THE IMPACT OFPRIVATIZING BANKING INDUSTRY IN TANZANIA

A CASE STUDY OF NATIONAL BANK OF COMMERCE

THE IMPACT OFPRIVATIZING BANKING INDUSTRY IN TANZANIA

A CASE STUDY OF NATIONAL BANK OF COMMERCE

By

Frank Fredrick Kisenge

A Dissertation Submitted in Partial Fulfillment of the Requirements for the Award of Master of Science in Accounting and Finance (M.Sc. A&F) of Mzumbe University

2013

CERTIFICATION

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University, a dissertation entitled: **The Impact of Privatizing Banking Industry in Tanzania: A Case Study of National Bank of Commerce, Headquarter** in fulfillment of the requirements for the degree of Masters of Science in Accounting and Finance.

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I, **Frank Fredrick Kisenge**, do hereby declare to Mzumbe University-Tanzania that, this is my own original work and that it has not been presented and will not be presented to any other institutions, other University for the similar or other degree award.

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It is also, to make note that all deficiencies or errors that may be contained in this document are absolutely my sole responsibility.

DEDICATION

To my beloved parents my late father, Mr. Fredrick N. Kisenge and mother Amina H. Kisenge,My brothers Senzige Kisenge, Kajiru Kisenge, Semvua Kisenge, Emmanuel Kisenge, Mramba Kisenge, and my Sister Farida Kisenge and Lucy Kisenge. Without forget my cousin KassimuTani.

LIST OF ABBREVIATIONS

AFCP	-	The Annual Finance and Credit Plan
ATM	-	Automation Machine
BAFI	-	Bank and Financial Institution Act
BOT	-	Bank of Tanzania
CRDB	-	Cooperative and Rural Development Bank
DCS	-	Developing Countries
DFI	-	Development Finance Institution
DSE	-	Dar es Salaam Stock Exchange
EACB	-	East Africa Central Bank
EF	-	Efficiency Structure
FDI	-	Foreign Direct Investment
FEP	-	Foreign Exchange Plan
GOBS	-	Government Owned Bank
IMF	-	Internal Monetary Fund
LDCS	-	Less Developed Countries
MP	-	Market Power
NBC	-	National Bank of Commerce
NMB	-	National Microfinance Bank
NPBS	-	Newly Privatized Banks
NPL	-	Non-Performance Loan
PBZ	-	People Bank of Zanzibar
ROA	-	Return on Asset
SAP	-	Structural Adjustment Programs
SSA	-	Sub Sahara Africa
THB	-	Tanzania Housing Bank
TIB	-	Tanzania Investment Bank
TPB	-	Tanzania Postal Bank

ABSTRACT

Financial support from the banking industry and other financial institutions is a key element for a business to succeed in their move towards contributing to the poverty alleviation, creation of employment, winning business competitions and increase productivity capacities. Without finance, small entrepreneurs cannot acquire or absorb new technologies nor can they expand to compete in the global markets or even strive to business linkages with large firms. Failure to finance access has been cited as a major problem in recent years. However, there are significant perceptions as to the size and causes of financing gap.

The major objective of the study was to identify impact caused by privatizing banking industry in Tanzania. A detailed relevant literature, review was done so as to set the study within its wide context and to show the reader how the study supplements the work that has already been done. A case study designed was adopted where NBC, was chosen as a case.

Findings of this study show that there is a major positive effect by privatizing bank industry due to great changes done by those who might have taken the business by expand the business which result increase in employment, increase number of branches which brought services near citizen, also they brought new technologies which facilitate the use of bank services without being in the bank premises for example the use ATM machine, Internet Banking, On line payment service example –purchase of Luku, Telephone credits and the payroll processing service.

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CHAPTER ONE

AN OVERVIEW OF THE STUDY

1.1 Introduction

1.1.1 Overview of Financial Sector in Tanzania

A bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses. Due to their influence within a financial system and the economy, banks are highly regulated in most countries. Most banks operate under a system known as fractional reserve banking where they hold only a small reserve of the funds deposited and lend out the rest for profit. They are generally subject to minimum capital requirements which are based on an international set of capital standards, known as the Basel Accords(http://en.Wikipedia.org/wiki/banking).

1.2 History of Bank Industry

Banking in its modern sense evolved in the 14th century in the rich cities of Renaissance Italy but in many ways was a continuation of ideas and concepts of credit and lending that had its roots in the ancient world. In the history of banking, a number of banking dynasties have played a central role over many centuries. Banking in the modern sense of the word can be traced to medieval and early RenaissanceItaly, to the rich cities in the north like Florence, Lucca, Siena, Venice and Genoa. The Bardi and Peruzzi families dominated banking in 14th century. Florence, establishing branches in many other parts of Europe. One of the most famous Italian banks was the Medici Bank, set up by Giovanni di Bicci de' Medici in 1397. The earliest known state deposit bank, Banco di San Giorgio (Bank of St. George), was founded in 1407 at Genoa, Italy. The oldest bank still in existence is Monte dei Paschi di Siena, headquartered in Siena, Italy, which has been operating continuously since 1472. It is followed by Berenberg Bank of Hamburg (1590) and Sveriges Riksbank of Sweden (1668) (http://en.Wikipedia.org/wiki/banking).

