

CAUSES OF NON PERFORMING LOANS IN COMMERCIAL BANKS
A CASE STUDY OF RUKWA AND DAR ES SALAAM REGIONS OF
CRDB BANK

CAUSES OF NON PERFORMING LOANS IN COMMERCIAL BANKS
A CASE STUDY OF RUKWA AND DAR ES SALAAM REGIONS OF
CRDB BANK

By

SIMON MTABAZI

Research Dissertation Presented to the Faculty of Commerce in Partial Fulfilment for
the Award of Masters of Accounting and Finance

2013

DECLARATION

I, Simon Mtabazi, declare that this research report is my own original work and that it has not been presented and will not be presented to any other University for a similar or any other degree award.

Simon Mtabazi

Signature.....

Date.....

Research Supervisor

Shrinivas Madishetti

Signature.....

Date

DEDICATION

I dedicate this work to my beloved family especially my mother Magdalena, who all together in one way or another have supported me throughout my studies to the completion of this report. Also this work is dedicated to Mr. Salum M. Chima the Regional Administrative Secretary (RAS) of Rukwa region. All I can say is that: May Almighty Lord blesses you.

COPYRIGHT

All rights reserved. No part of this publication may be reproduced in any form without the prior written permission of the Researcher or Mzumbe University

©

Simon Mtabazi.

2013

ACKNOWLEDGMENT

The preparation and production of this thesis would have not been possible without assistance from a number of committed individuals. Thus my great pleasure is to convey my sincere gratitude to the RAS RUKWA Management. All kinds of support, material and moral, that the management and staff of RAS RUKWA provided in accomplishment of this thesis report and their cooperation is highly appreciated. It may be impossible to mention each and every individual who supported me in making this thesis successful.

My heartfelt thanks are also expressed to my supervisor, Prof. Srinivas Madishetti for his unconditional assistance, helpful comments and his guidance while writing this report that enabled me to come up with this thesis. Sir, may God bless you.

I would like also to extend my sincere appreciation to the CRDB management for their support, It may be impossible to mention each and every individual who supported me in making this thesis successful one thing I can say, is that I do appreciate you all, thank you and may God bless you.

.

ABBREVIATIONS

BOT	-	Bank of Tanzania
BFIA	-	Banking & Financial institutions Act
CRB	-	Credit reference bureau
CRDB	-	Cooperative Rural Development Bank
GDP	-	Gross Domestic Product
IT	-	Information Technology
NPAs	-	Non-Performing Assets
NPLs	-	Non-Performing Loans
NMB	-	National Microfinance Bank
NBC	-	National Bank of Commerce
ROI	-	Return on Investment
Tzs	-	Tanzania Shillings- a unit of currency in Tanzania

ABSTRACT

The purpose of the study was to find out the causes of non-performing loans in commercial Banks. The study focused on level of Non Performing Loans in CRDB Bank and the causes or factors for Non-Performing Loans.

A case study research design of CRDB Bank Limited was employed. Interviews and questionnaires were used to collect data for the study. The sample size used was seventy nine (79). This comprised 44 officials of six (6) CRDB Bank branches and 35 beneficiaries of CRDB Bank credit facilities. Qualitative and quantitative methods of analyses were used.

This thesis is organized into five chapters. Chapter one covers introduction of the study, background of the problem, statement of the problem, research questions, objectives, significance, scope, limitations and delimitation of the study. Chapter two presents review of related literature. In this chapter, theoretical underpinnings are discussed in the view of expanding an understanding of the key issues concerning Non-performing Loans. Chapter three, research methodology covers study design, sampling techniques; data collection methods and analysis are presented. Chapter four discusses various findings and analysis, while several recommendations and conclusion are found in chapter five.

The findings revealed that external factors are more prevalent in causing non performing loans in CRDB Bank Limited. The factors causing non performing loans were natural calamities or change in economic condition such as inflation rates, government policy, change in real GDP and the integrity of the borrower. Findings suggest that integrity of borrower such that use of funds for purposes different from agreed ones as a major factor that cause NPLs. Findings imply that close monitoring of borrowers is critical to lending business.

Establishing a good relationship with borrowers was found to be the most favorable strategy which can be employed by CRDB in the effort of reducing non-performing loans also CRDB need to strengthen their loan management process especially in monitoring their borrowers and probably come up with new ways of monitoring them.

TABLE OF CONTENTS

DECLARATION.....	i
COPYRIGHT	iii
ACKNOWLEDGMENT	iv
ABBREVIATIONS	v
ABSTRACT	vi
LIST OF CHARTS	x
LIST OF FIGURES.....	xi
CHAPTER ONE.....	1
INTRODUCTION.....	1
1.0 Background of the study.....	1
1.2 Statement of the Research Problem.....	3
1.3 Research Objectives	5
1.3.1 General Objective.....	5
1.3.2 Specific Objectives.....	5
1.3.3 Research Questions	5
1.4 Significance of the study	5
1.5 Scope of the study	6
1.6. Limitation of the study	6
CHAPTER TWO.....	7
LITERATURE REVIEW	7
2.1 Introduction	7
2.1. Background Information of CRDB Bank (T) Limited.....	7
2.1.2Restructuring	8
2.1.3 Mission	8
2.1.4 Ownership	8
2.1.5 Management Structure	9
2.1.6 Nature of Business and branches network	10
2.2 Theoretical Literature Review	10
2.2.1 The Concept of loans.....	11

2.2.2 The Study of Non Performing Loans	12
2.2.3 Importance of loans to banks.....	12
2.2.4 Lending Methodology	13
2.2.5 Basic rules of lending	13
2.2.6 Credit appraisal.....	15
2.2.7 Collection policy	18
2.2.8 Strategic Debt Collection	20
2.2.9 Collection tools and techniques.....	21
2.2.10 Credit risk	23
2.2.11 Challenges on Loan Recovering.....	25
2.2.12 The Position of Non Performing Loans in Tanzania.....	27
2.2.13 Impact of Non Performing Loans on banking.....	29
2.2.14 CRB as the tool to minimize Non Performing Loan's	31
2.2.16 Why is a Credit Reference Bureau important	33
2.2.17 Empirical Literature Review	34
2.2.18 Conceptual framework on NPLs	37
2.2.18.1 Explanations of Variables in relation with NPLs.....	38
CHAPTER THREE	41
RESEARCH METHODOLOGY.....	41
3.0 Introduction	41
3.1 Area of study	41
3.2 Unit of Inquiry.....	41
3.3 Research design.....	42
3.4 Data collection methods	42
3.4.1 Primary Data.....	42
3.4.2 Secondary Data.....	42
3.5 Sampling methods	43
3.5.1 Sample size.....	44
3.6. Data analysis strategy	44

CHAPTER FOUR	45
ANALYSIS AND FINDINGS.....	45
4.1 Introduction	45
4.2 Profile of the respondents	45
4.2.1 Profile of employees.....	45
4.2.2 Profile of Defaulters	46
4.3 Trends in NPLs of CRDB Bank (T) Ltd	48
4.3.1 Sectorial Distribution of Loans and NPAs	50
4.4 Causes of Non-Performing Loans	51
4.4.1 Response of Employees on factors that cause NPLs in CRDB.....	52
4.4.2 Response of defaulters on factors that cause NPLs in CRDB.....	58
4.5 Interview with Respondents	65
CHAPTER FIVE.....	69
RESEARCH SUMMARY CONCLUSSION AND RECOMMENDATIONS ..	69
5.0 Introduction	69
5.1 Summary	69
5.2 Conclusion.....	70
5.3 Recommendations	71
BIBLIOGRAPHY	74
APPENDICES	76

LIST OF CHARTS

Chart 2.1: Quarterly NPLs of the Selected Economic Activities.....	28
Chart 4.1: CRDB Bank Plc Sector Loan Portfolio April 2010.....	50
Chart 4.2: Major Factors That Cause NPLS According To Employees.....	54
Chart 4.3: Major Factors that Cause NPLs According To Defaulters.....	61

LIST OF FIGURES

Figure 2.1 : Economic And Financial Implications of NPLs.....	30
Figure 2.2: Conceptual Framework of NPLs.....	37

CHAPTER ONE

INTRODUCTION

1.0 Background of the study

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

The traditional role of a bank is lending and loans make up the bulk of their assets (Njanike, 2009). According to the research by Havrilesky and Boorman (1994), interest on loans contributes significantly to interest income of commercial banks. Reed and Gill (1989) pointed out that traditionally 85 percent of commercial banks income is contributed by interest on loans. Loans therefore represent the majority of a bank's assets (Saunders and Cornett, 2005). Lending is not an easy task for banks because it creates a big problem which is called non performing loans (Chhimpa J, 2002) as cited in (Upal, 2009). Due to the nature of their business, commercial banks expose themselves to the risks of default from borrowers (Waweru and Kalami., 2009).

According to Alton and Hazen (2001) non performing loans are those loans which are ninety days or more past due or no longer accruing interest. (Hennie ,2003) agrees arguing that non performing loans are those loans which are not generating income. Non-performing loans are also commonly described as loans in arrears for at least ninety days (Guy, 2011). Therefore in this study, non performing loans are loans that are ninety or more days delinquent in payments of interest and/or principal (Bexley and Nenninger, 2012). Despite ongoing efforts to control bank lending activities, non performing loans are still a major concern for both international and local regulators (Boudriga et al, 2009).

Business credit is an integral part of economy. Virtually every business transaction that concerns another business involves credit. Trade credit is the single largest source of business financing by volume. Business credit is extended from one business firm to

another, for the purpose of acquiring goods that will eventually be resold or items that will be used to make goods for resale. Without business credit, most of business would not exist. Business credit is, in reality, the capital required to conduct business. Billions of dollars worth of goods and services are transacted daily through the business credit process, which is mostly conducted by banks.

The aim of bank is to earn profit for its shareholders, among the basic source of bank earnings is the interest on its asset (i.e. loan and investments) the excess of interest received over interest paid can be used to pay the cost of operating the bank and what remains is the profit to the bank stockholders as dividend (Duesenberry, 1987).

Loans are one of the bank assets that can generate the bulk of interest income, therefore successful assets and liability management requires that a bank closely monitor its credit extension and collection procedures to minimize defaults. That is loans are disbursed to right customers so that likely hood of timely debt re-payment can be insured.

Historically Banking crises in the world have occurred when a bank create loan of poor quality which cause non-payment of loan by borrowers. The non-payment of loan may lead the bank occasionally get into trouble because of insufficient liquidity. Studies in other countries show that most of bank failures have been caused by non performing loans (Brownbridge, 1998).

The collapse of Tanzania Housing Bank and Meridian Bio bank, closure of Greenland Bank and Trust Bank as well as privatisation of Tanzania's giant's commercial bank NBC Ltd., had brought a challenge to other banks and financial institutions to fasten control over non repayment of loans so as to minimize credit risk. National economic downturn, insider lending, political connection of bank owners, customer failure to disclose vital information during the loan application process, lack of proper skills amongst loan officials were among major factors identified in other countries to cause non performing loans (Santomero, 1997; Brownbridge and Harvey, 1998; Basel, 1999; Waweru and Kalani, 2009). Controlling non performing loans is very important for both the performance of an individual bank and the economy's financial environment (McNulty et.al, 2001). It is thus

the essence of this study to establish factors behind non performing loans thereby identifying weaknesses, if any, in the system and possibly suggests reasonable measures for improvement.

1.2 Statement of the Research Problem

For most banks, loans are the largest and most obvious source of credit risk. However, other sources of credit risk exist throughout the activities of a bank, including, the banking book and in the trading book, and both on and off the balance sheet. Banks are increasingly facing credit risk (or counterparty risk) in various financial instruments other than loans, including acceptances, inter bank transactions, trade financing, foreign exchange transactions, financial futures, swaps, bonds, equities, options, and in the extension of commitments and guarantees, and the settlement of transactions.

Many credit problems are associated with weaknesses in the credit granting and monitoring processes. Commercial banks find carrying out a thorough credit assessment (or basic due diligence) a substantial challenge. For traditional bank lending; lack of capabilities, competitive pressures and the growth of loan syndication techniques create time constraints that interfere with basic due diligence principle.

Since exposure to credit risk continues to be the leading source of problems in banks world-wide, banks and their supervisors should be able to draw useful lessons from past experiences. Banks should now have a keen awareness of the need to identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred.

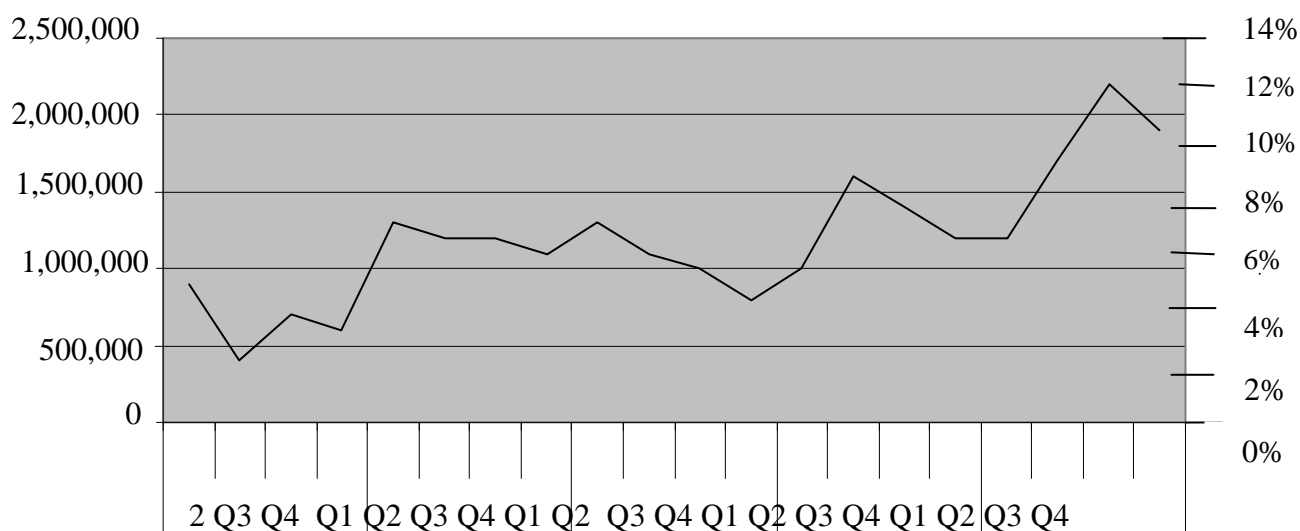
It is argued that the non-performing loans are one of the major causes of the economic stagnation problems. Each non-performing loan in the financial sector is viewed as an obverse mirror image of an ailing unprofitable enterprise. From this point of view, the eradication of non-performing loans is a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

Among banks in Tanzania CRDB Bank plays important roles in development of the country economic, The Bank was established in 1996 and has grown and prospered over the years to become the most innovative, first choice, and trusted bank in the country. CRDB Bank has been recording progressive profit every year since its foundation and has paid dividends annually.

Studies in other countries show that most of bank failures have been caused by non performing loans, for example [Khemraj (2005) revealed that the banking crises in East Asia and Sub-Saharan African countries were preceded by high non-performing loans.

Experience in Tanzania shows that many borrowers obtain loans from commercial banks but they are more often unable to repay their loans. Bad loans arise if there is no careful evaluation of loan applications followed by close monitoring of borrowers, This stimulated research in trying to establish the causes of non-performing loans in banks so this study intend here to know the level of nonperforming loans in CRDB such as shown in the diagram below, and later to find out what are the causes of these Non performing loans in CRDB Bank.

Chart 1.1 : Non-Performing Loans & Advances to total advances (%)



Source: Serengeti Adviser’s analysis of financial statement of CRDB

The diagram above shows a trend in non- performing loans in CRDB Bank from 2006 to 2010. The upward trend in Non-performing loans in CRDB Bank is alarming that this is a cause to concern. While quite a number of studies have investigated the causes of NPL, most of these studies have been done in developed countries with few being done in developing countries, also few studies explain about Non-performing loans in CRDB Bank, the attempt are made here to fill this gap, and therefore this study aims to examine the level and causes of Non-performing Loans in commercial banks especially CRDB thereby identifying weaknesses, if any, in the system and possibly suggests reasonable measures for improvement.

