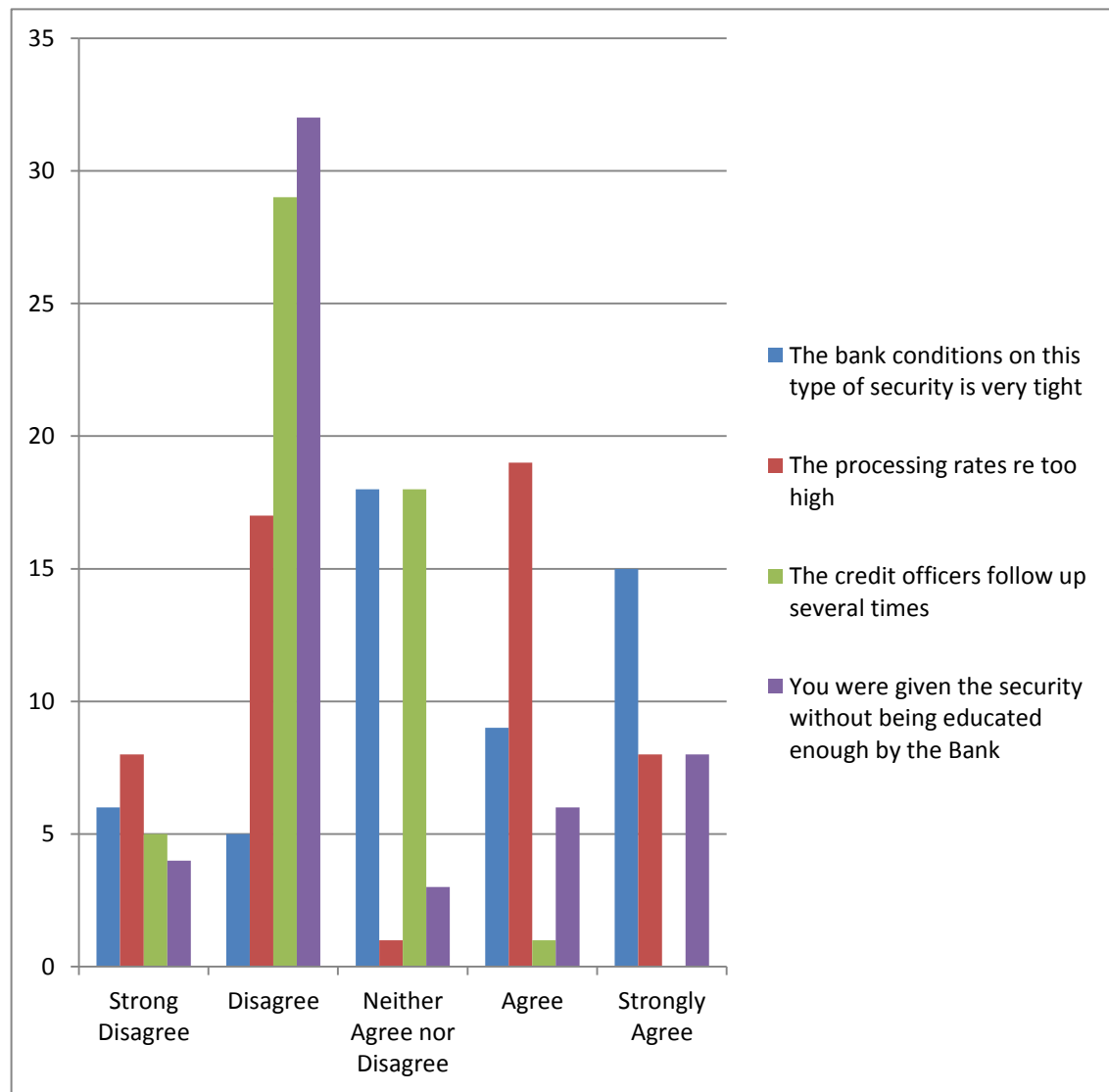
Again, 25 Respondents (47%) rejected that the processing rates on banking guarantee are too high, 27 Respondents (51%) accepted that processing rates are too high and 1 respondent (2%) was neutral. More to say is, 34 respondents (64%) rejected on the credit officers follow up several times, 1 respondent accepted on the credit officers follow up and the rest 18 respondents (34%) were neutral. This automatically signifies that the rate of credit officers follow up is low on this security/ facility, and this can be due to the collateral placed in lieu of the contract. The collateral increases the level of confidence of the credit officers.