In Tanzania the Commercial banking was introduced in the country in 1905, when the Deutsch-Ostafrikanische Bank opened its office in Dar es Salaam. This bank had a concession from the German government to issue its own notes and coins, which helped the bank to meet the demand for coins in exchange for its notes. A temporary mint was set up in Tabora. In 1911, another German bank, namely the Handelsbank fuerOstafrika, opened a branch in Tanga. There also was an official savings bank. After World War I, the Mainland became a mandate territory of the United Kingdom (UK) and its monetary system was aligned to that of Kenya and Uganda, mainly in two aspects,through the establishment of the EACB in December 1919 and by auctioning off the assets of the German banks and permitting British banks to open their offices (http//www.bot.org).

The regulations defining the Constitution, Duties, and Powers of the EACB stated that it had been constituted to provide for, and to control the supply of, currency in the East African Protectorate, the Uganda Protectorate, and any other dependencies in East Africa, which might be added by the Secretary of State, to ensure that the currency was maintained in satisfactory condition, and generally to watch over the interest of the dependencies as far as currency was concerned. Originally, the EACB operated in Tanzania Mainland, Kenya, and Uganda. Zanzibar adopted its currency in 1936. Other occupied countries joined the Board later, but withdrew from it again after some time. The Board itself stopped functioning in 1966, when Central Banks came into existence in Tanzania, Kenya, and Uganda(www.bot.org).

The Board was authorized to issue its own currency notes and mint coins according to the designs approved by the Secretary of State for circulation in its area of operations. The rate of exchange between the Board's currency and the pound sterling was fixed by the Secretary of State. Board currency was essentially issued in exchange for pound sterling, indicating that the EACB's currency was backed predominantly by pound sterling following the decision to dissolve the EACB and to establish separate Central Banks in Tanzania, Kenya, and Uganda. The Bank of Tanzania Act, 1965, was passed by the National Assembly in December 1965, and

the Bank was opened by the first President of Tanzania Mwalimu Julius K. Nyerere on June 14, 1966 (www.bot.org).

The Act empowered the Bank of Tanzania to perform all the traditional central banking functions. However, within eight months of the inauguration of the Bank, in February 1967, the Arusha Declaration was proclaimed, and, with it, the Bank had to reorient its policies. Most of the traditional instruments of indirect monetary policy stipulated in the Act became inoperative, as there was no longer an environment of the type which exists in a competitive system, where indirect instruments are effective. The Annual Finance and Credit Plan (AFCP), supported by a system of administered interest rates, were devised as the main instrument of monetary policy from 1971/72. Similarly, the Foreign Exchange Plan (FEP) was devised to control the use of foreign exchange in accordance with national priorities. The plans were formulated in the Ministry of Development Planning, in consultation with the Bank. However, the Bank and the banking system were responsible for their implementation. A system of direct controls was used for this purpose, as stipulated in the Exchange Control Ordinance and the Import Control Ordinance. During the same period, several other developments occurred, e.g., a radical transformation of the rural economy, as a result of the villagisation programme, industrialisation, and persistent weaknesses in the Balance of Payments. In order to enable the Bank to better address these developments, the Bank of Tanzania Act was amended in 1978, with the result that additional developmental functions were vested in the Bank (www. Bot.org).

1.3 History of Privatization

Privatization may have several meanings. Primarily, it is the process of transferring ownership of a business, enterprise, agency, public service or public property from the public sector (a government) to the private sector, either to a business that operate for a profit or to a non-profit organization. It may also mean government outsourcing of services or functions to private firms, e.g. revenue collection, law enforcement, and prison management, Privatization has also been used to describe two unrelated transactions. The first is the buying of all outstanding shares of a publicly traded

company by a single entity, taking the company private. This is often described as private equity. The second is a demutualization of a mutual organization or cooperative to form a joint stock company.

Over view of financial sector in the world, during the modern era, proponents of state ownership have justified government control of business in three principal ways. First, public ownership has been justified as a way to ensure that business enterprises balance social and economic objectives, rather than focusing exclusively on profit maximization. Second, state ownership has been motivated as a response to significant market failures particularly the challenges posed to economic efficiency by natural monopolies and as a method to internalize production externalities such as pollution.

Third, proponents assert that public ownership can be justified under certain conditions involving informational asymmetries between principal (the public) and agent (the producer), where complete contracts cannot be written and enforced. Underlying all three cases is the assumption that governments can and do act benevolently, and thus that state ownership is economically efficient. Certainly, state ownership has also been imposed many times in history by ascendant political parties specifically in order to redistribute wealth and income from less to more deserving members of society, but this exercise in raw political power is usually justified by dogma, rather than by serious economic theory (Megginson2003).