1.3 Research Objectives

1.3.1 General Objective

The main objective of this study was to find out the causes of Non-performing loans in commercial banks.

1.3.2 Specific Objectives

The following specific objectives were geared towards achieving the main objectives:

- 1) To study the level of NPLs in CRDB Bank (T) Ltd.
- 2) To study and analyze the causes of NPLs at CRDB Bank(T) Ltd

1.3.3 Research Questions

The study guided by the following questions:

- i. What is the trend of Non-Performing Loans at CRDB?
- ii. What are the causes for Non-performing Loans at CRDB Bank?

1.4 Significance of the study

The findings of this research are of great importance to different groups such as

- Upon completion of this study, the result will help staffs of CRDB Bank to understand the conditions and procedures undertaken by the CRDB Bank in processing and granting loans to customers in order to achieve its objectives.

- The research findings will enable the organization to eliminate weaknesses or change the system of granting loans to customers for the aim of improving the whole credit management system.
- The study increases the knowledge of the researcher in Accounting and finance field. Moreover the study will lead the researcher to fulfill the conditions for the award of Msc of accounting and finance.

1.5 Scope of the study

The study focuses on the CRDB (T) Ltd, involving six (6) branches of it, four (4) branches in Dar es Salaam and two branches in Rukwa region, this is premised on the fact that the CRDB Bank has been operating long enough to give the kind of academic insight the study seeks to offer.

The aim of using these two regions were to find data from two regions which are quite different, such that Dar es Salaam which is already economically developed and Rukwa region which is still in low level of development such that the region's economic infrastructures is underdeveloped and most of the customer's businesses operate under competitive environment also their sales return are uncertain, specifically, this study focuses on those defaulters who operate under sole trade.

1.6. Limitation of the study

Time was a major constraint in this study. As a result of limited time within which to complete this work, the study was carried out using a case study approach. The issue of non-performing loans is a sensitive and confidential issue since it has a bearing on bank performance and reputation therefore to get some relevant papers and documents were strictly prohibited. The study was further narrowed down to some loan officers and some management staff of the bank, from whom primary data was obtained. This also posed a limitation since there could be some biases regarding the information obtained. However, to overcome this I had to interview many respondents from the same institution in order to fill in the missing details.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This part gives the theoretical base of the study. It explains the current state of the knowledge in this field of study. Lowis & Charles (1987) have advocated that a literature review should state what previous researchers say about the topic of study. However John (1994) has provided the following purpose of literature review.

- (i) It shares with the reader the results of other studies that are closely related to the study reported.
- (ii) It relates a study to the larger, ongoing dialogue in the literature about the topic, filling in gaps and extending prior studies.

This chapter focuses on the review of relevant literature on loans and other core aspects of the topic under study. Here under this chapter cover the following.

- i. Background of the CRDB Bank
- ii. Theoretically literature review
- iii. Empirically review, followed by
- iv. Conceptual framework

2.1. Background Information of CRDB Bank (T) Limited

In order to understand the background of CRDB Bank here we have to look to how it was started, mission of the bank, ownership, management structure, the nature of the business and branches network.

2.1.1 Incorporation

CRDB BANK LTD is a private commercial bank. The Bank was established on July 1st 1996 to succeed the former Cooperative and Rural Development Bank (CRDB), which was a public institution with majority of shares held by the Government of the United Republic of Tanzania. The succession was a result of the liberalization of the banking industry in

Tanzania. The liberalization which followed the enactment of the Banking and Financial Institutions act (BFIA) of 1991 and Government's policy to divest its interest in the sector prompted a recapitalization of the Bank to levels stipulated by the BFIA (1991). CRDB Bank has been recording progressive profit every year since its foundation and has paid dividends annually. The Bank reached an important milestone recently and was listed on the Dar es Salaam Stock Exchange on 17th of June, 2009.

2.1.2 Restructuring

CRDB has been blessed with an invaluable partnership from the Danish International Development Agency (DANIDA). DANIDA's commitment and support in technical, managerial and financial areas of the Bank's operations has been instrumental for the success of CRDB BANK LIMITED.

2.1.3 Mission

CRDB is a local leading Tanzanian bank providing quality financial services with a strong focus on retail clients and customized corporate services while ensuring a competitive return to shareholders. Through their wide linked branch network and dedicated staff, they offer convenient access throughout the country.

2.1.4 Ownership

CRDB Bank Plc endeavours to provide investors with transparent, timely and comprehensive disclosure whenever such information is available. This is undertaken through a proactive process whereby information is continually and broadly disseminated to the general public on quarterly and annual basis. Below is the CRDB Bank Plc shareholding structure showing shareholders owning above 10%, between 10% and 1% and below 1% of the Bank's share capital as at 31st January, 2013

Table 2.1: CRDB Bank Plc shareholding structure

NAME	SHARES HELD	%	SHARES HELD	%
	31/01/2013		30/09/2012	
ABOVE 10%				
DANIDA Investment Fund	467,781,934	21.5	467,781,934	21.5
Parastatal Pension Fund	217,401,749	10	217,401,749	10
Sub Total	685,183,683	31.5	685,183,680	31.5
BETWEEN 1% AND 10%				
SCB (T) Nominee Ltd SCB (M) Re Pictet and CIE A/C	133,113,784	6.1	106,908,684	5
Public Service Pension Fund	71,531,350	3.3	71,531,350	3.3
SCB (T) Nominee Ltd SCB (Mauritius) GHANA	67,909,524	3.1	66,237,824	3
The Local Authorities Pension Fund	44,372,958	2	44,372,958	2
SCB (T) Nominee Ltd SCB(M) Re Altree Custody Serv.	53,247,034	2.4	37,150,000	1.7
Western Zone Tobacco Growers Cooperative Union Ltd	36,000,000	1.7	36,000,000	1.7
CMG Investment Ltd	34,588,554	1.6	34,588,554	1.6
Hans Macha	28,082,800	1.3	28,082,800	1.3
Lindi Development Fund	21,660,000	1	21,660,000	1
Sub Total	490,506,004	22.5	446,532,170	20.6
SHAREHOLDERS OWNING SHARES BELOW 1%	1,000,824,473	46	1,044,816,310	47.9
Grand Total	2,176,532,160	100	2,176,532,160	100

Source: CRDB Bank Investors information

2.1.5 Management Structure

CRDB Bank organizational structure is made up of the following;

- Managing Director
- Deputy Managing Director
- Department of Finance and Administration
- Department of Retail Clients and Marketing
- Department of Credit
- Department of Internal Audit
- Treasury Department
- Department of International Banking & Institutional Clients
- Department of Operations
- Secretariat Department
- Department of Human Resource

2.1.6 Nature of Business and branches network

CRDB bank is a private bank offering full range of banking services which includes deposit products like savings accounts, current accounts, investment products such as fixed deposit accounts, credit products like overdrafts and loans and money transfer services both locally and internationally. They are also an insurance agent for Royal Insurance (T) Limited offering a full range of insurance products which include fire, motor, theft etc. The bank is the largest banking institution in Tanzania, by assets, providing commercial banking services to individuals, small-to-medium sized corporate clients and large corporations. As of March 2011, CRDB Bank's total assets were valued at about US\$1.8 billion (TZS: 2,800 billion). In December 2011, shareholders' equity was valued at approximately US\$178 million (TZS: 276 billion).

It offers a comprehensive range of Corporate, Retail, Business, Treasury, Premier, and wholesale microfinance services through a network of over 85 branches, 250 ATMs, 15 Depository ATMs, 12 Mobile branches, 900 Point of Sales (POS) terminals and scores of Microfinance partners institutions. The Bank also operates through Internet and Mobile banking.

From the background of CRDB Bank it shows that this is the largest banking institution in Tanzania and it operates efficiently also as it is already registered in Dar es Salaam stock exchange market and one can be one of the owners of the bank through buying shares of this bank and this is good for the development of bank and society at large.

2.2 Theoretical Literature Review

This shows the concepts used in the study such as the following,

- i. Concepts of loans.
- ii. The study of NPLs
- iii. Importance of loans to banks
- iv. Lending methodology
- v. Basic rules of lending
- vi. Credit appraisal
- vii. Collections policy

- viii. Strategic debt collections
- ix. Collections tools and techniques
- x. Credit risk
- xi. Challenges on loans recovering
- xii. The position of NPLs in Tanzania
- xiii. Impact of NPLs on banks
- xiv. The roles of Credit reference bureau

2.2.1 The Concept of loans

Loan

- ❖ Is a thing especially some of money lent to be returned with or without interest. Oxford dictionary (1951: 699) Loans are offered to customers with a fixed period and amount, they are provided to finance fixed investment need of business as assessed through the appraisal to determine its validity.
- ❖ Means a line of credit or advancement that allows a person to write cheque for amounts exceeding actual deposit balances in his/her bank account. In practice, such advancement is granted by a commercial bank to its customers by specifying the tune to which that account may be overdrawn on fluctuation basis (always deposit and withdrawals running in the same current account) for a period not exceeding one year.(Markowit ,1959),
- ❖ Means all items not shown in the balance sheet but which constitute credit risk. Such risk includes guarantees, acceptances performance-bonds, letters of credit and other off-balance sheet items deemed to constitute credit risk by bank.
- ❖ Means any loan or overdraft that is not generating income and such loan or overdraft has been past due for ninety days or more. (Markowit ,1959).

According to the Bank of Tanzania Act, 2006;

"loan" or "advance" includes any loan, discount, overdraft, lease financing, export bills purchased, other bills received or purchased, import bills, customer's liability on acceptances, drawings against uncleared effects, encashment of cheques drawn against other branches or offices where the drawer's current account has insufficient cleared and withdraw able balance or against other banks, or any other credit extended to a person by a

bank or financial institution, excluding the undrawn or unavailed balance of any line of credit.

2.2.2 The Study of Non Performing Loans

Non-performing loan

Means any loan or overdraft that is not generating income and such loan or overdraft has been past due for ninety days or more.(Sharpe ,1964)

According to Bank of Tanzania:

“Non Performing Loans” means any credit accommodation for which contractual repayment is ninety days or more past due or is classified as substandard, doubtful or loss hinder the criteria prescribed in Regulation 11, and is placed on a non accrual basis; (The Management of Risk Assets Regulations,2008)

By bank regulatory definition;

Non-performing loans consist of;

- Other real estate owned which is taken by foreclosure or a deed in lieu of foreclosure
- Loans that are 90days or more past due and still accruing interest, and
- Loans which have been placed on nonaccrual(i.e. loans for which interest is no longer accrued and posted to the income statement)

According to the International Monetary Fund (IMF);

A loan is non performing when payments of interest and principal are past due by 90days or more, or at least 90 days of interest payments have been capitalised, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full

2.2.3 Importance of loans to banks

Banks make their profit by obtaining fund from lenders at low interest rate and re-lending to borrowers at high rate of interest. The different represent gross profit, which must pay for its own operating expenses and make a net profit.

(Lipsobe ,1996) pointed out that banks profit become the difference between two rates, that is the higher the interest it can charge the better the profit and the lower the rate it pays to the funds the better the profit too. But the bank should be very careful not to charge too much since the market is very competitive and customers can easily be lost to other banks, which charge lower interest rate.

2.2.4 Lending Methodology

Lending involves the process of delivering financial services with an intention to finance the matter for which the loan is meant for. The lending methodology can be categorized as lend to individuals singly or lending to individuals via group guarantee

2.2.5 Basic rules of lending

These are principles to be considered before lending money to customers, thus the bank should always remember that the money lent to customers doesn't belong to it, its depositors and shareholders' money. Therefore every endeavour should be made to avoid bad debts, as this may result in few advances and loss of income to the bank. There are rules and principles to guide the bank in deciding whether to lend or not.

Gardner (1992) outlines that; the credit manager must adhere to the following basic rules of lending

- a) Profitability
- b) Source of repayment
- c) Character and ability of the borrower
- d) Purpose of facility
- e) Terms of the facility
- f) Safety

These are further elaborated below as follows

Profitability

All credit facility granted to the institution's customers must produce profit, either directly or indirectly.

Source of repayment

Before granting credit facility, the credit manager should ensure that a reliable source of repayment exists and that the advance will be paid within the agreed period. When considering the period of repayment, sufficient margin should be provided for unforeseen circumstances such as downward market trend, or the general economic condition of the country. Besides payment of interest and instalment, the funds generated by the business should preferably leave adequate margin of meeting needs for future expansion or other business contingencies. Where the fixed assets adequately secure the facilities, the sale proceeds of such security should not be considered as a prime source of adjustment of the facilities.

According to NBAA the accountant manual (2001), explain four sources of funds the borrower can use to repay the loan as follows:

- (i) Additional capital invested in the business
- (ii) Refunding the debt with another lender.
- (iii) Conversion of asset.
- (iv) Earnings

Additional capital invested and debt refunding is usually dismissed in the loan decision-making activities. Analysis of the applicant ability to repay usually is limited to the conversion of place in the borrowing needs of the business.

Characteristics and ability of the borrower

The credit manager should know his customers well and should be able to judge their intention and ability to use the credit facilities to their advantage. Advantage should be

granted to those borrowers with full confidence to the branch manager. Integrity of the borrower and his ability to conduct business, are of paramount importance and take prudence over the value of security offered. The director or partners of limited companies or partnership should be a person of integrity, experience and drive.

2.2.6 Credit appraisal

Before granting any credit, the Bank shall consider and satisfy itself that the borrower is capable of fulfilling its commitments.

This refers to an art of evaluating and examining information before granting loans. Business credit administration manual points out that a borrower as well as business /project appraisal must be carried out to ascertain the credit-worthiness of the borrower as well as the viability of the businesses or project to be financed. (Rouse, 1992)

Borrower investigations or appraisal involve the five C's of credit, these are character, capacity, collateral, condition, credit history and capital as here under explained

- **Character:**

This refers to personal traits of the borrowers (completely apart from financial standing), which may be significant in the credit decision. Terms such as ethical, honesty and integrity are important in this regard. Character is said to be the most important C's of credit because the dishonest borrower can always find the way to avoid the restrictions imposed by the lender on the agreement.

- **Capacity:**

Capacity to generate income refers to the ability of the borrowers to generate sufficient funds through liquidation of assets or earning to repay the loan. Capacity refers to capacity to pay and capacity to contract.

- (i) **Capacity to pay**

One may have the determination to pay back, the question is, and do he /she have the necessary financial resources to meet his /her commitment.

In the case of individuals it is the question of looking of one's pay slip. Also it is important to know the position of the applicant to determine whether in the event of the applicant being retrenched, will he/she be in a position to secure another job.

(ii) Capacity to contract

To see whether your customer is capable of entering into a legally binding contract bearing in mind that a company is a person separate from the person who administer it, and it can sue and be sued in its own name.

- **Collateral**

This refers to the ability of the borrower to pledge specific assets to secure the loan. These assets may be fixed in nature i.e. land and buildings or working capital i.e. inventories and receivables. Collateral is important in reducing risk, it should be viewed as a substitute for adequate earnings potential.

- **Conditions**

Refers to the general economic conditions beyond the control of the borrower that may affect the liability of the loan repayment, some industries are seasonal such as farming, which are most severely affected by adverse condition like drought or flood, also competition within the industry should be taken into consideration

- **Credit History**

This gives full details of the credit that the applicant was previously able to obtain and the degree of promptness with which those obligations where discharged. The credit manager must be careful as some companies and individuals deliberately cultivate good references by selective prompt payments. By making inquiries through other organisation, financial institutions or credit agencies, the credit manager should be in a position to obtain the full information.

- **Capital**

This indicates the difference between assets and liabilities. A strong capital base indicates healthy. The extent and sophistication of credit appraisal will be governed by the nature of the business to be financed.

Also Business/credit appraisal or investigations includes,

- (i) Past finance performance; Marketing, management, availability of skilled and unskilled labour for the project business/project.
- (ii) Cost, benefits and profit from the intended business and project.