In addition to that, 36 respondents (68%) rejected on the point that they were given a security without being educated, 14 respondents (26%) accepted that they were given security without being educated and 3 respondents (6%) were neutral this suggests that most applicants were educated enough.

Table 4.4: Experience of customers who obtained bank guarantee					
Experience	Strongly Disagree	Disagree	Strongly Agree	Agree	Neither Agree nor Disagree
Bank conditions are tight	6	5	15	9	18
Processing rates are too high	8	17	8	19	1
Follow-up by credit officers	5	29	0	1	18
Given the security without being educated enough	4	32	8	6	3
	Reject		Accept		Neutral

Source: Research Findings, 2013

Figure 3: Experience of customers who obtained bank guarantee



Source: Research Findings, 2013.

4.3 Factors considered in establishing the issuance cost

This section highlights factors that are considered in establishing the issuance cost. In their reply when asked, for those factors, they (bankers) mentioned nature of business, project of the contractor, credit worthiness and value of a contract. The said factors are explained as follows:

4.3.1 Nature of Business

The study considered this factor in the establishment of an issuance cost, because a business's nature can influence a lot in terms of cost in the act of valuation. As the word “**nature**” stands for qualities/ characters of something, characteristic of a business contributes much into the computation of the issuance cost. Nature stands for what type of a business it is and why things happen at that business. This means, if the business has more than one branch/ subsidiary, then the exercise of valuation will merely have more costs in aspects of travelling costs from one station to another. Again nature of the business may enable a credit officer to calculate the possible risks attached to the latter.

4.3.1 Project of a Contractor

Here the study found that, a project to be fulfilled by a contractor is the one which have initiated the application of a bank guarantee so that for the contract to be binding between the contractor and his/her client (with an assumption that client required that security). This will affect the value of the issuance cost because always some of the components of the issuance cost are calculated on the percentage of the value of the project to be undertaken. For example, application fee, mortgage fee and legal fee are all calculated as a percentage of the project value. This is to say, if the value of the project

will be significantly higher, then an issuance cost will be directly proportional (Study Findings, 2013).

4.3.2 Security Provided

Here a security provided matters, since it will be established by the lender if the provided security covers the guarantee fully or partly. And if the collateral does not fully cover the debt, then a scheme will have been designed where the portion remained uncovered could be shifted into either of the other components of an issuance cost. That is to say, value of the security, be it cash or a real asset, provided has a significant impact to the existence of the so said issuance cost.

4.3.3 Credit Worthiness

When talking about the credit worthiness of a firm, the study institutes that, those applicants with good reputation on these bank guarantees due to the goodwill attached from their previous contracts. People with this said goodwill are the one who will benefit from a low issuance cost because some of the components of the issuance cost like valuation fee will be omitted for the consecutive application (if same collateral is used) due to the observation that this fee is mostly included when one is applying for a bank guarantee for the first time, with an assumption that the valuation made prior are the exact ones prevailing if it is a business operating on the concept of a going concern except few adjustments will take place in case of the occurrence of the unforeseen events like inflation and exchange rates in case of a foreign contract.

Also the study has found that, when an applicant has many projects which require the use of a bank guarantee, then issuers will tend to lower all associated costs in order to retain the prevailing customer and attract more to apply. This is said because there are

costs associated with the attached risks on the pertinent project which are not vivid/ only fictitious in the whole process of accumulating total issuance cost.

The said factors are represented by Table 4.5 below that all bankers responded with a greater percentage to the said factors in the table.

Table 4.5: Factors considered in establishing issuance cost

Responses	Frequency	Percentage %
Nature of business	18	100.0
Project of a contractor	18	100.0
Credit worthiness	18	100.0
Security provided	17	94.4

Source: *Study Findings, 2013*

4.4 The components involved in coming up with the issuance cost

This section maps elements which are considered in establishing an issuance cost in the sense that entails what actually contributes/ constitutes to the making up of the issuance cost with respect to bank guarantee. These components were given out by credit officers from CRDB Bank PLC.