State ownership of banking both grew from the broader trend towards state ownership and was driven by specific factors. “Benevolent” reasons include a perceived lack of private capital with sufficient risk tolerance to finance growth; inadequate funding to sectors and groups with low financial but high social returns; a desire to promote industrialization and development at a pace more rapid than private financing would allow; and a desire to maintain domestic control over a nation’s financial system. Less attractive, but equally compelling reasons include ideology (punishing capitalists), a desire to disenfranchise politically unpopular groups (postwar France’s perception that main banks collaborated with Nazi occupiers); a

reaction to foreign dominance for newly independent former colonies and a desire to use banks as tools for political patronage and advantage (Megginson2003)

1.4 Nature of the Study

1.4.1 Background of the Research Problem

The bank system in Tanzania has passed a long way from the colonial era up to now, at the time of independence, foreign commercial banks dominated the banking system were Standard Bank of South Africa, National and Grind laysBank and Barclays Bank. Other smaller foreign banks which were in operations included, Ottoman Bank (1958), Bank of India (1953), Bank of Baroda (1953),Commercial Bank of Africa (1961), and National Bank of Pakistan (1962) (Mutaitina, 2000).

After Arusha declaration in 1967, all financial institution were nationalized and put under the control of the government. All commercial banks were merged into one bank known as the National Bank of Commerce (NBC) under the 1967 act (Establishment and vesting of Asset and Liabilities). It was hoped that nationalizing banking system and applying social rather than private profitability criteria, would transcend the existed limitation of the foreign banks and attain inter alia and rapid extension of bank facilities throughout the country(Mutatina, 2000).

A fairer remuneration of deposit and hence with above an accelerated rate of saving mobilization, efficient distribution of the savings mobilization through the banking system according to national priorities and modest profit for the government, the banking sector eventually become a monopoly bank to reach these expectations depends largely on its legal standing and the type of control exerted over it by the monetary authorities (The central bank and the treasury)Unexpectedly the bank sector performed poorly, partly because of undue government interference and partly due to the ineffective banking legislation that was in operation by that time.

In 1991 an act was enacted to consolidate the law relating to banking and harmonize the operations of all the financial institution in Tanzania. It was; and still is expected that the Act will foster sound banking activities, regulate credit operations and

provide for other matter incidental to or connected with those purposes (Bank and financial Institution act1995). Up to 1993, however the banking system consisted entirely of insolvent and inefficient government-owned banks .The largest being the National Bank of Commerce which for instance accounted for 90 percent of commercial bank deposits and the Cooperative and Rural Development Bank (CRDB) which accounted of five percent of the sector. The balance in the banking sector consisted of the Peoples Bank of Zanzibar (PBZ) and the then defunct Tanzania Housing Bank (THB). The sector later on permitted the entry of private Banks 1993. The early entry included Meridian BIAO and Standard chartered. Today the banking system in Tanzania consists of thirty two banks, 8 region banks and five listed financial institutions(wikipedia.org/wiki/List_of_banks_in_Tanzania).

1.5 Statement of the Problem

Globalization has created distinctive characteristics in the banking industry, one of which is the removal of barriers to entry resulting, into rushgrowing domestic banking industry. This situation raised competition, hence efficiency in delivery of services at competitive prices.

Studies have been conducted in developing countries like Nigeria on impact of privatizing the banking industry. The evidence showed performance improvement in nine banks that were privatized, which a notable improvement is given the inhospitable environment for true financial intermediation. The study also reveals negative impact of the continuing government ownership on the performance of many banks. The result complemented aggregate indications of decreasing financial intermediation over 1990s banks that focused on investment bonds and non-lending activities enjoyed a relatively high performance (Beck et al, 2005).

According to Bank of Tanzania, financial stability report of September 2011, there is a room for improvement in banking sector in Tanzania as the bank sector continues to deepen and mature with the prospects of increasing the number of banks and financial institutions which will provide innovative financial products at a reasonable cost. Despite the current government policy which encourage private sector to be a

leader in the industry and the government remains as a regulator, little has been documented on the impact of privatization. As a result there is a need to investigated and inform policy maker on how to exploit the positive impact and minimize the negative impact of privatization on the banking industry taken into account the importance of the industry in the development of the economy.

1.6 Objective of the Study

1.6.1 General Objective of the Study

The main objective of this study is to evaluate performance of privatizing banking industry in Tanzania.

1.6.2 Specific Objectives

(i) To establish the key performing indicators (KPIs) of the banking industry

(ii) To evaluate the performance of the banking sector prior privatization using the identified KPI's.

(iii) To evaluate the performance of the banking sector after privatization using identified KPI's.

1.7 Research Questions

(i) Does privatization change the performance of banking sector?

(ii) What are the key drivers for privatizing the banking sector?

(iii) What are the problems or challenges encountered in performance due to privatization of the banking sector?