Profitability projections for the period during which the client facility will be repaid,
Gardner (1992)

The following should be considering before the bank provide a loan to its customer,

I. Amount of the Credit

The credit facility shall be granted and its repayment schedule shall be appropriate for the credit and purpose of the credit. The terms and conditions must be clearly spelt out and in proper accordance with the type of facility.

II. Repayment terms

The type of the facility granted and its repayment schedule shall be appropriate for the credit and purpose of the credit. The terms and conditions must be clearly spell out and in proper accordance with the type of facility.

III. Risk Assessment

Risk Assessment shall be made covering every aspect of the business (such planning, marketing, management and also inherent risks). Ways to mitigate these risks should be given insurance against possibility of non-payment (security). Each credit granted by the Bank shall be properly secured by collateral which can be easily realized and repay the loan in full in case of default. After all these, there are credit approval i.e. appraisal and approval functions shall be separated. Appraisal report will be the basis for approval that is each approving authority will approve, reject the credit application based on information provided in the appraisal report. A signed copy of the appraisal report must be kept in main file.

IV. Credit Documentation

After approval of the credit facility, the bank and the borrower shall duly execute a credit agreement and securities will be perfected before utilization of the credit is allowed.

V. Credit Utilization

No disbursement, drawing or utilization of any credit facility shall be allowed until all terms and conditions are fulfilled including the following:

- Perfection of securities
- Execution of credit agreement documents

The Branch Manager together with the branch controller shall authorize the first utilization of all approved credit facilities upon being satisfied that all terms and conditions have been fulfilled and that credit agreement and security documents properly executed securities perfected and that all documents kept under branch safe custody. Subsequent withdraws and the credit officer responsible for that customer before approval will initiate disbursements from the account by the branch manager and or only delegated officer.

2.2.7 Collection policy

Chadowline (1999) Explained that collection policy indicates what collection devices and system are employed. Who is responsible for collecting past due accounts? When the orders applications withheld? Goals of good loan collection system must insure the following;

(i) Aid the working capital position of the firm.

Every company needs cash to operate and payments must be collected promptly and in full, if the creditor wants to avoid cash flow problem.

(ii) Reducing operating expenses and bad debts.

The collection system should not generate excessive cost for the company e. g telephone expenses, mail cost, legal fees, collection agency fees etc. an especially costly type of expense is a bad debts

(iii) Retain customer goodwill.

Collections can be an emotion-charged activity. The collection devices and activities should be matched to the known seriousness of the delinquency. Retaining customer goodwill is important repeat sales from quality customers and to the overall operation of a firm.

(iv) Rehabilitate the customer.

Rehabilitate the customer- some customers are indeed delinquent and have fallen behind in their payments. Assisting customers who will benefit from rehabilitation efforts may help cement life long relationship with a particular credit grantor.

(v) Aid the sales effort.

A good collection department will often improve sales. Credit customers will generally borrow money from financial institutions when they are up date with their payments and where their status is good. Previous collection problems that were not handled well may cause embarrassment, which prevents future business.

(vi) Promote good communication with customer.

Contracts and communication that occur between the creditor and the debtor must be timely and effective. Failure to communicate may be the actual cause for collection difficulties. The debtor must also be reminded occasionally of the seriousness of their delinquency. Therefore collection efforts revolve around effective communication skills and the ability to understand human behaviour. Good collectors are persistent, understanding and above all, good communicators.

(Bank and Financial Institution Act 2001)

Follow-up of borrowers in arrears

The visit by the loan officer to a borrower in arrears which brings the highest return in payment of arrears is a visit the next day after a payment is missed. The longer the borrower is allowed to continue in arrears, the less likely it is that the arrears will over be

paid and the less productive follow up become. A visit to a borrower in arrears should never be delayed for more than three days.

When a loan officer meets a borrower who has missed a payment, the discussion will proceed along the following line.

- (i) Why was the payment missed?
- (ii) Was the instalment due date forgotten?
- (iii) Was the borrower unable to come to the bank for some reasons?
- (iv) Was there a special business problem so that the cash was not available on the due date?
- (v) Is the cash to make payments now available?
- (vi) When will the borrower come to the bank and pay?

The loan officer will prepare a report of visit to borrower in arrears for each visit made to such borrower. Including in this report is 'an agreement to pay' to be signed by the borrower, this shows the date on which the borrowers agree (s) he will pay amount in arrears. Refusal by the borrower to sign an agreement to pay will be considered as indicating a willingness to pay.

Principles of loans collection

Good business requires that standard principles of collection are adhered to and good methods of loan collection are employed so that to avoid risks, (Chadowline, 1999) explains principle of collections as follows; Certain principles have been found especially used in the field of collection and may be grouped into the following areas; (i) collect the money, (ii) Maintain the systematic follow up, (iii) Get the customer to discuss the account, (iv) Preserve goodwill.

2.2.8 Strategic Debt Collection

It would be nice if all customers paid their bills by the due dates. But they don't and since you may also occasionally "stretch" your payables, you can't altogether blame them.

Collection turnover is to business what blood is to human being. Prompt collection that retains customer goodwill must be the goal. It is necessary to avoid abusive collections actions as these only alienate the customers. The first thing that should be established is a system that will inform the credit manager as quickly as possible that the account has fallen into an overdue position. (Solomon 1996)

2.2.9 Collection tools and techniques

A well-designed collection system can be compared to be series of screens that sift delinquent customers into various categories. Earlier screens are low in cost and handle the customer gently to preserve goodwill. Later screens are less routine, cost more to apply and may be somewhat sharper in action. They may not preserve goodwill with such certain. The screens tend to classify debtors into much smaller and more exact assortments.

A general collection system progresses through four stages based on the collection effort involved,

- (i) The impersonal routine stage
- (ii) The Impersonal appeals stage
- (iii) The personalized appeals stage
- (v) The drastic or legal action stage

Thus through the four stages, the collection department gradually increases pressure up to the point that the debtor should (but, unfortunately, does not always) feel that there is no more desirable alternative than paying and that there is no escape from this conclusion. Solomon (1996).

Modes of collections

Business credit Administration program manual pointed out the modes of loan collections being the invoice, the statement, collection agency, repossession, attorneys and telephones that are highlighted here as follows;

(i)The invoice

In trade credit business normally the collection procedure starts with the invoice, which records the debtor's liability. Payment is often made against the invoice. The invoice must clearly set out the terms on which goods are sold, the invoice must state clearly the goods purchased and the price and should impress by being good design and neatly printed. (Rajevski, 1985)

(ii) The statement

Statements are normally used in service industry or for consumer credit. It's not a legal requirement to send out monthly statements, but they serve as a collection reminder. The statement will set out the customer's account at a given date, and normally statements are used to reconcile with invoices. As with invoice, the statements must be well designed, dated and state clearly the credit terms and conditions. (Rouse, 1992)

(iii) Collection Agency

Referring an account to a collection agency is normally a drastic action taken by a creditor and normally reserved for problem accounts. However collection agencies may be employed as an outsourcing method. The advantage of using a collection agency varies considerably. Also the reputation of the agency needs careful investigation. (Rouse, 1992)

(iv) Repossession

Repossession is the legal process to take possession of goods for failure to pay amounts agreed. A debtor may have pledged an automobile as security on a loan, for example, repossession is the process a creditor would use to claim legal rights to possession of the automobile. Although generally the creditor's last desire to retake merchandise that is not paid for, this may be the only action left.

The right of repletion specifies that if the creditors can show a title or a possession right superior to that of the debtor, then the merchandise can be retaken in case of non-fulfilment of the terms of the contract.

Repossession can take place only when the creditors has a secured interest in the merchandise and when a writ of repleton has been obtain after suit has been filed and judgement rendered.(Rajevski, 1985).

(v) Attorneys

Another technique is to turn the account over to an attorney who will act like collection agency in attempting to secure payment. Handing over to an attorney comes about when the creditor has finally decided that he no longer wishes to continue business relationships with the debtor. However this method is very costly and normally takes time to collect using this process. (Rajevski,1985).

(vi) The telephone

This is very effective tool to demand payment, but is seldom used as a follow up to a statement or letter of demand. A telephone saves time and expense and if tactfully handled, is more personal. The use of a telephone can easily be combined with other techniques in collection. However, at times using a telephone can prove very expensive, especially if the creditor fails to extract payment from the debtor to evade phones or just make false promise.

2.2.10 Credit risk

Credit risk is the possibility that a loss could arise from non-payment or late payment of a financial obligation by a customer. That is, the risk that the counter-parties will be unable to meet their obligations, most transaction give rise to counter-party risk with a general rule being that the longer the claim on the counter- party exist the greater the risk. Banking and Financial Institution Act, (2006).

Possible reasons for not paying loans in time

The following are the causes of credit risk or reasons for not paying in time such as follows;

- **Ineffective credit Management**

This arise when management fail to monitor and control the credit facilities, Ineffective management cause credit risk when one of the following happens.

(i) Misjudge of creditworthiness.

This happens when the credit managers fail to analyse worthiness of borrowers of which sum of money granted is based upon.

(ii) Lack of skill in gathering or ferreting information upon which a proper credit appraisal or analysis should be based.

(iii) Management's failure to correctly interpret the market for credit service, since a good financial management require that proper market is established to avoid risk associated with poor market of particular products.

(iv) Management's failure to protect the physical property of the receivable ledger which is referred as security. The security act as a safeguard of asset invested so as to avoid credit risk.

- **Debtor circumstances**

These are the factors causes' credit risk but they are direct or indirect contributed by borrowers such as change in capacity and character of borrowers

(i) Capacity;

Changes in the debtor's employment, earning capacity or indebtedness militate against the integrity of his promise and produce an unexpected specific risk.

(ii) Character;

Changes in the willingness of debtor to comply with their purchase, contract causes dissatisfaction with product/services, marital disagreements and displeasure with creditor's collection tactics.

- **Environment circumstances**

This are factors which cause credit risk, arise out of environment changes for instances during business recession, political influence in debts and natural disasters like union strike and war.

- (i) Business recessions

Referring to economic point of view, during economy recession value of money decrease abnormally while demand to purchase decrease, this bring difficulties in settlement of debts.

- (ii) Expropriation and political repudiation of debts

Any political interference in lending decision can result to credit risk since payment delay or default will relay on political influence.

- (iii) Natural disasters, union strikes, wars etc

When natural disaster, union strikes and war occur, it disturbs the whole business performance as a result firm can fail to meet its financial obligations.

2.2.11 Challenges on Loan Recovering

The following are the challenges facing financial institutions in loan recovering

Multiple Borrowings

Lack of credit reference bureau can lead to this such that there is no credit information system, so clients can taking loans from various finance Institutions. The problems arise when the repayment period is due. Clients find themselves in problems because they have to repay more than one loan at the same time. This makes some of them to borrow in one institution and pay another.

Dishonesty of some loan officers

Some loan officers are not honest. They register ghost clients. They take the money themselves and disappear. This is expected to be overcome when then bank has manage to review the recruitment criteria because there will be a low chance of recruiting wrong staff.

Poor infrastructure

This happens especially in rural areas; reaching clients in rural areas is a challenge to banks. Access to roads is bad; there is no reliable communication, water or power.

Judicial Costs

Dealing with defaulters using judicial instruments is costly in terms of money and time and this can put the lending institutions a great risk of incurring much loss.

2.2.11.1 Loan Recovery strategy

Ways to minimizing delinquency and default

Delinquency and default always occur to many financial institutions, which need serious study, so as to provide ways to adopt so as to minimize delinquency and default. A delinquency is a failure to repay an obligation when due or as agreed.

Experience in Tanzania shows that many borrowers obtain loans from commercial banks but they are more often unable to repay their loans. Bad loans arise if there is no careful evaluation of loan applications followed by close monitoring of borrowers (Davis and Kearns; 1989, Bank of Tanzania; 1991 and Donaldson; 1989). Also Bad loans arise if there is no regular monitoring to facilitate identification of their causes.

Bad loans need special attention (control mechanism) and prompt action to turn them around. Prompt action, however, must be well guided by dealing with causes and not symptoms of the problem. Bad loans arise if there is contingent delayed or misdirected action which leads to further deterioration in the quality of loans. (David and Kearns, 1989 and Donaldson, 1986).

(Zimhost , 1997) tresses the following as the ways to minimize delinquency

Accept that most delinquency is caused not by credit institutions that have not implemented an affective credit methodology also to create an image and philosophy that consider late payments as unacceptable option.

Due to the researcher finding the financial institutions must provide develop borrower selection techniques that entrepreneurs with bad intentions or bad image or bad reputations

and make sure that loan size and terms do not make repayment difficult also to establish an incentive system that uses both financial and non-financial incentives to encourage on time repayment

Ensure that from the borrower's perspective the benefit of on time repayments and cost of late payments for outweigh the benefit of on time repayment.

Provide information to field workers that enable them to conduct effective and timely follow up of loans and to manage their portfolios efficiently.

Develop a portfolio information system that enables them to conduct timely and useful analysis of portfolio quality, determine trends in the portfolio overtime and identify possible causes of delinquency. Establish prudent loan loss reserve and write off policies that prepare the institution for such write off. Ensure that income and assets are accurately reflected in the financial statement.

Table 2.2: Approach to Debt Management

<p>Strategy</p> <ul style="list-style-type: none"> - Economic value - Link to other part of business - Customer relationship - branding 	<p>Models & Instruments</p> <ul style="list-style-type: none"> - Risk measurement models - Measurement based decision support system - Value-based customer segmentation - Provision forecast models
<p>Technology</p> <ul style="list-style-type: none"> - Integrated IT - Adaptive contact solution - Workflow solution - Capacity and process support 	<p>Process</p> <ul style="list-style-type: none"> - Legal compliance - Account analysis - Legal/collateral realization - Distressed debt-sale - Bankruptcy management
<p>People</p> <ul style="list-style-type: none"> - Recruitment/retention - Training - Performance - Incentivization - Motivation 	<p>Organisation</p> <ul style="list-style-type: none"> - Structure - Management - Outsourcing - Supplier management

Source: KPMG Germany 2007-Managing Credit Risk-Beyond Basel II

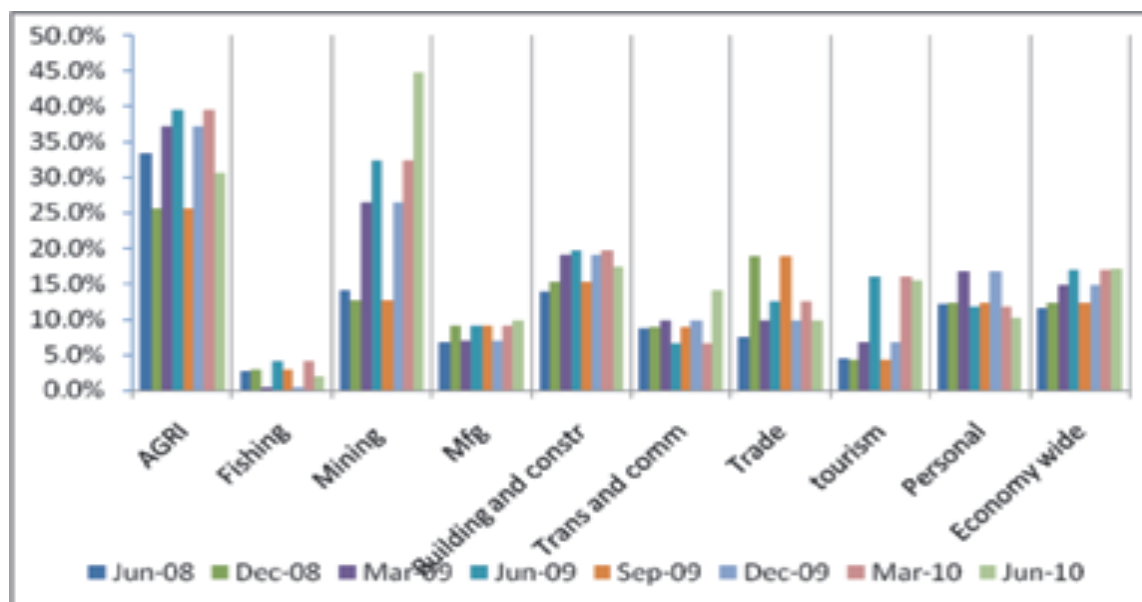
2.2.12 The Position of Non Performing Loans in Tanzania

The financial sector is one the catalysts for high economic growth since the sector acts as conduit for expansion of private enterprises in a particular country.