The study (credit officers) identified three factors which are mainly considered during the establishment of issuance cost and these are:

4.4.1 Application Fee

This fee is paid at the very start, usually when you complete the mortgage application. It is to “book” or “reserve” your mortgage funds whilst your application goes through. The mere aim of this fee is to hold the bank accountable and responsible due to the application made. Not only that, but also to discourage the borrower from quitting the process while the arrangements have already been initiated because this fee is often non-refundable. Usually application fee are set as a certain percentage of the total amount to be required as a guarantee by a borrower. As per this case, CRDB were not ready to disclose this percentage rate by saying that this fee varies considerably (Study Findings, 2013).

4.4.2 Mortgage Fees

These are the fees which are associated with the security provided when a bank guarantee is provided by the concerned bank. Mortgage fees can be agreeable to be paid upfront or adding them to the mortgage balance. This is said, if it will be paid upfront, then a lender will not charge interest on the lending fee (i.e. the repayment will have excluded interest therein) over the rest of the mortgage term. If it will be added to the mortgage balance, a certain portion will have to be added on top of the mortgage amount

initially provided. The study found that it is worthwhile to pay the fee upfront due to the mentioned fact (Study Findings, 2013)

4.4.3 Legal Fees

These are sometime known as **Conveyance Charge**. These are fees payable to a solicitor or licensed conveyance for undertaking the legal work involved with the mortgage or remortgage. In a nutshell it has to be said as the fee paid to a legal person for performing his/ her tasks in lieu of a mortgage. Legal fee is normally paid when the mortgage completes. However, one might have to pay an upfront deposit “on account” to cover the costs to the solicitor or conveyance of doing preliminary searches and work. If the borrower wishes to stop the mortgage s/he will have to pay some of the legal fees and costs for any work that the solicitor or conveyance has undertaken.

4.4.4 Valuation Fee

This is a fee charged by a mortgage lender for commissioning a mortgage valuation. A mortgage valuation is quite a basic inspection of the borrower’s property and its purpose is limited to whether a home is a suitable security to lend on. If one wants a more in-depth survey, this will cost significantly more.

The study found that valuation fee has to be paid upfront when one makes a mortgage application. Also a refund of a valuation fee in case of dropping mortgage application is subject to whether the valuation has already been done or not. This is to say, if the valuation has already taken place there will be a slim chance of a refund unless otherwise there will be a good chance of a refund.

The said components of issuance cost are shown in table 4.5 as they were given out by the said bank officers.

Table 4.6: Components in establishing issuance cost

Responses	Frequency	Percentage %
Application fee	18	100.0
Mortgage fee	18	100.0
Legal fee	18	100.0
Valuation fee	18	100.0

Source: Study Findings, 2013

4.5 Justification for including issuance cost components

This is the process of looking at components used in establishing the cost of bank guarantee, and to prove or show that the action of including the said components in identifying an issuance cost to be just, right, desirable or reasonable. The inclusion is justifiable because, of the literatures read and for the reason that the components were given out by relevant personnel (bank officers) who are the main preparers of the facility (BG).

Under (Item 2.7; Processing Bank Guarantee) the study was inquisitive to what actually caused the issuance cost of a bank guarantee to be high and what is the exact composition of the issuance cost. From the field of study, the study found that, respondents (bankers) who were faced by questionnaires, provided answers of the said components as the dire composition of the issuance cost and the mere fact is, the components are actually used in the whole process of preparation of a bank guarantee in sense of including them in total cost. This objective resulted into the growth of the question as it can be seen from **APPENDIX 1** Question 4 and which respondents used this mark of a question to elaborate the mere compositions of issuance cost.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

This section gives a detailed conclusion and recommendations on the above findings of the study. The said narrations of the results are put down in the following order: The second part of this chapter provides a critical discussion and conclusion on findings of what actually cause high cost in issuing bank guarantee. The third part discusses on the first objective of the study (determination of customers' preference on bank guarantees) and as to why the factors have been included as the appropriate ones. The fourth part confers on the factors which are considered in establishing the issuance cost and why have been considered. The fifth part postulates the components of the issuance cost and why they were considered significant.