(iv) What is the impact on performance of banking sector after privatization

1.8 Significance of the Study

There are number of stakeholders including, banks, customers (business and individuals) and policy makers interested to get insight and sense of privatization of banking sector. It is expected that the findings from the study will be benefit lenders, (banks and nonbanks financial institutions) as it will provide understanding of impact and problems of privatizing banking sector. This will provide policy maker with new insight on running banks publically and enable the government to formulate

appropriate policies. Banks will benefits as it is believed that the recommendations from this study in most cases will improve their vision towards performance.

1.9 Scope of the Study

This study will focus only on banking financial institution operating in Tanzania and providing services to individuals, small and medium enterprises. The study uses only secondary data to determine the performance and efficiency of privatize bank in Tanzania. The data for a number of banks before privatization was not possible to get as number of them was not there before privatization and the one available after privatization change the names. Some of them were splits in to more than one and each was given a new name after privatization, this made the data before privatization difficult to get. However, the trend data on Customer Deposit, Operating Expenses, Loan& Advance, Interest Rate, Number of employees, Number of branches and Number of products (service) offered was gathered through secondary data sources for the period between 1997 and 2011.

1.10 Limitations of the Study

Budget constraints due to lack of enough fund to facilitate data collections has been one of the limiting factor, others constrain were time for collection and compilation of report, availability of all data in a consistence years for all banks as they have different age, change in name after privatization.

Assessing Bank performance post-privatization is a very challenging task, both methodologically and statistically. This is usually done either by comparing pre and post enterprise performances or by trying to work out a counterfactual scenario under a reasonable" set of assumptions ("what would have happened in absence of privatization?"). Unfortunately, there are very vigorous studies dealing with Tanzania for one thing access to banks financial data is very limited and even when banks are willing to disclose information on post –privatization performance there are often unable to provide pre privatization data for comparison.

This situation is aggravated by the fact that in most situations, there is no post-privatization monitoring. Last but not least, privatizations often do not take place in a vacuum, but are part of an evolving macroeconomic framework where liberalization policies can affect enterprise behavior and financial performance External economic shocks such as a sharp reduction in commodity prices or more generally, a global economic downturn or boom, are also likely to affect enterprise performances, which makes the analysis very time sensitive. In such circumstances, assessing causality between privatization and enterprises performance is a difficult challenge.

CHAPTER TWO

LITERATURE REVIEW

2.1 Theoretical Literature

This chapter attempts to review the relevant literature on banking sector, also will discusses the theoretical framework of analysis for access to banking sector and its role in economic growth. It may be realized from the one set that, this study is not about choosing between private owned banking sector and public owned banking sector but rather about how banking sector can develop in order to provide efficient financial service. The study contends that impact of privatizing financial sector in Tanzania have increase efficiency and performance in financial sector.

The question we address in this study is what is the impact of privatization of the banks on bank performance and efficiency?

It is clear that state ownership is widespread, particularly in developing countries, however, is that state ownership has been declining steadily over time, and this has accelerated dramatically since the late 1980s, state ownership is higher in countries with a socialist legal tradition than in any other. This is hardly surprising, since banks were central tools of control and credit allocation in the command and control communist system that developed in the Soviet Union after 1917, and was then imposed on CEE after WWI. These countries began privatizing after winning their independence in 1989, but they have had insufficient time to completely divest their holdings. Countries with French civil law commercial codes have generally higher state ownership than those with German or English common law codes. This difference was vastly more pronounced before 1993, however, when the core French civil law states in Western Europe (France, Spain, Portugal, Belgium) all had banking sectors that were dominated by state ownership. Beginning with France in 1986-87, however, all these countries launched massive privatization drives and now very few banks remain in state hands in any of these core civil law countries. This

observation that the western countries most wedded to state ownership historically have almost completely privatized their banking sectors (Megginson, L.W, 2003).

2.2 Privatization Process in Tanzania

The Tanzania's financial sector development history can be divided in two distinct phases, prior and post 1991. Prior 1991 the financial sector was predominantly under state control characterized by high monopolistic tendencies. The private sector was discriminated through a system of preferential interest rates limiting its role in economic development. By 1973, the share of banking system's credit to government had reached around 80%, before persistently rising to the peak of 93% in 1987. High macroeconomic instability characterized by double digit inflation and low and unstable economic growth. In 1986, comprehensive reforms were undertaken to build a private sector led economy (Mbowe, W.2011).

Post 1991was characterized by comprehensive financial reforms to liberalize the sector, accompanying the broad economic reforms started in 1986. The aim of the reforms was to put in place conducive environment for free market operations and improve provision of financial services to support economic growth. Key Legislation milestones: BAFI Act (1991) reintroduced competitive banking abolished in 1967. Foreign Exchange Act (1992) liberalized external trade and foreign exchange. Capital Market Act (1996) gave way to the establishment of DSE in 1998. In 1995, BoT Act (1995) refocused BoT's primary objective to price stability as a means of achieving sustainable economic growth. The drive towards price stability was broad based as the government also adopted a more responsible cash budget system in 1996/97 (Mbowe, W.2011).