The level of NPL is an important element when assessing the health of the financial system. In times of economic slowdown, loan repayments become constrained and thus asset quality tends to deteriorate. As per regulatory requirements, this situation would require banks to make additional provisions which in turn have an impact on banks' capital.

Unlike in the 1990s and up to early 2000s when the level of the non-performing loans in Tanzania commercial banks were at 50 percent and above, bank's performance in the year 2008 to 2011 was characterised by strong growth to the private sector and this can be proved by Quarterly NPLs of selected economic activities below.

Chart 2.1: Quarterly NPLs of the selected economic activities



Source: Bank of Tanzania

The Quarterly NPLs of selected economic activities from June 2008 to June 2010 show that mining activities are suffer an upward trend of NPLs as it was 25% in Dec 2008 then rise to 45% in June 2010. While the level of NPLs in agricultural activities decline from 38% in June 2008 to 30% in June 2010.

The 'Financial Stability Report-2011' by the Bank of Tanzania stated that, during the second half of 2009, the ratio of Non-Performing Loans at the industry level registered a declining trend, the ratio of non-performing loans closed at 6.7 percent as of the end of 2010.

The report also says that the decline was in line with the implementation of the Tsh1.7 trillion presidential economic rescue packages which, among other things, provided for loans rescheduling and loss compensation to affected companies. Within a six months period, “the NPL ratio had declined from 7.8 per cent to 6.7 per cent by December 2009 – and, hopefully, to six per cent in 2011,” the central bank report reads in part.

The major factors that cause increased Non-Performing loans include weaknesses in the legal system regarding contract enforcement, weaknesses and time-consuming title deeds registration procedures; lack of credit references bureaux and past history of non-performing loans. It is however expected that the NPLs will start declining in the future.

The tables below show the level of Non-Performing Loans in three largest bank in Tanzania banking industry such that NMB, CRDB and NBC

Table 2.3: Trend of NPL’S in NBC (Tzs million)

Year	2008	2009	2010	2011
NPL’S and Advances	29,675	50,547	134,634	6,801
NPL’S and Advances to Total Gross Loans	4%	7%	17%	9.5%

Source: Audited Financial Statements of NBC

Table 2.4: Trend of NPL’S in NMB (Tzs million)

Year	2008	2009	2010	2011
NPL’S and Advances	32,290	25,811	32,288	18,128
NPL’S & Advances to Total Gross Loans	5.54%	3.75%	3.69%	1.59%

Source: Audited Financial Statements of NMB Ltd

The tables 2.2 and 2.3 above show the incidence of loans defaulting in Tanzania in two prime banks in Tanzania note that table 4.3 in chapter four show the trend of NPLs in CRDB.

2.2.13 Impact of Non Performing Loans on banking

The following are the impact of Non Performing Loans on banking;

Profitability

NPL means booking of money in terms of bad asset, which occurred due to wrong choice of client. Because of the money getting blocked the profitability of bank decreases not only by the amount of NPL but it lead to opportunity cost also as that much of profit invested in some return earning project/asset. So NPL does not affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity.

Liquidity

Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for shortest period of time which lead to additional cost to the company.

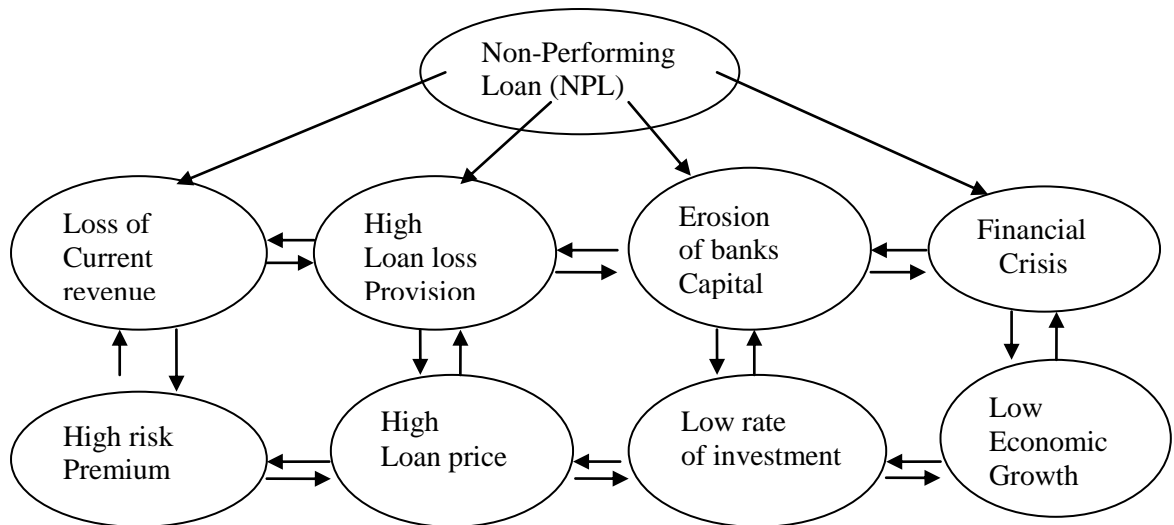
Involvement of Management

Time and efforts of management is another indirect cost which bank has to bear due to NPL. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now days, banks have special employees to deal and handle NPAs, which is additional cost to the bank.

Credit Loss

If a bank is facing problem of NPA, then it adversely affects the value of bank in terms of market for credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting in their money in the banks.

Figure 2.1 : Economic and Financial implications of NPLs



Source: Bangladesh Institute of Bank Management : NPLs in the banking sector of Bangladesh.

The above figure illustrates the effect of NPLs in a bank-centered financial system

2.2.14 CRB as the tool to minimize Non Performing Loan's

The theory of asymmetric information tells us that it may be difficult to distinguish good from bad borrowers (Auronen, 2003), which may result into adverse selection and moral hazards problems. The theory explains that in the market, the party that possesses more information on specific item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender) (Auronen, 2003). The party that knows less about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction (ibid). Adverse selection and moral hazards have led to substantial accumulation of nonperforming assets (NPLs) in banks (Bester, 1994); (Bofondi and Gobbi, 2003).

A credit reference bureau is a company that collects information from various sources and provides consumer credit information on individual consumers for a variety of uses. It is an organization providing information on individuals' borrowing and bill-paying habits.

A privately owned, profit-making establishment that as a regular business collects and compiles data regarding the solvency, character, responsibility, and reputation of a particular individual or business in order to furnish such information to subscribers (Banks, Micro Finance Institutions and Credit Institutions), in the form of a report allowing them to evaluate the financial stability of the subject of the report.

This way, the institution that is opening a new account for you will have enough information about the way you pay the accounts you already have, so that they can make responsible decisions about granting you credit, through this the financial institutions will minimize the possibilities of nonpayment of loans.

The main business of a Credit Reference Bureau is to maintain credit information reported to it by lenders and other providers of credit, and to provide credit information in response to enquiries from members.

2.2.15 Credit Reference bureau in Tanzania

The Bank of Tanzania Act, 2006 mandates the BOT to create a Credit Reference System designed to collect and provide information on the payment record of all clients of banks and financial institutions, savings and credit schemes and other entities engaged regularly in extension of credit in Tanzania.

The establishment of the credit reference system is a continuation of government's efforts to reform the financial sector which dates back to the enactment of the Banking and Financial Institution Act, 1991 which paved the way for creating an effective and efficient financial system in the country. lack of credit reference system in Tanzania has been one of the major factors limiting access to credit. Small firms and individuals borrow at high rates because of the high risks involved as lenders do not have information on their credit behaviors. As a result of lack of credit information, banks and financial institutions have been setting high lending rates as a means of mitigating any risks which could result from the scant information they have about borrowers.

2.2.16 Why is a Credit Reference Bureau important

Credit information such as a person's previous loan performance is a powerful tool to predict his future behavior. For example, adequate credit information could facilitate lenders in screening and monitoring borrowers as well as avoid giving loans to high risk individuals. If you apply for a new loan or credit facility, a credit provider will look at your credit report and quickly see whether you are a person who repays your debt responsibly and punctually.

This way, a credit provider can minimize their risk and have confidence when offering you credit because they have the assurance and the evidence that you have the means and ability to repay them by looking at how you repay your other accounts.

Also consumers can benefit from a good credit information system because it reduces the effect of credit monopoly from banks, and it provides incentives for borrowers to repay their loans on time.

For example, Research conducted by Nairobi University, school of business show that in the recent past, the banking sector in Kenya was saddled in a momentous non-performing loans (NPLs) portfolio. This invariably led to the collapse of some banks. A discriminant analysis was conducted using discriminant analysis to predict whether the use of Credit reference Bureau by commercial banks has any impact on Non-performing loans.

The predictor variables were, NPL/Advances, advances/Deposits and Return on Assets for both periods. The research findings tell that the use of credit reference bureaus has an impact on non-performing loans banks should implement in their lending policies the use of the credit reference bureaus in making credit decisions as well as recovery of bad debts. Since the introduction of the CRB's in 2008, banks have been able to reduce the level of non-performing loans to advances ratio compared to the periods prior to 2008.

Also Credit Reference Bureaus are vital to the economy as they:

- Allow for faster access to credit
- Allow consumers and commercial entities to buy now and pay later

- Help lenders to assess the risk so that they are able to extend credit
- Help lenders keep the rates lower by not having to raise the price to counter for poor payment behaviour of a few
- Help lenders exclude poor payers from the process
- Give borrowers access to credit without them having to save the full amount before they can buy
- Increase the level of economic activity in the country
- Stimulate lending by promoting collateral free lending to those without collaterals

2.2.17 Empirical Literature Review

This part contains the recommendations put forward by different researchers in recent year relevance to the problem under study on Non performing loans. A non-performing loan is an advance by a financial institution that is not earning income and full payment of principal. As such interest is no longer anticipated (Van Greuning, & Bratavonic, 2003). There is no global standard to define non-performing loans at the practical level. Variations exist in terms of the classification system, the scope, and contents. This pitfall potentially adds to disorder and uncertainty in the non-performing loans subject. For instance, as described by Park (2003), during the 1990s, there were three different methods of defining non-performing loans: the 1993 method based on banking laws; the “Bank’s Self-Valuation” in March 1996; and the “Financial Revival Laws-Based Debt Disclosure” in 1999.

Goacher et al in their study on causes for NPLs found that there is a significant positive relationship between the loan-loss rate and internal factors such as high interest rates, excessive lending, and volatile funds also Non-performing loans were influenced by external factors such as gross domestic product growth, high real interest rates, lenient credit terms and excessive lending by commercial banks.

Salas and Saurina (2002) reveal that real growth in GDP, rapid credit expansion, bank size, capital ratio and market power explain variation in NPLs.

Furthermore, Jimenez and Saurina (2005) examine the Spanish banking sector from 1984 to 2003; they provide evidence that NPLs are determined by GDP growth, high real interest rates and lenient credit terms.

Rinaldi and Sanchis-Arellano (2006) analyze household non performing loans for a panel of European countries and provide empirical evidence that disposable income, unemployment and monetary conditions have a strong impact on non performing loans.

Berge and Boye (2007) find that problem loans are highly sensitive to the real interest rates and unemployment for the Nordic banking system over the period 1993–2005, A study conducted by Espinoza and Prasad (2010) focused on macroeconomic and bank specific factors influencing non-performing loans and their effects in GCC Banking System. After a comprehensive analysis, they found that higher interest rates increase non performing loans but the relationship was not statistically significant.

In Africa, Fofack (2005) investigated the determinants of non-performing loans in sub-Saharan Africa using correlation and causality analysis. The analysis was based on data drawn from 16 African countries, Using a pseudo panel-based model for several Sub-Saharan African countries, Fofack (2005) finds evidence that economic growth, real exchange rate appreciation, the real interest rate, net interest margins, and inter-bank loans are significant determinants of NPLs in these countries. The author attributes the strong association between the macroeconomic factors and non-performing loans to the undiversified nature of some African economies.

In Kenya (Waweru and Kalani, 2009) found unfavorable economic environment specifically the national economic downturn leading to the depression of business to be perceived as the most important factor that caused NPLs.

Also in Africa, Brownbridge, (1998) , Richard (2011) concludes that many of the bad debts in banks were attributable to moral hazards; the adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending at high interest rates to borrowers in the most risky segments of the credit market. To the borrowers’ side, they also tend to divert the funds to risky investments once they are granted the loans.

In Tanzania, according to findings cited by Richard, E (2006) suggest that use of funds for purposes different from agreed ones as a major factor that cause NPLs.

The high NPAs suffered by governments banks and other financial institutions had led to the restructuring of almost all banks, In Tanzania, empirical evidence suggest that NPAs are due to external (macro) and internal (micro) factors, (William,1995;Chijoriga,1997;Kimei,1998) included in the internal factors are reckless lending, corruption, fraud and dishonest, management deficiencies, poor credit documentation and non-use of credit classification, lending to insider and poor supervision capacity.

External factors such as bank deregulation/regulation policies and procedures, lack of information among bank customers, political and government interventions as being causes of NPL.

Table 2.5: Summary of Empirical Review

Author	Year	Country	Causes identified for NPLs
Khemraj, T and Pasha, S	2009	Guyana	-Real effective exchange rate - GDP growth is inversely related to non-performing loans -relatively higher interest rates and lend excessively are likely to incur higher levels of non-performing loans.
Richard, E	2006	Tanzania	-use of funds for purposes different from agreed ones as a major factor that cause NPL
Jimenez and Saurina	2005	Spain	-provide evidence that NPLs are determine by GDP growth -high real interest rates -lenient credit terms
Fofack,H	2005	Cameroon	- reveals that changes in the real effective exchange rate have a positive impact on NPLs of commercial banks - high real interest rate
William, Chijoriga, Kimei	1995,1997,1998	Tanzania	- suggest that NPAs are due to external(macro) and internal(micro) factors
Waweru and Kalani	2009	Kenya	-found unfavorable environment specifically the national economic downturn leading to the depression of business to be perceived as the most important factor that caused NPLs
Sanchis-Arellano	2006	Spain	-analyze that disposable income, unemployment and monetary conditions have a strong impact on NPLs
Berge and Boye	2007	Norway	-find that problem loans are highly sensitive to the real interest rate and unemployment
Espinoza and Prasad	2010	Spain	-they found that higher interest rates increase NPLs
Brownbridge, Richard	1998,2011	United Kingdom	-Concludes that NPLs in banks were attributable to Moral hazards, high interest rates and diversion of fund.
Goacher et al	2002	United kingdom	-High interest rates -Excessive lending -Lenient credit terms