The study concentrated on establishing what can be the actual cause accelerating high cost in the issuance of a bank guarantee to customers of CRDB BANK PLC Morogoro Branches being as a representative of other branches. In case of costs associated with bank guarantee (as seen above) were all identified and studied properly as to why they deserve the inclusion

5.1.1 Customers' Preference on Bank Guarantee

The results of the study indicates that, customers are aware of the existence of a bank guarantee and the guarantees are highly preferred by customers faced by this opportunity, the study found that, customers prefer this facility because in the public procurement context, a successful tenderer may be required to provide a bank guarantee for sum commensurate with the value of his obligation to perform under the public contract so that in the event of default the contracting authority can invoke the guarantee against the bank. Occasionally, guarantees may be required from inception of a tender submission, and due to that it accelerates the demand of a bank guarantee.

The increasing rate on seeking a bank guarantee is demoralised by the issuers due to a number of reasons, one being that the facility has high cost as compared to other facilities (e.g. normal loans). This defeats the purpose of competition which is to encourage a range of prices, from which the lowest (or most economically advantageous) can be selected. Today, bank guarantee consumers expect banks to react to their preferences and gladly punish those that don't. These expectations include the when, the how, and the what of marketing communications and offers. Ever since customers' suggestion is to lower costs associated with the same, then banks in Tanzania have to reduce the said costs and hence make the facility attractive because this cost has already been communicated to relevant authorities by customers. This has to be facilitated so that for consumers of BG to enjoy the facility compared to the opportunity cost of such an engagement. Internal factors leading to High Cost in the issuance of BG were ranked from the findings

5.1.2 Factors considered in establishing the issuance cost

The study found some factors considered in establishing the issuance cost. These are nature of business; project of a contractor, security provided and credit worthiness of an applicant. Some of the factors involved here have a chance of being relevant (credit worthiness and nature of business) because, the said factors have a direct impact to the associated risks in the sense that if the borrower does not have a good credit feature or his/ her business's nature is more riskier, here an issuance cost with respect to the mentioned factors will be higher in order to cancel the effect of the said risk if it will happen.

5.1.3 Components involved in coming up with an issuance cost

The said four components associated to cost in the formation of an issuance cost and every component was clearly defined and reasons for its establishment were provided so that to understand the actual meaning of its inclusion in the total figure of the issuance cost. The study observed that, some components of issuance costs have slim chances of being irrelevant because they make a bank guarantee to be seen as a very expensive facility while there also other rates which are supposed to be charged during redemption of a guarantee. This can be analytically explained as follows:

Application fee has a sense of being relevant due to the reason of developing a commitment between parties involved, due to the responsibility attached by the paid amount as an application fee. That is to say, there had been no commitment/responsibility issue; this fee would have been irrelevant.

Mortgage fee is in one way relevant and in another way irrelevant. It is relevant when an applicant uses a real asset(s) as collateral to cover the associated risks but this can be completely irrelevant when the applicant has maintained a fixed deposit account with the said bank and the said account acts as collateral. That is said because, even if an applicant uses an FDR to cover the risk, this mortgage fee will still prevail in the total

cost. Those are hindrances in line with costs associated in building up an issuance cost (Study Findings, 2013).

Apart from components of issuance cost, there are other factors which have also been found to be of severe causes of problems in the whole process of application of a bank guarantee.

These are price fluctuations between the application period and the redemption period. This mostly happens when the bank guarantee secures activities which encompass international projects which often contain the trading of one currency by another through the so called foreign currency exchange which is often faced by sudden fluctuations of exchange rates, interest rates and inflation rates.

Again, level of technology applied by the contractor in accomplishing the project has been found to be another factor which contributes to the failure of accomplishing the intended project properly. This is said to be on the sophistication of facilities needed to be employed to accomplish the contract. If poor equipment is used, it is automatically that the project completion will delay and breach the contract. As per the case of CRDB Customers, most of them do not have up-to-date machines which can facilitate work and improve the duration of completion so this is the serious problem.

Political instability is another facet which contributes to the failure of customers to accomplish their contracts nicely. As political instability is said to be a situation where by a country is currently going through political turmoil. It may also involve the death of people within that country and in many cases the country deteriorates in terms of its economic progress because most properties are left confiscated by the said event. That is

to say, political instability has severe impacts to customers who reside in such territories in mark with the accomplishment of the engagement entered.