The questions that drives attentions is whether and to what extent privatization of financial sector has been playing toward improving profitability and efficiency in financial sector of the country (Mutaitina O. R 2000). Profitability and efficiency improvements of privatization of a large state-owned might come at the expense of reduced or increased access to financial services for some groups, especially the rural or peripheral area.

The privatization of Tanzania's National Bank of Commerce provides a unique episode for studying this. The bank was split into two, the National Bank of Commerce 1997 limited, a commercial bank that assumed most of the original bank's assets and liabilities, and the National Microfinance Bank (NMB), which assumed most of the branch network and the mandate to foster access to financial services. The National Bank of Commerce 1997 Ltd’s profitability and portfolio quality improved although credit growth was slow, in line with the privatization experiences in other developing countries. Finding a buyer for the National Microfinance Bank (NMB) proved very difficult, although after years under contract management by private banking consultants, Rabo bank of the Netherlands emerged as a purchaser. Profitability has improved and lending grown slowly, and the share of non-performing loans remains low (Cull, Robert and Spreng, Connor P. 2008).

The privatization process of state owned banking institution is not yet complete as in particular Tanzania Investment Bank (TIB), Twiga Bancorp and Tanzania Postal Bank (TPB) remain on public ownership, though Tanzania Postal Bank (TPB) has an agency contract with the postal service (a significant share holder in the bank) which give it an extensive indirect network for deposit taking and money transfer business, its own branches network but prospects for successful lending activities are limited, this situation makes the bank not to perform well because profit of the banks come from lending activities (Financial Sector Assessment Tanzania 2003).

Twiga Bancorp Ltd., formerly known as National Bureau de Change Ltd., was established in 1992 as a wholly-owned subsidiary of the then National Bank of Commerce. In 1998 the National Bureau De Change was transformed into a non-bank financial institution, empowered to handle all banking transactions with the exception of taking deposits on current account, In January 2005, the National Bureau de Change changed its name to Twiga Bancorp Limited full owned by the government. The colorful event of officially launching the bank's new name took place on the 14th January, 2005 and become a full bank institution.

Tanzania Investment Bank (TIB) was established in 1970 as a development finance institution (DFI). After operating as a DFI for about 25 years, TIB was transformed into an investment commercial development bank in order to enhance its capacity to meet the challenges of the market place.

TIB's principal objective is to provide finance and specialized investment banking services to corporate clients on a commercial basis. The range of products and services offered by TIB is intended to meet the requirements of the present day (complex) business environment in a manner that is flexible and responsive to our client needs. Tanzania Investment Bank Ltd. is the name to trust for superior products and services.

TIB offers credit facilities to corporate clients in the form of long, medium and short-term working capital, and have formed longstanding relationships with companies across all sectors of the Tanzanian economy. With paid up capital increasing from 7.6 billion to 23.7 billion and projected to reach TZS 50 billion in the period of 2008-2011, TIB is without a doubt playing its role in building tomorrow's Tanzania. The aim behind it all is quite simple – to be the development bank championing economic growth in Tanzania.

Given that a number of Tanzanian banks are completely owned by government, for the purpose of this study, a bank that has been allowed to enter capital market to raise its capital by diluting government equity has been considered as privatized. Hence all the banks in which dilution of government ownership has taken place are included in the set of privatized banks. Performance refers to financial performance of banks which is measured by relevant accounting ratios as, the return on assets (ROA).

The conceptual framework for this study will be build and drawn from the literature on the government's participation in the financial markets. Governments' ownership of the banks as part of the 'commanding heights' approach was advocated by Lewis (1950) and Gerschenkron (1962). The development theories emphasize that government ownership to help channeling savings for long-term projects of strategic

interest. The ‘political theorists’ oppose this view and state that government ownership leads to misallocation of resources and inefficiencies of government enterprises and that there are political motives behind such public ownership. It has long been argued that privatization of firms makes them efficient and perform better (Galal*et al*. 1994; World Bank 1995; La Porta and Lopezde-Silanes 1997), this support the view that privatization helps improve performance.

The main function of the banking sector is to ensure that resources and credit are directed to the most productive and efficient projects that will contribute to future growth. It also monitors the performance of firms, plays a crucial role in corporate governance by enforcing contracts and support payment systems. The role of the government within the financial system is to ensure that financial institutions serve these vital functions as efficiently as possible through regulation and close monitoring of banks. In Tanzania these functions are been performed by the Central bank of Tanzania (Bank of Tanzania). Not surprisingly then in developing countries (DCs), state ownership of banks is widespread (Barthet al.2000; La Porta et al., 2002; Megginson, 2005).

Recent evidence points to the costs of government ownership of banks: (Barth et al 2000) show that greater state ownership of banks tends to be associated with less efficient and less developed financial systems. In a related study, (La Porta et al. 2002) find that government ownership of banks in 1970 is associated with slower subsequent financial development, lower growth of per capital income and productivity. They also note that these negative associations are not weaker in less developed countries. In the same vein other scholar, (Demirgu¨c¸-Kunt and Huizinga 1999) argue that DCs have less developed banks and stock markets in general.