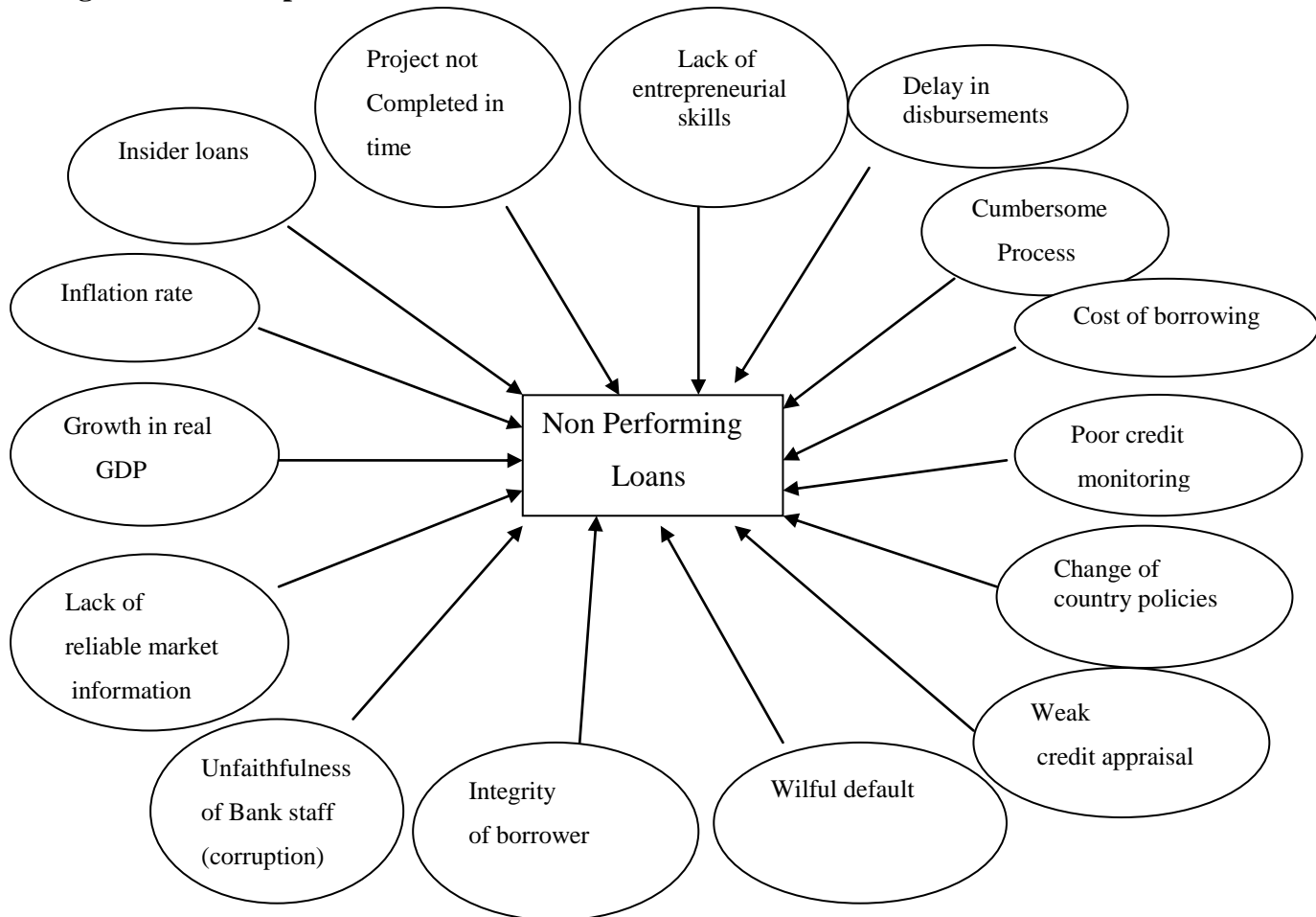
The tables 2.5 above summarize the findings on empirical review.

2.2.18 Conceptual framework on NPLs

Conceptual frameworks are type of intermediate theory that attempt to connect to all aspects of inquiry (e.g., problem definition, purpose, literature review, methodology, data collection and analysis. Conceptual framework can act like maps that give coherence to empirical inquiry.

Based on the following conceptual frame work below, this conceptual framework is the guide for this study.

Figure 2.2: Conceptual framework of NPLs



Source: own work

2.2.18.1 Explanations of Variables in relation with NPLs

There is a strong association between NPLs and several factors, the relation between these factors and NPLs are shown here under, The rise in the NPLs in bank can be due to diversion of funds away from the original purpose for which they were granted, as well as willful default (or misappropriation of funds) by borrowers.

That apart, adverse economic and market factors, ranging from recessionary conditions, regulatory changes and resource shortages to inefficient management and strained labour relations have impacted the health of businesses, and driven them to default on their loan repayments.

Also there a positive relationship between the inflation rate and non-performing loans, studies, shows that inflationary pressures contribute to the high level of impaired loans, inflation is responsible for the rapid erosion of commercial banks' equity and consequently higher credit risk in the banking sectors.

Also strong positive growth in real GDP usually translates into more income which improves the debt servicing capacity of borrower which in turn contributes to lower non-performing loans. Conversely, when there is a slowdown in the economy (low or negative GDP growth) the level of NPLs should increase.

Bercoff, Giovanni and Grimard (2002) showed that operating efficiency helped explain NPLs. i.e. banks that incur big cost for loan follow-up would have a comparatively lower nonperforming loan.

The impact of real interest rates on NPLs is extensively documented in the literature. In fact, several studies report that high real interest rate is positively related to this variable (see for example, Jimenez and Saurina, 2005 and Fofack, 2005). According to Dash and Kabra (2010) the banks with aggressive lending policies charging high interest rates from the borrowers incur greater non-performing loans. The table 2.6 below summarize explanation of variables relative to NPLs.

Table 2.6: Explanation of Variables relative to NPLs

Factors	Details	Increase	Decrease	Impact in NPLs
Cost of borrowing	High costs of borrowing		-	Reduce level of NPLs
Inflation rate	High inflation rate	+		Increase level of NPLs
Weak credit appraisal system	Weak credit analysis from the beginning	+		Increase level of NPLs
Cumbersome process	The prospect of getting into the detailing that banks require is really cumbersome	+		Increase level of NPLs
Insider loans	Number of loans secured by those inside the bank without having required documents		-	Reduce level of NPLs
Willful default	Due to underdevelopment of credit orientation, borrowers diverted loans advanced for unintended purpose.	+		Increase level of NPLs
Poor credit monitoring	Lack of loan follow up by bank	+		Increase level of NPLs
Integrity of borrower	Borrower's tend to divert the funds to other investments with intention of more profits, failure of those unmentioned project means non repayment of loans		-	Reduce level of NPLs
Lack of Reliable market information	People engaged in business without knowing where to sell or buy. Failure to get market means operating business in loss.	+		Increase level of NPLs
Business failure/ lack of entrepreneurial knowledge on borrowers side	Engage in unstudied business lead to failure of business, this means lost of everything which were injected in the business.	+		Increase level of NPLs
Project not completed in time	This can be due to delay in disbursement, insufficient amount or competitive environment	+		Increase level of NPLs
Delay in disbursements	Application process takes a long time, there are possibilities of change in economic conditions, so secured loan can be insufficient.	+		Increase level of NPLs
Change in real GDP	improvement in the real economy is likely to see an instantaneous reduction in the NPLs	+		Reduce level of NPLs
Unfaithfulness of bank staff (corruption)	lead to ghost borrowers, or weak credit appraisal	+		Reduce level of NPLs
Change of country policies	Introductions of regulatory policies which does not support lending activities	+		Increase level of NPLs

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

Research methodology is a systematic attempt or procedure that helps the researcher to avoid self deception. The researcher always aims at providing accurate description and explanation on things he has observed. The research methodology applied in this work was aim to insure accurate observations and explanations. In the present study, various statistical tools such as ratio, percentages, average have been used to analyse and interpret the data.

3.1 Area of study

CRDB Bank was used as a case study, because it involve a single organization, it provide an opportunity to apply different methods of data collection such as interviews, observation, questionnaires and documentary sources.

3.2 Unit of Inquiry

In order to obtain the relevant information the following units of inquiry was used in the investigation:

Population of the employees of CRDB Bank

- ✓ Credit Department
- ✓ Heads of Departments/Units
- ✓ Managing Directors' office.
- ✓ Senior and Junior staffs.
- ✓ Customers.

The information was obtained from bank borrowers through visits to their business premises.

3.3 Research design

The research was a case study design, this is because;

- (i) The research was done at a single unit such that the CRDB Bank Ltd
- (ii) It facilitates a depth study in the field of research problem
- (iii) It focused on contemporary events and did not need control over environment or behavioural assignment leading to writing a thesis
- (iv) A case study design uses a variety of data collection methods such as questionnaire, interview, observation and documentation.

3.4 Data collection methods

Data collection methods which were employed for the purpose of this study include observations (participatory observation), documentary, interviews and questionnaires. The researcher considered these methods to be appropriate to meet the research objectives.

3.4.1 Primary Data

Primary data was collected from the sample population through survey employing the questionnaire and face to face interviews.

3.4.2 Secondary Data

Secondary data was collected from the company's books, journals and newspapers also from company's published audited financial statements to find out how non performing loans have affected the bank in terms of liquidity and profitability as well as from online sources

Interview

This is a form of verbal interaction between the interviewer and the interviewee design to elicit information from that interviewee.

Unstructured interviews were conducted and this is mainly done because the respondents might be busy so they could not get enough time to fill the questionnaires. Also interviews were held in addition to seek clarification on some responses and to complement some information which will not be fully captured through questionnaire. During the interviews the researcher was guided by the research questions posted in the questionnaires so as to get consistent information relevant to the study.

Questionnaire

This is a piece of paper containing written questions in which respondents are required to answer. These are questions designed by researcher so as to obtain relevant information to his/her research problem. There are two types of questionnaires, that is open questionnaires in which is the set of alternative answers to a questions, and closed questionnaire is where the respondents is provided with questions that are not binding.

The researcher use open ended questionnaires to all respondents of this study. This kind of questionnaire was chooses because it gives the respondent the wide scope of expressing him/herself so they were in a position to elaborate their cases which might differ from one respondents being busy at some time will equally be of great consideration in choosing this method.

3.5 Sampling methods

This is a procedure whereby a population of interest is designed and an attempt is made to select a subset of predetermined size. Sampling frame is the number of population available at CRDB Bank (T) Ltd as well as the number of customer files made available to the researcher.

Sampling Procedures

Both probability and non-probability sampling techniques were employed.

Purposive sampling

This is a form of sampling in which the selection of the sample is based on the judgment of the researcher as to which subjects best fit the criteria of the study. Purposive sampling was used due to the fact that it provides opportunity to some key respondents to be included

into a sample by virtue of their positions and status so as to respond on specific (selected) matters. In the side of customer the researcher deals with those customers who have borrowed from CRDB Bank.

3.5.1 Sample size

Table 3.1: Justification for Sample Size

Category	Respondents	Target respondents	Percentage of sample to population	Sample taken	Percentage of sample responded out of the sample
Employees	120	50	41.67	44	88
Defaulters	300	60	20.00	35	58.3

Source: Own computation

Sample size was taken from six (6) CRDB Branches, each of the branch have minimum of 20 employees, and the minimum number of defaulters for each branch are 50 defaulters. For the purpose of this study the researcher has taken only those defaulters who operate under sole trade system. The respondents for this study were 120 employees of CRDB and 300 defaulters of the bank, the target respondents were 50 employees which is 41.67% and 60 defaulters which is 20%.

Out of the fifty (50) questionnaires sent to the target population, forty four (44) usable responses were collected. This represented a response rate of 88% percent and implies that 12% percent of the questionnaires were not returned at all. Of the business premises interviews, thirty five (35) were successfully contacted, giving a success rate 58.3% percent. Twenty five (25) interviews were unsuccessful because the targeted interviewees were time constrained and poor infrastructure in their business located areas. The statistics in Table 3.1 above gives a fair representation of the target population and hence the validity of data.

3.6. Data analysis strategy

The data collected was classified, tabulated and analysed by applying percentages and chi square statistical test, whenever necessary tables and charts were presented showing analysis of data and this result of quality information.

CHAPTER FOUR

ANALYSIS AND FINDINGS

4.1 Introduction

This chapter analyses the data collected and presents the findings along with discussion. For the purpose it deals with the presentation of profile of the respondents, trends of NPLs of CRDB (T) Ltd and the factors which cause Non Performing Loans along with discussion.

4.2 Profile of the respondents

For identifying the causes for NPLs in selected regions of CRDB (T) information is collected from 83 respondents comprising of 44 employees and 35 defaulters of the bank. The profile of the both the groups are presented here under.

4.2.1 Profile of employees

The profile of employees helps to understand their ability and appropriateness in responding to the specific questions relating to the study. The 44 respondents are taken from six categories of employees who deal with banking activity. The profile of these respondents is presented in terms of selected variables viz; experience in banking and lending and level of education. For convenience the experience is classified into two groups 1-10 years and more than 10 years and level of education is divided into graduates and masters and above. The ascertained information is presented in table 4.1.

Table 4.1: Experience and level of education of the employees

Current Role	Experience in Banking & Lending (1-10 years) more than 10 years				Level of Education Graduates masters & above				Frequency
Loan officer	7	43.75%	9	56.25%	11	68.75%	5	31.25%	16
Credit analyst	4	33.3%	8	66.7%	4	33.3%	8	66.7%	12
Credit Documentation officer	3	37.5%	5	62.5%	6	75%	2	25%	8
Credit Approval officer	1	25%	3	75%	2	50%	2	50%	4
Relationship manager	1	50%	1	50%	-	-	2	100%	2
Branch manager	-	-	2	100%	-	-	2	100%	2
Total	16	36.4%	28	63.6%	23	52.3%	21	47.7%	44

Source: Field Findings

The following observations can be made from the table 4.1;

- Based on the experience back ground of the employee respondents 63.6% have more than 10 years of experience while 36.4% of respondents have worked with the bank in lending units have service between 1 and 10 years. Further in all category of the respondents majority are from experience group of more than 10 years.
- Based on education back ground 47.7% of respondents have masters or PhD while 52.3% already have degree or advanced diploma. It can be further observed that in key areas of credit management like credit appraisal, analysis, relationship majority are from masters and higher qualifications.

The fact that majority of the respondents had many years experience in bank and also possess required education signifying that all respondents possess required knowledge of the lending activities hence helped capture a good quality of data.

4.2.2 Profile of Defaulters

35 defaulters from seven professional categories are included in this study. The profile of these default respondents is presented in terms of their capital, education level, family size,

and experience in business. Table 4.2(a) presents the responses in terms of capital invested and education level and table 4(b) presents data in terms of rest of the variables.

Table 4.2(a): Profile of Defaulters

occupation	capital				Education level						Total respondents
	50,000 to 1,000,000		1,000,000 and above		Primary		Secondary		University		
Gov't Service	3	60%	2	40%	1	20%	3	60%	1	20%	5
Private service	2	40%	3	60%	1	20%	2	40%	2	40%	5
Self employed	4	50%	4	50%	3	37.5%	4	50%	1	12.5%	8

4.2(b): Profile of Defaulters

Unemployment	6	66.7%	3	33.3%	2	22.2%	7	77.8%	-	-	9
Retired	1	33.3%	2	66.7%	-	-	3	100%	-	-	3
House wives	3	100%	-	-	3	100%	-	-	-	-	3
Farmers	2	100%	-	-	2	100%	-	-	-	-	2
Total	21	60%	14	40%	12	34.3%	19	54.3%	4	11.4%	35

Source: Field Findings and Own Computation

Table 4.2(c): Profile of defaulters

occupation	Family size				Experience in business				Total respondents
	1 to 4 member		4 and above		1 to 5 years		5 years and above		
Gov't Service	1	20%	4	80%	4	80%	1	20%	5
Private service	2	40%	3	60%	3	60%	2	40%	5
Self employed	3	37.5%	5	62.5%	5	62.5%	3	37.5%	8
Unemployment	3	33.3%	6	66.7%	6	66.7%	3	33.3%	9
Retired	-	-	3	100%	2	66.7%	1	33.3%	3
House wives	1	33.3%	2	66.7%	-	-	3	100%	3
Farmers	-	-	2	100%	-	-	2	100%	2
Total	10	28.6%	25	71.4%	20	57.1%	15	42.9%	35

Source: Field Findings and Own Computation

The following observation can be made from the above tables:

- 71.4% of the total defaulters were not employed in the formal sectors and remaining employed in formal sector.
- Among the defaulters from non- formal sector 22.9% and 25.7% were self employed and unemployed respectively, other remaining defaulters were retired, house wives and farmers.
- The numbers of defaulters engaged in government services as well as in private services were 28.6%.
- Education is one of the most important characteristics that might affect the person's attitude. As per table 4.2(a), 88.6% have primary or secondary education while it's only 11.4% who have degree or advanced diploma.
- 60% of defaulters level of working capital range between 50,000-1,000,000/-, while the family size of 71.4% of defaulter respondents were four (4) persons and above

Thus it shows that the defaulter respondents hail mostly from non-formal sector, low education, higher family size and capital of below one million.