From the observation of the study, it acclaims that an issuance cost is mostly attached by either irrelevant costs or by relevant costs which contain extraneous rates despite of the mentioned obstacles accelerated customers to fail honouring their contracts. And the said fact is mostly attributed by the sense of bankers or banking sector in view that the projects to be engaged as per applied guarantee to be the most profitable ones so that they can benefit from the said profit. This is done because of the assurance placed that an applicant of a bank guarantee is ambitious in taking the projects so that they can earn profit from them thereon.

Lastly, financial institutions have a tendency of discouraging different investors by limiting the number of their facilities in highly growing towns/ cities due to the fact that many business people at that time possess an obligation of returning back their debts, when the borrowed funds are used properly, they generate income from the investments made and this is done so that to reduce the competition and make the said investors be able to return their debts accordingly.

5.2 Recommendations

Based on the findings and conclusions made, the following recommendations are made:

- i) It is irrefutable that worldwide bank guarantee arrangements are catching fire due to the prevailing engagements. Tanzania being part of the global financial system may not afford to isolate itself by shying away from this wave. However, the increasing rate of these arrangement has likely spurred major paradigms shifts in terms socio-economic set ups taking into account that Tanzania is one among the developing countries which need a high demand of different economic activities so that to attain the targeted millennium goals. The facilitation by banks in providing BG will easily accelerate the said movement in reaching the millennium goals.
- ii) It is fully agreed that a vibrant competitive and efficient financial sector that reaches the majority of an economy's population, is a cornerstone of sustained high levels of economic growth and development. High level of economic growth will be achieved when there will be a high level of technology because the two move on together. That is to say, low level of technology being one of the obstacle instigating poor performance and poor time management in accomplishment contracts, has to be eliminated by the Government of URT to provide a full support in up lifting a level of technology of the same.
- iii) The said challenges in the issuance of bank guarantees have to be eliminated/reduced so that to attract more contractors in the act of fulfilling their contracts in the manner prescribed by their clients which in long run will develop the whole country at large. The act of eliminating the said unnecessary costs should become action-oriented instead of reactionary.
- iv) Again, development of the so called high demand of the facility will be in existence and in turn will result into benefiting both parties, that is say, a bank will benefit from the said high demand of a bank guarantee also customers will benefit from achieving their contracts for future prosperity of their operations. The said increase in demand of the bank guarantee due to low costs attached will result into a higher quantity sold with an assumption of constant price (Law of Demand and Supply). This can be achieved by choosing the right security which

is Fixed Deposit (First Class Security) which has lower costs as compared to landed properties which require valuation by professional valuers as seen above.

- v) Another thing which has to be done by the said applicants is, before the application of a bank guarantee, unforeseen events like exchange rate risks, price fluctuation and political instability have to be looked into by using the past records and prevailing level of technology and the fight against inflation should continue and consequently a reduction in the central bank discount rate would be necessary to reverse the increasing trends in spreads in a liberalised financial sector. Also, internal and external hedging techniques have to be applied in case of exchange rate risks, together with measures before and during undertaking of the projects in case of a political risks.
- vi) Banks should shift from risk based lending to emphasis on customers' ability to assess their liquidity ratio, loan officials should be in position to calculate both the liquidity and leverage ratios of the companies they deal with to include
 - a) Calculation of the working capital, which is equal to current assets minus current liabilities. Current assets include cash, marketable securities (Treasury bills, for example), accounts receivable and inventory. Current liabilities include notes payable, accrued taxes and other liabilities that are due within a year. A high working capital means the company is able to secure the contracts engaged in terms of the availability of sophisticated materials and machines which are highly productive.
 - b) Computation of current ratio, which is equal to current assets divided by current liabilities. Although the current ratio substantially greater than 1.0 provides ample liquidity. It also could indicate that a company could incur more capital

expenditure (even by credit means) in the acquisition of more machines which are more advanced so that to facilitate the completion of the engaged project.