Using bank-level data for 80 countries (Boubakri N. et al. 2005), over the period 1988–1995, they investigate the impact of financial development on banks profitability and margins. They show that higher bank development is related to lower bank profitability and interest margins, which reflects an increased efficiency resulting from a greater competition among banks. More, Cornett et al. (2000)

examine performance differences between privately owned and government-owned-banks (GOBs) in South Korea, Indonesia, Malaysia, Philippines and Thailand for the period 1994–1999. They find that government ownership is associated with significant inferior performance. With the recession starting in 1997, the performance of GOBs is worse than that of privately-owned banks. Likewise, in his review of the empirical evidence on state versus private ownership, Megginson (2005) concludes that ‘‘state ownership of commercial banks yields few benefits, and associated with many negative economic outcomes’’.

Also the academic literature has recently devoted attention to the outcomes of privatization in the banking industry (Clarke and Culls 2002), the study in Argentina, and (Unal and Navarro_s 1999) in Mexico. A first multinational study on the performance of newly privatized banks (NPBs) is by (Verbrugge et al. 1999). The authors find that privatization yields limited bank performance improvements. However, their sample is largely dominated by OECD countries and includes only six banks from DCs. Thus their results cannot be generalized to the specific experience of DCs. More recently, (Otchere 2005) analyzed the pre- and post privatization operating performance of privatized banks and their rivals in middle- and low-income countries.

The most recent evidence on the reforms in transition economies also provides us with valuable insights. Several studies on bank privatization provide results that government- ownership is less efficient than private (mostly foreign) ownership. For example, (Bonin et al. 2005) show that privatization by itself is not sufficient to increase (International Monetary Fund 2000) profitability (return on equity) of foreign banks is significantly higher than that of domestic banks in transition economies. This result is more recently confirmed (Grigorian and Manole 2002) where it's found that banks controlled by foreign investors are more efficient.

Also the study on impact of privatization on bank performance finds that financial performance is significantly improved after divestiture (Bonin et al. 2005), and that ‘‘the new owners, mainly foreign investors, incur the costs to upgrade and develop

new business. Other studies shows that the entry of foreign investors and the enactment of accounting reforms in the second round of privatization in Mexico lead to a more stable and efficient banking sector (Haber, 2005).

Since the introduction of Structural Adjustment Programs (SAP) in the late 1980's, the banking sector worldwide has experienced major transformations in its operating environment.

Countries have eased controls on interest rates, reduced government involvement and opened their doors to international banks (Ismi, 2004). Due to this reform, firms of the developed nations have become more visible in developing countries through their subsidiaries and branches or by acquisition of foreign firms. More specifically, foreign banks' presence in other countries across the globe has increasing tremendously. Since 1980's, many foreign banks have established their branches or subsidiaries in different parts of the world. In the last two decades or so, the number of foreign banks in Africa in general and Sub-Saharan Africa in particular has been increasing significantly (Ongere,V.P and Kusa,G.K 2013).

On the contrary, the number of domestic banks declined (Claessens and Hore, 2012.) These have attracted the interests of researchers to examine bank performance in relation to these reforms. There has been noticed a significant change in the financial configuration of countries in general and its effect on the profitability of commercial banks in particular. It is obvious that a sound and profitable banking sector is able to withstand negative shocks and contribute to the stability of the financial system (Athanasoglou et al. 2005). Moreover, commercial banks play a significant role in the economic growth of countries. Through their intermediation function banks play a vital role in the efficient allocation of resources of countries by mobilizing resources for productive activities. They transfer funds from those who don't have productive use of it to those with productive venture.

In addition to resource allocation good bank performance rewards the shareholders with sufficient return for their investment. When there is return there shall be an

investment which, in turn, brings about economic growth. On the other hand, poor banking performance has a negative repercussion on the economic growth and development. Poor performance can lead to runs, failures and crises. Banking crisis could entail financial crisis which in turn brings the economic meltdown as happened in USA in 2007 (Marshall, 2009.) That is why governments regulate the banking sector through their central banks to foster a sound and healthy banking system which avoid banking crisis and protect the depositors and the economy (Heffernan, 1996; Shekhar and Shekhar, 2007.) Thus, to avoid the crisis due attention was given to banking performance.

A more organized study of bank performance started in the late 1980's (Olweny and Shipho, 2011) with the application of Market Power (MP) and Efficiency Structure (ES) theories(Athanasoglou*et al*., 2005). The MP theory states that increased external market forces results into profit. Moreover, the hypothesis suggest that only firms with large market share and welldifferentiated portfolio (product) can win their competitors and earn monopolistic profit. On the other hand, the ES theory suggests that enhanced managerial and scale efficiency leads to higherconcentration and then to higher profitability. According to Nzongang and Atemnkeng in Olweny and Shipho (2011) balanced portfolio theory also added additional dimension into the study of bank performance. It states that the portfolio composition of the bank, its profit and the return to the shareholders is the result of the decisions made by the management and the overall policy decisions.