4.3 Trends in NPLs of CRDB Bank (T) Ltd

The first objective of the study was to present the trends in NPLs of CRDB. For the purpose the trends of non- performance loans and advances, total loans and advances, total Shareholder funds, total assets ascertained from the annual reports of the bank for the period from 2008 to 2011. On the basis of this data the trends in NPLs are worked out in terms of the ratio of NPLs to gross loans, the ratio of NPLs to total shareholder funds and the ratio of NPLs to total assets and shown in table 4.3.

Table 4.3: Trend of NPL'S in CRDB (Tzs million)

Year	2008	2009	2010	2011
NPL'S and Advances	37,947 (100)	60,612 (159.72)	132,675 (349.63)	134,783 (355.18)
Loans, Advances And Overdrafts	836,803 (100)	949,505 (113.47)	1,123,348 (134.24)	1,429,262 (170.80)
Total Shareholder's Fund	139,557 (100)	207,774 (148.9)	240,922 (172.63)	254,764 (182.55)
Total Assets	1,449,673 (100)	1,854,867 (127.95)	2,305,225 (159.02)	2,713,641 (187.2)
NPL and Advances to Total Gross Loans	4.5%	6%	11%	9%
NPLs and advances to total hare holder funds	27.19%	29.17%	55.05%	52.91%
NPLs and advances to total assets	2.62%	3.23%	5.76%	4.97%

Source: Audited Financial Statements of CRDB PLC

The analysis of table 4.3 reveals the following:

- There has been continuous increase in gross loans over the period of study from TZs 836,803,000 in December 2008 to TZs 1,429,262,000 in December 2011 indicating about 170.8 percentage taking 2008 as the base year. It shows an average annual increase of $(70.8/3)$ 23.6 percent.
- The NPAs have gone up from TZs.37, 947 million in 2008 to TZs.134, 783 million in 2011 marking about more than three and half times increase. The average annual increase was $(255.18/3)$ 85.6 percent.
- Consequently NPL's to gross loans has gone up from 4.5% to 9% during the study period. Thus the trend reveals that NPA's have gone up at higher rate when compared to increase in gross loans consequently resulting into increase in NPA's to gross loans.
- There has been continuous increase in Total shareholders' fund over the period of study from TZs 139,557,000 in December 2008 to TZs 254,764,000 in December 2011 indicating about 182.55 percentage taking 2008 as the base year. It shows an average annual increase of $(82.55/3)$ 27.52 percent. The ratio of NPLs to shareholders fund also gone up from

27.19% to 55.5% during the study period. The increase of this was highest in 2010 and subsequently marginally came down.

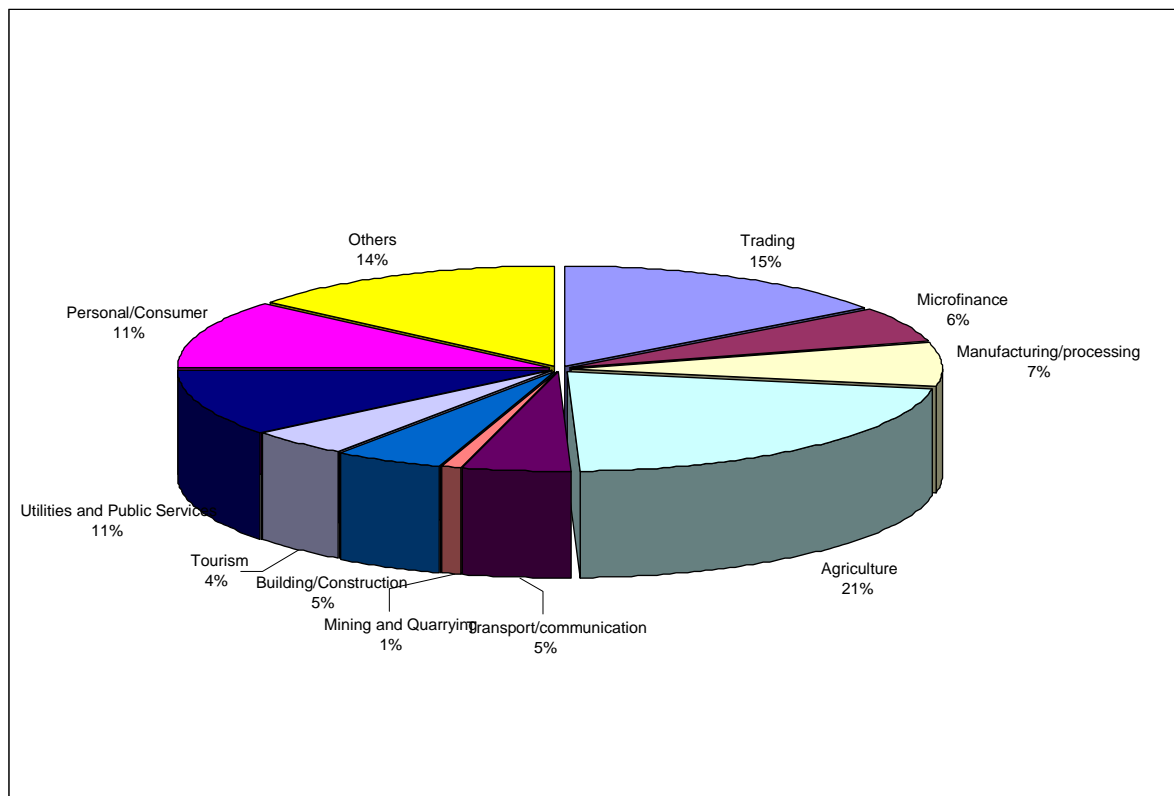
- The total assets of the bank have been increased from TZs 1,449,673 in 2008 to TZs 2,713,641 in 2011, this indicating about 187.2 percentage taking 2008 as the base year. The ratio of NPLs to total assets also has gone up from 2.62% to 5.67% during the study period. It was highest in the year 2010 and came down marginally in 2011.

Thus it can be inferred that the NPLs have gone up in absolute terms and as a percentage of gross loans, shareholder funds and total assets during the study period the increase was higher in 2010 and marginally came down. This might have taken place on account of higher proportion of increase in NPAs as compared to gross loans, shareholders' funds and total assets.

4.3.1 Sectorial Distribution of Loans and NPAs

An attempt is made to study the sectorial distribution of loans. The major sectors for which advances are made include Agricultural, Trading, and Personal/consumer, utilities and public services and manufacturing sectors of the economy. Chart 4.1 below shows the details;

Chart 4.1: CRDB BANK PLC SECTOR LOAN PORTFOLIO APRIL 2010



Source: CRDB Investors Information April 2010

The results summarized in chart 4.1 above show that 21% of loans were granted to agricultural sector, 15% of total loans were directed to trading, while personal/consumer loans takes 11% of total loans, 11% of total loans were granted to utilities and public services while the remaining 42% were granted to different sectors of the economy. Quarterly NPLs of selected economic activities, published by Bank of Tanzania showed that agriculture and SMEs are the leading sectors in NPLs.

4.4 Causes of Non-Performing Loans

In order to find out what factors are dominant in being causes of NPLs in CDRB, The researcher ask the respondents both employees and defaulters the causes of NPLs, the following was their responses

4.4.1 Response of Employees on factors that cause NPLs in CRDB

The responses of employees are ascertained on 15 factors which were identified in the review of literature and shown in the conceptual frame work. The factors identified are not mutually exclusive and hence employees have been asked to give more than one response depending upon their experience. Thus their responses taking their profile background as the base are presented in table 4.6.

Table 4.4: Factors that cause Non-Performing Loans – responses of employees

Factor	Experience in Banking				Level of Education				Number of Employees on each Factor	%
	1 to 10 years		more than 10 years		Graduates		masters and above			
Cumbersome process	7	58.3 %	5	41.7 %	9	75%	3	25%	12	3.9
Unfaithfulness of bank staff (corruption)	2	40%	3	60%	4	80%	1	20%	5	1.6
Integrity of borrower	16	36.4 %	28	63.6 %	23	52.3 %	2	47.7 %	44	14.2
Change in real GDP	12	34.3 %	23	65.7 %	18	51.4 %	1	48.6 %	35	11.3
Weak loan portfolio management by bank staff especially weak credit analysis from the beginning	14	35%	26	65%	15	37.5 %	2	62.5 %	40	12.9
Natural calamities or change in economic conditions like inflation etc	15	39.5 %	23	60.5 %	11	28.9 %	2	71.1 %	38	12.3
Change in country policies	4	50%	4	50%	5	62.5 %	3	37.5 %	8	2.6
Project not completed in time	12	80%	3	20%	6	40%	9	60%	15	4.9
Lack of reliable market information	2	40%	3	60%	2	40%	3	60%	5	1.6
Cost of borrowing	3	75%	1	25%	2	50%	2	50%	4	1.3
Business failure/inexperienced or lack of entrepreneurial knowledge on borrowers side	12	42.9 %	16	57.1 %	11	39.3 %	1	60.7 %	28	9.1
Poor credit monitoring	15	44.1 %	19	55.9 %	16	47.1 %	1	52.9 %	34	11.0
Willful default	13	56.5 %	10	43.5 %	11	47.8 %	1	52.2 %	23	7.4
Insider loans	2	50%	2	50%	1	25%	3	75%	4	1.3
Delay in disbursements	5	35.7 %	9	64.3 %	6	42.9 %	8	57.1 %	14	4.5
Total									309	100

Source : Own Computation from Primary Data

The analysis of the table 4.6 reveals the following:

1. In all 309 responses were received on 15 factors from 44 respondents. The responses for every factor were varying between 1.3% and 14.2% of total responses..
2. Among all 14.2% of the responses are in favor of lack of integrity of borrowers indicating that the loans availed are diverted for other purposes. Taking the experience background as the base this view was endorsed by 63.2% of respondents who have more than 10 years' experience and remaining less than 10 years' experience. Taking education of the respondents as base this opinion was endorsed by 47.7% masters' qualification and 52.3% graduates. Thus it can be inferred that this is the prime reason for NPAs as per the employees.
3. 12.9% of the responses reveal weak loan portfolio management by bank staff especially weak credit analysis from the beginning. Taking the experience background as the base this view was endorsed by 65% of respondents who have more than 10 years' experience and remaining less than 10 years' experience. Taking education of the respondents as the base this opinion was endorsed by 62.5% masters' qualification and 37.5% graduates. Thus it can be inferred that this is the second major factor which cause of NPAs as per employees.
4. 12.3% of the responses reveal natural calamities or change in economic conditions like inflation etc causes NPAs. Taking the experience background as the base this view was endorsed by 71.1% of respondents who have more than 10 years' experience and remaining less than 10 years' experience. Taking education of the respondents as the base this opinion was endorsed by 60.5% masters' qualification and 39.5% graduates. Thus it can be inferred that this is the third major factor which cause of NPAs as per employees.
5. 11.3% of the responses reveal change in real GDP. Taking the experience background as the base this view was endorsed by 47.7% of respondents who have more than 10 years' experience and remaining less than 10 years' experience. Taking education of the respondents as the base this opinion

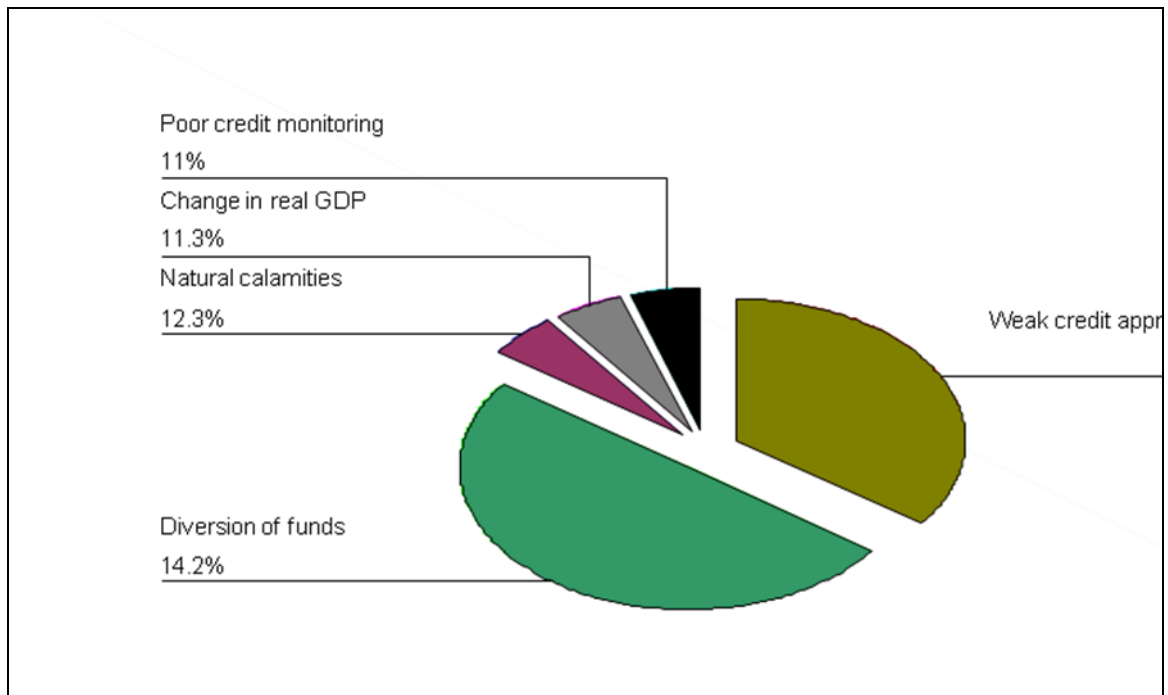
was endorsed by 63.6% masters' qualification and 36.4% graduates. Thus it can be inferred that this is the fourth major factor which cause of NPAs as per employees.

6. 11.0% of the responses reveal poor credit monitoring. Taking the experience background as the base this view was endorsed by 52.9% of respondents who have more than 10 years' experience and remaining less than 10 years' experience. Taking education of the respondents as the base this opinion was endorsed by 55.9% masters' qualification and 44.1% graduates. Thus it can be inferred that this is the fifth major factor which cause of NPAs as per employees.
7. 9.1% of the responses reveal Business failure/inexperienced or lack of entrepreneurial knowledge on borrowers side. Taking the experience background as the base this view was endorsed by 57.1% of respondents who have more than 10 years' experience and remaining less than 10 years' experience. Taking education of the respondents as the base this opinion was endorsed by 60.7% masters' qualification and 39.3% graduates. Thus it can be inferred that this is the sixth major factor which cause of NPAs as per employees.

Thus as per employees point of view, lack of integrity of borrowers indicating that the loans availed are diverted for other purposes, weak loan portfolio management by bank staff especially weak credit analysis from the beginning, natural calamities or change in economic conditions like inflation etc, change in real GDP and poor credit monitoring were the top five factors which resulted into NPAs in CRDB. Improper credit analysis results into loaning to undeserved, diversion of funds for social purposes other than the purpose for which loans were given become burden to the borrower and result into nonpayment of loans. This may be the consequence of improper monitoring by the officials of the bank.

The major factors that cause NPLs as per the responses of the employees is presented in the following diagram.

Chart 4.2: Major factors that cause NPLs according to employees



Source: Field Findings

Testing the significance of the results:

Chi square test was applied to identify the significance of the responses of respondents taking their background as the base, among 15 factors for which responses were given by the respondents as the causes NPLs, nine (9) major factors were chosen to test the significance of the results taking education and experience difference as the base.

The value of the test-statistic is: $\chi^2 = \sum (O_i - E_i)^2 / E_i$

Where **O_i** is the observed frequency and **E_i** is the expected frequency.

Critical value is determined from the chi square normal distribution table. To make study more accurate 0.05% level of significance is applied to conclude whether the educational background and experience background has any impact on their responses. The null hypotheses are taken as that there was no impact of variations in educational background and experience background on the responses of the respondent employees. The nine factors chosen are named as follows for this testing.