- c) Determine the quick ratio, also known as the acid-test ratio. It is equal to the sum of cash, marketable securities and accounts receivable components of a company's current assets divided by its current liabilities. This is a fine test because it excludes all current stocks in the analysis of the current ratio as compared, which can act as acute benchmark.
- d) Compute the capitalization ratio. It is equal to long-term debt divided by total capital, which is equal to long term debt plus share holders' equity. The term "owner's equity" or "partner's equity" is used for sole proprietorships and partnerships. Adverse changes in business and economic conditions could jeopardise the ability of the company with high-capitalization ratio to make the scheduled interest and principal payments of the security if not based on FDR terms.
- e) Determine the debt-to-assets ratio, which is equal to total debt divided by total assets. This ratio should be low. A ratio greater than 1.0 is danger sign. High ratio implies less protection of creditors, which may in turn cause an in ability of the contractor to secure the given guarantee. This is said, high level of debts indicates in ability to pay.
- f) Calculate the times-interest-earned ratio, which is equal to operating income divided by interest expenses. Operating income

is equal to sales minus operating expenses, which includes direct labour, raw materials and overhead expenses. A high times-interest-earned ratio means the company is profitable enough to cover the interest expenses. This is a good indicator to the provision of a bank guarantee because there is a reasonable assurance to the redemption of the facility.

5.3 Areas for future study

From the researcher's findings the researcher suggests the following areas for further research

- i) Risk assessment with regard to completion of different performance contracts engaged.
- ii) Existence of formulated policies to encourage high level of assurance with respect to engaged contracts.

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Appendix 1: Questionnaires for the Bankers

Questionnaire No.....

MZUMBE UNIVERSITY

FACULTY OF COMMERCE

MSC PROGRAMME

Dear respondent

This questionnaire is aimed to obtain data concerning causes pertaining to the high costs in issuing bank guarantee by different commercial banks in Tanzania. The study is conducted as partial fulfillment for the reward of masters' degree at Mzumbe University, and you have been identified as potential respondent to this study. It is in the same context that confidentiality will be ensured. Your response will not be revealed to a third party.

INSTRUCTIONS

1. Give your recommendations and suggestions as per requirement on questions 1, 2, 3, 4, 5, 7, 8& 9
2. Put the appropriate scale for question 6 part i-ix. Note the scale rate below

Scale 1 = Strongly Disagree

2 = Disagree

3 = Neither Agree nor Disagree

4 = Agree

5 = Strongly Agree

QUESTIONS

1. What is the percentage of Bank Guarantee to total securities at your Branch?

.....
.....
.....

2. Which customers qualify to be granted Bank Guarantee at your Branch?

.....
.....
.....

3. Which criteria do you use to grant Bank Guarantees at your branch?

.....
.....
.....

4. What are the necessary costs (processing costs) associated with the preparation of a bank guarantee?

.....
.....
.....

5. How do you make a follow-up in the act of paying a third party when it happens your customer has not fulfilled the contract?

.....
.....
.....

6. Are the following reasons cause your customers who have obtained a Bank Guarantee from your Bank fail to accomplish their contracts with their clients (third party)?

Reason	Scale
Unfavourable economic environment	
Poor bank security assessment	
Speedy process of evaluating a guarantee offered	
Government interventions	
Owner concentration	
Inappropriate use of facilities granted by the bank	
Lack of borrowers business knowledge	
Unwillingness of borrowers to fulfill	
Security amount	
Schedule and amount of amount installment	

7. From your own opinion, what other factors could be causing the customers seeking for a Bank Guarantee not to accomplish their contracts as agreed?

.....

8. What measures are to be taken by the bank for customers who fail to cover their party of the contract with the third party?

.....

9. What recommendations and suggestions do you think will help the bank to cut down the unnecessary costs as pertaining to these bank guarantees so that they appear attractive for customers to apply for?

.....

.....

.....

.....

10. What are other possible risks associated with a bank in issuing a bank guarantee to its customer?

.....

.....

.....

****Thank you in advance for completing this questionnaire****

Appendix 2: Questionnaires to the customers

Questionnaire No.....

MZUMBE UNIVERSITY

FACULTY OF COMMERCE

MSC PROGRAMME

Dear respondent

This questionnaire is aimed to obtain data concerning causes pertaining to the high costs in issuing bank guarantee by different commercial banks in Tanzania. The study is conducted as partial fulfillment for the reward of masters' degree at Mzumbe University, and you have been identified as potential respondent to this study. It is in the same context that confidentiality will be ensured. Your response will not be revealed to a third party.