From the above theories, it is possible to conclude that bank performance is influenced by bothinternal and external factors. According to Athanasoglou et al., (2005) the internal factors include bank size, capital, management efficiency and risk management capacity. The same scholars contend that the major external factors that influence bank performance are macroeconomic variables such as interest rate, inflation, economic growth and other factors like ownership.

In this study, we try to provide some insights into the impact of privatization on bank performance in the specific context of Less Developed Countries (LDCs), and

explore whether the risk-taking behaviour of NPBs has changed after divestiture, and whether the identity of the controlling shareholder has an impact on such behavior. Well functioning financial services enhance economic development by improving productivity facilitating domestic and international transaction broadening availability of credit for small and medium enterprises and house hold, especial from Less Developed Countries (LDCs), mobilizing and channeling domestics saving attracting Foreign Direct Investment (FDI) and efficiency. In Tanzania these remain a challenge, and associated by weak regulations and institutional management, limited skills and difficulties in property management capital account liberalization.

African financial services are generally weak, according to UNCTAD (2007). Only six percent of Tanzania population has access to banking but some of the privatization programmers undertaken in 1980s/1990s improved situation (UNCTAD 2007). Tanzania has been implemented a number of policy measure to create a stable liberalized external sector from mid 1980s there has been gradual liberalization of the external sector by reducing the foreign exchange controls which resulted into replacement of the exchange act of 1992. These reforms went hand in hand with liberalization of foreign exchange system shifting from fixed exchange rate system to a market oriented exchange rate in 1993. In 1996 Tanzania went further with liberalization measure by adopting article VI of International Monetary Fund (IMF) that require liberalization of all current account transaction. This was followed by partial liberalization of the capital/financial account that allowed foreigners to participate in direct investments activities in the country (Financial Sector Assessment Tanzania 2003).

Developing countries in the 1980s were confronted with fiscal crises that put considerable constraints on the capacity of the State to invest in SOEs. This had negative repercussions at the macroeconomic level that in turn adversely affected firms in both the public and private sectors. Often, reforms were part and parcel of structural adjustment programmes that emphasized speedy privatization, not necessarily privatization that would promote efficiency and equity. Given these sets of circumstances, considerations of efficiency have been less important for many

Governments than the need to overcome resource constraints. For those countries where public enterprises represented a substantial drag on the fiscal balance, the outcome of privatization can be deemed positive if it shifted the weight of financing investment from the public to the private sector.

The larger changes faced by developing countries from the late 1980s onwards make it particularly difficult to look at pre- and post privatization performance under the ceteris paribus assumption. The private sector has become more productive as a consequence of trade policy reform, domestic price liberalization and privatization. The developing countries that are often used as success cases underwent substantial macroeconomic changes and this changed macroeconomic framework was conducive to microeconomic efficiency gains.

Similarly, capital market development has resulted to a largeextent from financial liberalization and broader economic deregulation. More generally, the fact that many countries were undergoing structural adjustment programmes meant that the broader economic framework in which privatization took place was changing and this was an important contributing factor to successful privatization. Where this broader macroeconomic framework has not changed, it is unclear whether privatization can enhance SOE performance.

2.3 Empirical Literature

2.3.1 Evidence form North Africa

A large volume theoretical and empirical literature examines government ownership and privatization of state-owned banks, because the performance of the financial sector is crucial to economic growth (Robert and Connor, 2011). The main function of the banking sector is to ensure that resources and credits are directed to the most productive and efficient projects that will contribute to economic growth. A recent theoretical study points out to the negative aspects of government ownership of banks: Barth et al., (2000) showed that increased state ownership of banks tends to be associated with more risk-taking and less developed financial systems. Privatization has been an instrument in reducing state ownership in many countries

and sectors. The literature about the impact of privatization on the risk of firms is extensive and thoroughly reviewed by Megginson and Netter, (2001); Djankov and Murrell; (2002).

Most empirical studies documents which are enhanced by newly privatized bank risk, particularly in the developing countries, are often concomitant to a broad and complex process of "Financial Liberalization" that fundamentally changes the way the entire financial managed sector is operated. Specifically, liberalization can affect the value of the banking charter, the growth opportunities and risk exposure of banks. Demirguc and Detragiache, (1998) found that financial liberalization increases the likelihood of banking crises. This is consistent with the argument that financial liberalization allows banks to expand risk-taking activities that may eventually contribute to a crisis. In State-owned banks, the first problem is that politicians and bureaucrats can use them to achieve their political or personal goals. Although politicians can also encourage private banks to subsidize their constituents, private owners might be better motivated and able to oppose such interventions than public bureaucrats (Galal, 1991; Shirley and Nellis, 1991; Shleifer and Vishny, 1994; World Bank, 1995).