A= Integrity of borrowers

B= Weak credit appraisal

C= Natural calamities

D= Change in real GDP Cost of borrowing

E= Poor credit monitoring

F= Business Failure

G= Willful default

H= Project not completed in time

I= Delay in disbursements

1= Experience in banking 1to10years

2= Experience in banking more than 10 years

H₀ (null hypotheses) = the responses of the respondents with two levels of education do not differ significantly.

Contingency Table: Results($r \times c$)

The results of a contingency table X^2 statistical test

Data: contingency table

Experience level	A	B	C	D	E	F	G	H	I	Total
1.	16	14	15	12	15	12	13	12	5	114
2	28	26	23	23	19	16	10	03	9	157
Total	44	40	38	35	34	28	23	15	14	271

Expected: contingency table

Experience level	A	B	C	D	E	F	G	H	I	Total
1.	18.5	16.8	16	14.7	14.3	11.8	9.68	6.31	5.89	114
2	25.5	23.2	22	20.3	19.7	16.2	13.32	8.69	8.11	157
Total	44	40	38	35	34	28	23	15	14	271

Chi-square = 13.5, Degrees of freedom = 8, Probability = 0.096

Critical value at 0.05 level of significance =15.507 (Appendix II)

Not to reject H₀ because 13.5 is less than 15.507

Thus, we would not reject the null hypothesis that there is relationship between employees experience in banking and their responses on causes of NPLs.

Test of significance for the responses on factors of NPLs and educational background of the respondents: the nine factors and two levels of education included in this testing are given below:

A= Integrity of borrowers

B= Weak credit appraisal

C= Natural calamities

D= Change in real GDP Cost of borrowing

E= Poor credit monitoring

F= Business Failure

G= Willful default

H= Project not completed in time

I= Delay in disbursements

1= Graduate

2= Masters and above

Contingency Table: Results($r \times c$)

The results of a contingency table X^2 statistical test

Data: contingency table

Education level	A	B	C	D	E	F	G	H	I	Total
1.	23	15	11	18	16	11	11	06	06	117
2	21	25	27	17	18	17	12	09	08	154
Total	44	40	38	35	34	28	23	15	14	271

Degrees of Freedom = $(c - 1)(r - 1)$

Expected value: contingency table

Education level	A	B	C	D	E	F	G	H	I	Total
1.	19	17.3	16.4	15.1	14.7	12.1	19.93	06.48	06.04	117
2	25	22.7	21.6	19.9	19.3	15.9	13.10	08.52	07.96	154
Total	44	40	38	35	34	28	23	15	14	271

Chi-square = 6.76, Degrees of freedom = 8, Probability = 0.562

Critical value at 0.05 level of significance = 15.507 (Appendix II)

Not to reject H_0 because 6.76 is less than critical value of 15.507

Thus it can be concluded that the null hypotheses cannot be rejected as critical value is more than calculated value. Hence it can be inferred that the experience level do not have any impact on their responses.

4.4.2 Response of defaulters on factors that cause NPLs in CRDB

The responses of defaulters are ascertained on 15 factors which were identified in the review of literature and shown in the conceptual frame work. The factors identified are not mutually exclusive and hence defaulters have been asked to give more than one response depending upon their experience. Thus their responses taking their profile background as the base are presented in table 4.7.

Table 4.7: Factors that cause Non-Performing Loans – responses of defaulters

Factor	Experience in Business				Level of education						Number of defaulters on each factors	%
	1 to 5 years		5 years and above		Primary		Secondary		University			
Cumbersome process	18	54.5%	15	45.5%	12	36.4%	18	54.5%	3	9.1%	33	11.3
Unfaithfulness of bank staff (corruption)	5	62.5%	3	37.5%	4	50%	4	50%	-	-	8	2.74
Integrity of borrower	20	57.1%	15	42.9%	12	34.3%	19	54.3%	4	11.4%	35	11.98
Change in real GDP	5	31.3%	11	68.7%	2	12.5%	10	62.5%	4	25%	16	5.48
Weak loan portfolio management by bank staff especially weak credit analysis from the beginning	16	61.5%	10	38.5%	9	34.6%	15	57.7%	2	7.7%	26	8.9
Natural calamities or change in economic conditions like inflation	1	20%	4	80%	1		2	40%	2	60%	5	1.71
Change in country policies	1	100%	-		-		-	-	1	100%	1	0.34
Project not complete in time	6	33.3%	12	66.7%	7	38.9%	10	55.6%	1	5.5%	18	6.2
Lack of reliable market information	8	66.7%	4	33.3%	7	58.3%	5	41.7%	-	-	12	4.1
Cost of borrowing	18	60%	12	40%	10	33.3%	18	60%	2	6.7%	30	10.3
Business failure/ inexperienced or lack of entrepreneurial knowledge on borrowers side	17	54.8%	14	45.2%	11	35.5%	18	58.1%	2	6.4%	31	10.6
Poor credit monitoring	15	60%	10	40%	8	32%	13	52%	4	16%	25	8.6
Willful default	18	64.3%	10	35.7%	10	35.7%	15	53.6%	3	10.7%	28	9.6
Insider loans	1	50%	1	50%	2	100%	-	-	-	-	2	0.68
Delay in disbursements	14	63.6%	8	36.4%	11	50%	10	45.5%	1	4.5%	22	7.5
Total											292	100

Source: Own Computation from Primary Data

The analysis of the table 4.7 reveals the following:

1. In all 292 responses were received on 15 factors from 35 respondents. The responses for every factor were varying between 0.34% and 11.98%.
2. Among all 11.98% of the responses are in favor of lack of integrity of borrowers indicating that the loans availed are diverted for other purposes. Taking the experience background as the base this view was endorsed by 42.9% of respondents who have more than 5 years' experience and remaining less than 5 years' experience. Taking education of the respondents as base this opinion was endorsed by 54.3% secondary education and 11.4% graduates. Thus it can be inferred that this is the prime reason as per the defaulters which is resulting into NPAS.

3. 11.3% of the responses reveal cumbersome process. Taking the experience background as the base this view was endorsed by 45.5% of respondents who have more than 5 years' experience and remaining less than 5 years' experience.

Taking education of the respondents as the base this opinion was endorsed by 54.5% with secondary education and 9.1% graduates. Thus it can be inferred that this is the second major factor which cause of NPAs as per defaulters.

4. 10.6% of the responses reveal Business failure/inexperienced or lack of entrepreneurial knowledge on borrowers side. Taking the experience background as the base this view was endorsed by 54.8% of respondents who have more than 5 years' experience and remaining less than 5 years' experience.

Taking education of the respondents as the base this opinion was endorsed by 58.1% with secondary education and 6.4% graduates. Thus it can be inferred that this is the third major factor which cause of NPAs as per defaulters.

5. 10.3% of the responses reveal cost of borrowing. Taking the experience background as the base this view was endorsed by 60% of respondents who

have more than 5 years' experience and remaining less than 5 years' experience.

Taking education of the respondents as the base this opinion was endorsed by 60% with secondary education and 6.7% graduates. Thus it can be inferred that this is the fourth major factor which cause of NPAs as per defaulters.

6. 9.6% of the responses reveal willful default. Taking the experience background as the base this view was endorsed by 64.3% of respondents who have more than 5 years' experience and remaining less than 5 years' experience.

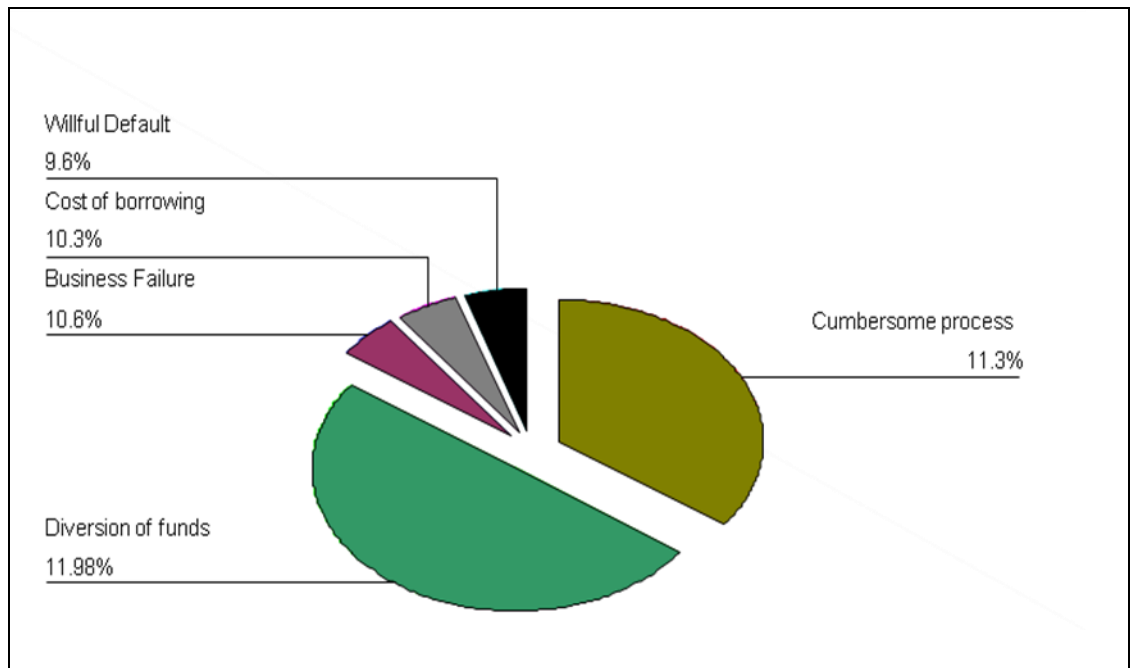
Taking education of the respondents as the base this opinion was endorsed by 53.6% with secondary education and 10.7% graduates. Thus it can be inferred that this is the fifth major factor which cause of NPAs as per defaulters.

7. 8.9% of the responses reveal weak loan portfolio management by bank staff especially weak credit analysis from the beginning. Taking the experience background as the base this view was endorsed by 61.5% of respondents who have more than 5 years' experience and remaining less than 5 years' experience.

Taking education of the respondents as the base this opinion was endorsed by 57.7% with secondary education and 7.7% graduates. Thus it can be inferred that this is the sixth major factor which cause of NPAs as per defaulters.

Thus as per defaulters point of view, lack of integrity of borrowers indicating that the loans availed are diverted for other purposes, cumbersome process, Business failure/inexperience or lack of entrepreneurial knowledge on borrowers side, cost of borrowing and willful default were the top five factors which resulted into NPAs in CRDB.

Chart 4.3: Major factors that cause NPLs according to defaulters



Source: Field Findings

The chart 4.2 above show the five major factors which cause NPLs according to defaulters.

Test of significance for business experience of the defaulters and their responses:

Chi square test was applied to identify the significance of the responses of respondents taking their background as the base, among 15 factors of NPLs top nine (9) major factors revealed by defaulters are used for this test.

The value of the test-statistic is: $\chi^2 = \sum (O_i - E_i)^2 / E_i$

Where **O_i** is the observed frequency and **E_i** is the expected frequency.

Critical value is determined from the chi square normal distribution table. To make study more accurate I use 0.05% level of significance. Based on the critical value, it was concluded whether sufficient data is available to not to reject the null hypothesis or not.

The nine factors which cause NPLs and their business experience levels are given under.

A= Integrity of borrowers

B= Cumbersome process

C= Business Failure

D= Cost of borrowing

E= Willful default

F= Weak credit appraisal

G= Poor credit monitoring

H= Delay in disbursement

I = Project not completed in time

1= Experience in business 1to5years

2= Experience in business more than 5 years

Contingency Table: Results($r \times c$)

The results of a contingency table X^2 statistical test

Data: contingency table

Education level	A	B	C	D	E	F	G	H	I	Total
1.	18	20	17	18	18	16	15	14	06	142
2	15	15	14	12	10	10	10	08	12	106
Total	33	35	31	30	28	26	25	22	18	248

Expected: contingency table

Education level	A	B	C	D	E	F	G	H	I	Total
1.	18.9	20	17.8	17.2	16	14.9	14.3	12.6	10.3	142
2	14.1	15	13.2	12.8	12	11.1	10.7	09.4	07.7	106
Total	33	35	31	30	28	26	25	22	18	248

Chi-square = 5.68, Degrees of freedom = 8, Probability = 0.683

Critical value at 0.05 level of significance =15.507

Null hypotheses cannot be rejected (H_0) because the calculated value 5.68 is less than critical value14.067.

Thus, we would not reject the null hypothesis that there is relationship between defaulters experience in business and their responses on causes of NPLs.

Test of significance for educational level of the defaulters and their responses:

χ^2 is also applied to know whether the educational background has any impact on the responses of the defaulter respondents. For the purpose the nine factors chosen along with educational levels are given here under.

A= Integrity of borrowers

B= Cumbersome process

C= Business Failure

D= Cost of borrowing

E= Willful default

F= Weak credit appraisal

G= Poor credit monitoring

H= Delay in disbursement

I= Project not completed in time

1= Primary Education

2= Secondary Education

3= University level

Contingency Table: Results ($r \times c$)

The results of a contingency table X^2 statistical test

Data: contingency table

Data: contingency table: education level of defaulters and their responses

Education level	A	B	C	D	E	F	G	H	I	Total
1.	12	12	11	10	10	09	08	11	07	090
2	18	19	18	18	15	15	13	10	10	136
3	03	04	02	02	03	02	04	01	01	022
Total	33	35	31	30	28	26	25	22	18	248

Expected: contingency table

Education level	A	B	C	D	E	F	G	H	I	Total
1.	12.0	12.7	11.2	10.9	10.2	09.4	09.1	08.0	06.5	090
2	18.1	19.2	17.0	16.5	15.4	14.3	13.7	12.1	09.9	136
3	02.9	03.1	02.8	02.6	02.4	02.3	02.2	01.9	01.6	022
Total	33	35	31	30	28	26	25	22	18	248

Chi-square = 4.98, Degrees of freedom = 16, Probability = 0.996

Critical value at 0.05 level of significance = 26.296 (Appendix II)

Since the calculated value of 4.98 is below critical value of 26.296 null hypotheses cannot be rejected.

Thus, we would infer that educational levels have no impact on the responses of the defaulter respondents about factors of NPLs

4.5 Interview with Respondents

In order to get understanding about the factors causing non performing loans, in-depth interview was conducted with senior bank officials together with credit beneficiaries(customers), All of the interviewees from bank have had over 10 years credit experience in addition to their several years of banking experience also the credit beneficiaries have had over 5 years in operating business. Some of the interviewees were not from CDRB bank that was covered by this research. The respondents have so many in common as to what they believed cause occurrence of nonperforming loans. The these respondent on the causes of NPLs are presented here under.

Banks internal factors

These are factors relating to internal inefficiencies due to systems, governance, human resource issues and the related. Under theme this most of the interview participants raised the following issues:

- Bankers lack of integrity,
- Terms and condition not being set properly,
- Credit analysts capacity limitation,
- Banks aggressive lending to maximize profit,
- Not conducting Know your customers (KYC) principles properly before lending,
- Over trading/over financing,
- Not understanding and seeing critically the macroeconomic environment,
- Excessive lending by banks on a particular sector ,such that poor portfolio diversification,
- Poor collateral valuation,
- In adequate institutional capacity, such that in terms of risk selection,
- Policies that failed to consider the macroeconomic environment,
- Poor monitoring and follow up,
- The credit approval process not being prudent and failing to comply with the existing bank policies,
- Inadequacy of credit risk management-from identifying, measuring and monitoring
- Governance problems,
- Poor or no management information system (MIS),
- Absence check and balance-in loan processing, follow up and monitoring/
follow up

Customer related factors

These are factors that emanate from borrowers and have strong bearing on occurrences of loan default. Under this ground the following were raised:

- Fund being directed to unintended purpose,

- Borrowers not making competitive analysis before engaging in a particular sector,
- Business management problems- most of family owned businesses don't have good Management and they also suffer from succession,
- Poor record keeping by businesses,
- Intentional or willful default,

External factors

These are factors that were beyond the influence of banks and borrowers. They are presented follows.