INSTRUCTIONS

1. Give your answers by providing a tick in the boxes provided of whether it is YES or NO on questions 1, 2, &3
2. Put the appropriate recommendation for another part of question 3.
3. Put appropriate scale for question 5

Note the scale rate below; Scale 1 = Strongly Disagree

2 = Disagree

3 = Neither Agree nor Disagree

4 = Agree

5 = Strongly Agree

QUESTIONS

1. Are you aware that financial institutions in Tanzania provide Bank Guarantee to potential customers who are in need of it?

Yes	
No	

2. If yes, have you ever applied for a bank guarantee?

Yes	
No	

3. If no why, if yes, have you ever encountered any problem during the application of a bank guarantee?

.....

Yes	
No	

4. If yes, what was the exact problem and in your opinion what do you think can be the reason of the problem?

.....

5. Do you think

Reason	Scale
The Bank conditions on this type of security is very tight	
The processing rates are too high	
The credit officers follow up several times	
You were given the security without being educated enough by the Bank	

****Thank you in advance for completing this questionnaire****

Appendix 3: Interview guide

I want to thank you for taking your time to talk me today. My name is _____ a student of Mzumbe University. And I would like to talk to you about factors causing high costs in the issuance of Bank Guarantees in Tanzania today. This interview is aimed to obtain data concerning with what causes high costs in the issuance of these bank guarantees in Tanzania. The study is conducted as partial fulfilment for the reward of masters' degree at Mzumbe University, and you have been identified as potential respondent to this study. The interview should take less than 30 minutes. I will be taping the session because I don't want to miss any of your comments. Although I will be taking some notes during the session, I can't possibly write fast enough to get it all down. Because we're on tape, please be sure to speak up so that we don't miss your comments. All responses will be kept confidential. This means that, I will ensure that any information I include in my report does not identify you as the respondent. Remember, you don't have to talk about anything you don't want to and you may end the interview at any time.

Are there any questions about what I have just explained?

.....
.....
.....
.....
.....

Are you willing to participate in this interview?

.....
.....
.....
.....
.....

Interview Questions

1. Do you have any bank guarantee with CRDB Bank at present?
2. How did you find the Bank conditions on this type of security? Explain
3. Where you informed of these conditions prior to the engagements? Explain
4. Are the insurers making follow ups on the principal repayment? Explain
5. How much had you taken as a Bank Guarantee?
6. What contract plan did you have at the time you borrowed the fund? or was the fund for other use? please explain
7. Do you use consultants in assisting you progress positively? Explain
8. What is the profit if any or loss if any you made in the year 2009-2011 if you remember?
9. Do you have any Guarantee from other financial Institutions or a Bank? Describe
10. Do you and your wife depend on this business to sustain your family needs? Explain
11. What are your recommendations and suggestions to CRDB Bank on cutting down costs associated with bank guarantees?

I'll be analysing the information you and others gave me and submitting a draft report to the organization in two month time. I'll be happy to send you a copy to review at that time, if you are interested.

Thank you for your time.

Appendix 4: List of CRDB Branches in Morogoro Municipality

1. Masika Branch
2. Morogoro Agency
3. Mandela Branch
4. SUA Branch
5. Mzumbe Branch
6. Mazimbu Branch

Appendix 5: Study time plan

The research is going to be conducted over a period of seven months as stipulated hereunder.

YEAR	2012					2013													
Month																			
	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12		
Activities																			
Research proposal																			
Literature review																			
Preliminary field work																			
Preliminary research																			
Observation																			
a. Field works																			
b. Analysis																			
Questionnaire																			
a. Field works																			
b. analysis																			
Interviewing																			
a. Field works																			
General Analysis																			
Thesis writing																			
Publications																			
Thesis submission																			

Appendix 6: Budget estimates (Activity Based Budget)

Activities	Cost
Research proposal	100,000
Literature review	150,000
Preliminary field work	100,000
Preliminary research	100,000
Questionnaire Administration	
a. Field works	130,000
b. analysis	70,000
Interviewing	
a. Field works	300,000
General Analysis	50,000
Thesis writing	200,000
Publications	250,000
Thesis submission	50,000
Total	1,500,000