- Intervention of external bodies in credit decision making.
- Poor credit culture,
- Macroeconomic factors like inflation, market problems etc.
- Unavailability of data to conduct project analysis,
- Inadequacy of the supervisory authorities polices
- Capacity limitation of the supervisory organ

From literature review and my research findings revealed 15 major factors that contribute to Non Performing loans such as following,

- i. Integrity of borrowers
- ii. Cumbersome process
- iii. Business Failure/ inexperienced or lack of entrepreneurial knowledge on borrowers side
- iv. Cost of borrowing
- v. Change in real GDP
- vi. Unfaithfulness of bank staff (corruptions)
- vii. Willful default
- viii. Weak credit appraisal
- ix. Poor credit monitoring
- x. Delay in disbursement
- xi. Project not completed in time
- xii. Natural calamities or change in economic conditions such as inflation

- xiii. Change in country policies
- xiv. Lack of reliable market information
- xv. Insider loans

When you look the comments or opinion of interviewees on those factors they believed cause occurrence of nonperforming loans most of them looks similar to those which I have already found on literature review and my research findings.

But the respondents on interview add other factors which was not covered on this study such as

- i. Intervention of external bodies in credit decision making.
- ii. Poor record keeping by businesses.
- iii. Governance problems.
- iv. Over trading/over financing.

Research findings indicated that non performing loans were caused by internal and external factors. In the context of CRDB Bank Ltd, internal factors such as weak credit analysis, poor credit monitoring, cumbersome process, delay in disbursement, cost of borrowing have a influence towards non-performing loans. Also research findings highlighted that external factor namely natural disaster, willful default, the integrity of the borrower and change in real GDP as the major factors that caused non performing loans in CRDB Bank Ltd Findings show that integrity of borrower such that diversion of fund and use for unintended purposes was the major cause of non-repayment of loans as they fall due. Researcher found that both borrowers and bankers contribute to diversions of the funds.

Diversion of fund caused by borrowers were mostly attributed by borrowers profitability motives thus they were convinced to spend more funds from their loans on project which fetched them bigger profit margins, although they didn't mention this project in their credit applications forms. Moreover there were other deliberate diversions, which also contribute to loans repayment failure.

The researcher during the study observed that there was no supervision among loan officers, which led to some of the customers starting new business for which loan was not applied. Normally loans are purposely to finance already started business, but if there is no routine supervision to the borrowers business premises it is easier for borrowers to divert the fund to projects other than the intended.

CHAPTER FIVE

RESEARCH SUMMARY CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter presents a summary for the whole study including major findings of the research, conclusion and recommendations which will assist the management of bank in reducing or solving problems of non-repayment of loans

5.1 Summary

As has been stated in chapter one the broad objective of this study was to identify causes of nonperforming loans. The objectives include analysing the trends of NPLs, determining factors which cause for NPLs from the point of view of employees of the CRDB bank and the defaulters. To achieve this broad objective, the study used mixed research approach for collection of information.

For the purpose case study design is applied and the two regions of CRDB bank are selected. Survey method is applied for collecting the opinions of employees and defaulters using factors stated in conceptual review which was developed on the basis of review of literature. Apart from that interviews also conducted with senior officials and loanees to elicit any other factors for NPLs .The collected data is classified tabulated and analysed by applying statistical tools like ratios and tests of significance and the conclusions drawn are presented below.

5.2 Conclusion

NPLs reflect the overall performance of the banks. A high level of NPLs suggests high probability of a large number of credit defaults that affect the profitability and liquidity of banks. It also affects the confidence of customers in banks. The NPL growth involves the necessity of provisions, which reduces the overall profits and shareholders' value. The conclusions of the study objective wise are presented here under.

Trends in Non-Performing Loans

The level of NPLs has gone up during the study period especially from the year 2010. NPLs as a percentage of gross loans, shareholder funds and total assets also have gone up. It signifies that the rate of increase in NPLs is higher than the rate of increase in total loans, shareholder funds and total assets, which is unwarranted.

Factors which cause Non-Performing Loans

Research findings indicated that non performing loans in CRDB Bank were caused by internal and external factors. The major internal factors influenced nonperforming loans were weak credit analysis, poor credit monitoring, cumbersome process, delay in disbursement, and cost of borrowing.

These internal factors can be easily controlled such as improving credit appraisal system, speed up loan process and reducing cumbersome process and make timely disbursement, regular follow up to see use of funds and reducing cost of borrowing are absolutely necessary measures for preventing or reducing NPLs which will enhance the creditability of the bank.

External factors can be a threat to the viability of bank because these factors cannot be easily controlled, finding show that the major external factor that caused non-performing loans in CRDB Bank were natural disaster, wilful default, the integrity of the borrower and change in real GDP. For example natural disasters such as inflation or change in real GDP

can lead to depreciate in the value of currency so the bank should use foreign exchange (FX) hedging tools to help reduce the risks associated with foreign currency fluctuations. So CRDB Bank has to be vigilant in its lending decisions so as to avoid loan losses and the accumulation of non-performing loans.

The study finally concludes that the NPLs situation is alarming the bank to take appropriate action so as to bring them down. It is necessary to take timely decision and execution taking the factors which are causing NPLs.

5.3 Recommendations

After close examination and analysis of the research findings, the following recommendations are suggested:

Given that the main cause of nonperforming loans is diversion of funds, such that use funds for unintended purposes therefore the bank should ensure that borrowed funds are being used for the intended purpose through enhanced credit monitoring, This can be achieved by,

- i. Conduct regular physical visit to the business premises to ascertain that funds disbursed are properly utilized. Physical personal visit is the most effective to collect loan but costly, the bank should determine the visit in advance by being as knowledgeable as possible about the borrower and the business. Once customer found to use fund for unintended purposes should be sued before the court on the ground of breaching the contract.
- ii. Adopting a relationship management approach. Such that establishing a good relationship with borrowers, this can be a good strategy which can be employed by CRDB Bank in the effort of reducing non-performing loans. This can be done through conducting seminars or workshop. Initiation of education programs to the borrowers concerning lending will enable borrowers to have enough knowledge concerning lending also educations to borrowers will enable them to know how the best to use borrowed funds.
Also through these educations programs will enable borrowers to have enough knowledge on how to manage their business and as findings reveal

that one of major factor that cause non-performing loans is business failure due to lack of business knowledge this will help to overcome this.

- iii. CRDB Bank should put in place a vibrant credit process that including proper customer selection, once the loan is sanctioned the regular monitoring and follow up is essential, also bank should put clear recovery strategies for sick loans.

Also the above strategy can be used to overcome poor credit monitoring which is one of the major factor which cause non performing loans.

- iv. CRDB Bank should start using credit reference bureau which is already launched here in Tanzania and that will facilitate the dissemination of credit information, such that credit reference bureau will help the bank to exclude poor payers from the process.

5.4 Recommendations on other factors

1. Also findings reveal weak credit appraisal as one of the major factor that cause nonperforming loans, such that weak loan portfolio management by bank staff especially weak credit analysis from the beginning, so to overcome this,
 - i. The bank should put proper credit evaluations process, and this should be based on objective evaluation and the project should economically viable and technically feasible also this strategy could be implemented to overcome the problem of insider loans which is one of the causes of nonperforming loans.
 - ii Also the bank should make sure that it conducts capacity building to credit analysts and other loan officers through training in credit intelligence so as to equip them with adequate and efficient skills in loan management.
2. Cost of borrowing was another major factor which causes non performing loans, since most of the sole traders operate under competitive business and low capital investments the bank should reduce cost of borrowing so as to assist the low income earners, such that high interest rates increases the cost of borrowing and this increase cost of doing business using borrowed money hence lead to non repayment of loans. This is possible when the bank increases its efficiency and productivity.

3. For the case of willful default the government should review its lending policies such that some borrowers were simply willful defaulters who took advantages of stack and cumbersome legal processes. Such that dealing with defaulters using judicial instruments is costly in terms of money and time and this can put the lending institutions a great risk of incurring much loss.
4. Also findings reveal that cumbersome process and delay in disbursements were among the factors which cause non performing loans so to overcome this bank should speed up loan processing and ensure timely disbursements.
5. The impact of external factors such as natural disasters or change in real GDP should be considered seriously during the credit assessment process, such that bank can use its risk management unit to implement models that will mitigate risks arising out of the environmental changes. Risk management guarantees that the organization creates and implements an effective plan to prevent losses or reduce the impact if a loss occurs.

It is apparent that banks need to seriously consider all the internal and external factors causing non performing loans as well as the impact of non-performing loans on the bank's overall performance.

5.5 Recommendation for further study

This study is confined to two selected regions of Rukwa and Dar es salaam also cover only 6 branches and deal only with sole traders, hence may limitation in generalizing the results. Hence, further research may be taken up extending the same study to different regions of Tanzania on all the sectors for which loans and advances were given.

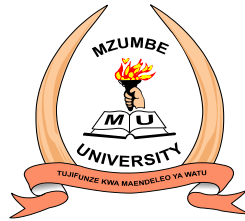
BIBLIOGRAPHY

- Auronen, L (2003). Asymmetric Information: Theory and Applications. Paper presented in the Seminar of Strategy and International Business at Helsinki University of Technology, May 21st 2003.
- Bank of Tanzania (1991), "Prudential Guidelines on Management of Risk Assets, Loans Classification and Provisioning for losses"
- Bank of Tanzania (2006), "Bank and Financial Institution Act 2006".
- Banking and Financial Institution Act (1991) I: Prudential guidelines of risk Asset Management.
- Barth, J.R; Caprio, G Jr and Levine, R (2004). "Bank Regulation and Supervision: What Works Best?". *Journal of Financial Intermediation*. 13, 205-248.
- CAPRIO, Gerald, Jr. (1996), "Bank regulation: The case of the missing model", Policy CBK (various issues), Annual Report and Accounts (Nairobi: Central Bank of Kenya)
- Chijoriga M.M (1997). *Application of Credit Scoring and Financial Distress Prediction Models to Commercial Banks Lending: The Case of Tanzania*. Ph.D. Dissertation, Wirtschaftsuniversitat Wien(WU), Vienna.
- Chadowline L.C (1999): Micro-credit Administration Program for Micro-Banking, Queens Park Zimbabwe
- Edward W.R. et al, "Commercial Banking" Prentice Hall, England 4th Edition.
Evans and Archer (1968)
- Gardner D. C (1992): Credit analysis DC Gardener group Pk, London Micro credit policy and procedure manual (2001)
- Gilbart J.W. et al: "The History principles and practice of banking", Greenwood Publishers, New York volume 1, 1968.
- HARVEY, Charles and Carolyn JENKINS (1994), "Interest rate policy, taxation and risk",

- World Investment”, New York, John Wiley and Sons.
- Internet: <http://www.crdb.com/home-profile> of CRDB Bank
- Internet: <http://math.hws.edu/javamath/ryan/chisquare.html>-chi square statistical test
- Markowitz H.N. (1959), “Portfolio Selection, Efficient Diversification of Process
Journal of Financial Services Research Vol. 12 No. 2 & 3,
- NBAA The Accountant Manual (2001) vol. 13
- Nicholas Rouse, (1992): Applied landing techniques. The chartered institute of bankers,
London.
- Rajevski, L. 1985, “Risk management in the banking operations”, Research Working
Richard, E (2006) *Credit Risk Management Policy and Strategies: The Case of a
Commercial Bank in Tanzania*. Licentiate Thesis, BA Publications.
- Rosy Kalra (2012), “*Non-Performing Assets of Commercial Banks- A Case Study.*” *The
IUP Journal of Monetary Economics*
- Ross, P. S (1997). *Money and Capital Markets: Financial Institutions and Instruments in a
Global Marketplace*. 6th ed. McGraw – Hill International Edition.
- Ross (1976) and Ross and Roll (1980) “The Arbitrage “Theory of Capital Asset Pricing”
- Waweru, N. M and Kalani, V. M (2009). Commercial Banking Crises in Kenya: Causes
and Remedies. *African Journal of accounting, Economics, Finance and Banking
Research*,4 (4), 12 – 33.

APPENDICES

Appendix I: Research questionnaire for CRDB Bank ltd



QUESTIONNAIRE

Instructions:

Dear respondent, the bearer of this questionnaire is an Msc student at the Mzumbe University. As part of his ongoing academic development he is required to conduct a research and write a report on causes of non performing loans in commercial banks-a case study of CRDB Bank

You have been selected for purposes of this study and are therefore requested, in support to our country's higher education sector, to complete this questionnaire and submit the same to its bearer. Please note that the information to be collected will be treated with utmost confidentiality and, used solely for academic purposes indicated hereon only. Thanks you for your assistance and support

Branch.....

Responder's designation.....

Telephone Number

Email

Date.....

Experience with CRDB..... (Years)

1. What type of financing facilities do you commonly offer to customers?

(Tick the appropriate response

a)Overdraft ()

b)Term Loan ()

c)Mortgage Financing ()

d)Personal loan ()

e) All above ()

2. Is the customers having understand loan product?

(Tick the appropriate answer)

Yes () No ()

If the answer is “NO” have your bank help customer to understand the loan please elaborate

3. What are the reasons for non payments of loans?

4. Is the borrowers has enough awareness of loan structure of CRDB?

Yes () No ()

If the answer “No” has CRDB help those borrowers to analyze loan structure

5. What is the general perception of your clients on your bank’s interest rates? I think it would be more reliable if it came from the customers.....

- a) Very high ()
- b) High ()
- c) Average ()
- d) Low ()

6. What measures are taking by bank when the loans are not repaid well?

- i)-----
- ii)-----
- iii)-----
- iv)-----

7. Do you think the bank is adequately assessing credit?

(Tick the appropriate answer)

Yes () No ()

8. If you are a credit analyst how can you notice customers with good or bad to get loan approval

i)-----

ii) -----

iii) -----

9. Are non performing loans a problem in your bank?

(Tick the appropriate answer)

Yes () No ()

10. Are there any policies or procedures in place to reduce non performing loans? *(if available, please mention few of them)*

.....

11. What are the challenges faced by CRDB in collections of loans?

i.

ii.

iii.

12. Did Credit Reference Bureau system being practices in your bank?

(Tick the appropriate answer)

Yes () No ()

Appendix II: Critical value table

Upper-tail critical values of chi-square distribution with ν degrees of freedom

ν	Probability less than the critical value				
	0.90	0.95	0.975	0.99	0.999
1	2.706	3.841	5.024	6.635	10.828
2	4.605	5.991	7.378	9.210	13.816
3	6.251	7.815	9.348	11.345	16.266
4	7.779	9.488	11.143	13.277	18.467
5	9.236	11.070	12.833	15.086	20.515
6	10.645	12.592	14.449	16.812	22.458
7	12.017	14.067	16.013	18.475	24.322
8	13.362	15.507	17.535	20.090	26.125
9	14.684	16.919	19.023	21.666	27.877
10	15.987	18.307	20.483	23.209	29.588
11	17.275	19.675	21.920	24.725	31.264
12	18.549	21.026	23.337	26.217	32.910
13	19.812	22.362	24.736	27.688	34.528
14	21.064	23.685	26.119	29.141	36.123
15	22.307	24.996	27.488	30.578	37.697
16	23.542	26.296	28.845	32.000	39.252
17	24.769	27.587	30.191	33.409	40.790
18	25.989	28.869	31.526	34.805	42.312
19	27.204	30.144	32.852	36.191	43.820
20	28.412	31.410	34.170	37.566	45.315
21	29.615	32.671	35.479	38.932	46.797
22	30.813	33.924	36.781	40.289	48.268
23	32.007	35.172	38.076	41.638	49.728
24	33.196	36.415	39.364	42.980	51.179
25	34.382	37.652	40.646	44.314	52.620

Lower-tail critical values of chi-square distribution with ν degrees of freedom

ν	Probability less than the critical value				
	0.10	0.05	0.025	0.01	0.001