For example, the profit-oriented owner of a private bank, especially when foreigner might be more motivated to protect the bank's prudential lending policies or cost minimization rules from government intervention than a public manager would be. Moreover, government control of bank capital increases the bank's exposure risk. First, if governments keep a share of control over the bank, it is a signal that it seeks to influence its policies including the allocation of credit to specific sectors of the economy. Government owned banks neglect the risk associated with this strategy. Loans given under this condition are generally non- performing that's why the credit risk increases.

Privatization is likely to dampen changes in both performance (Clarke et al., 2005) and risk measures. The authorities use public banks to achieve political purposes. State-ownership also signifies an obligation of the state to save the bank in case of a

collapse –unlike a private bank. Civil community interest satisfaction of any bank is the main priority of the State-owned bank's strategy and management: credit policy, which can lead to bad portfolio management and non-sophisticated services when the Bank politicizes its resources (Clarke and Cull 2002). Second, though in the public bank, government allocates its resources for local and subgroup development with the priority to help firms in bad economic situation. It injects big amounts of credit to finance vital to economic sectors; however, these credits tend to be nonperforming. Furthermore, it is, directly or indirectly, bound with monetary and budgetary policy control adequately to its interests, particularly in a crisis situation such as war (Sapienza, 2004). According to Nakane and Weintraub, (2005), public banks increase their credit risk because of their political orientation, which is characteristic of public banks in developing countries.

But, the government, sharing part of the capital, guarantee's a financial and legal protection, especially from the market, and protects banks from the risk of failure (Megginson and Netter, 2001). A bank, as a credit institution, provides liquidity insurance by offering demandable deposits and underwriting credit lines to firms (Diamond and Dybvig, 1983; Kashyap et al., 2002). In doing so, they become exposed to liquidity risk.

The concern is that a bank with a positive capital may fail due to a liquidity shortage. To prevent this, banks maintain precautionary ''liquidity buffers of tradable short-term assets, which can be converted into cash without loss at a short notice (Pawel et al., 2012). A credit institution aiming to avoid this situation must retain enough liquidity in its balance sheet. Bank deposits, interbank loans, stock market and the lender of last resort are the most important resources for the bank to avoid a liquidity shortage. The Influence of privatization on the role of these capital resources and the liquidity risk are contrasted in literature. Liquidity risk may come from a destabilizing behavior of depositors.

However, this makes the bank susceptible to run until all agents panic and attempt to withdraw their deposits simultaneously. Bank ruins can be prevented if the

government insures deposits by suspending the convertibility of deposits to cash. For the bank customers, the public organizations are immortal because the financial and monetary policy of the State is sufficiently expansive to limit the probability of bankruptcy(Leibenstein, 1966). The 2007–2009 sub prime crises showed that liquidity risk results from the collective reactions of the market participants.

The liquidity shortages are added to the liquidity tense situation in the financial markets. This proves the strong link between banks' funding risk (the ability to raise cash to fund asset holdings, see Matz and Neu, 2007; Drehmann and Nikolaou 2010) and market liquidity (the ability to convert assets into cash at a given price at short notice). Through this channel liquidity risk led to solvency problems and banks had to write off illiquid assets. This development has induced policy makers to focus on the interactions between funding and hence potentially yielding divergent privatization outcomes. By far, most privatized banks in the developing countries are bought either by a foreign bank or by a local investor such as a group of firms that operate simultaneously in the industry.

In developing countries, private bank structures are marked by foreign investors and industrial group shareholders. Their impacts on bank risk are important.Influential industrial groups can interfere in banking management by their important financial means, they could become active investors and affect the manager's choices. In addition, the participation of these groups offers certain advantages to the bank: the bank has a share of the economy of scale in the research and treatment of information allowing them to exercise control at a lower cost than isolated individual shareholders.

Moreover, the participation of these groups actually increases the bank risk due to the dependence on the group's financial situation. In the case of bankruptcy or crisis, these groups remove suddenly their contributions from the capital of the bank, which destabilizes the firm. So, the participation of industrial groups, despite their advantages, represents a source of risk to the bank. The market liquidity risk and related systemic risk are part of the macro-prudential approach (De Larosière Report,

2009). Getting a better grip on such dynamics, privatization has an influence on the relationship between the bank and the stock market. A securities market may play a role of fund raising mechanism by being of assistance to a bank, facing a possible liquidity shortage. Privatization is a key determinant of the stock market development.

For instance, Boutchkova and Megginson, (2000) analyzed the evolution of privatization through public share issues in several markets, and showed that it contributed significantly to the growth of the local market capitalization by improving investor diversification opportunities (Pagano, 1993; Subrahmanyam and Titman, 1999). Moreover, share issue privatization, involving the floating of shares in both domestic and international exchange, reduces informational barriers to foreign investment and enlarge firms' shareholder base (Chiesa and Nicodano, 2003) thereby boosting liquidity in the domestic market and bank. Simply, privatization induces a dramatic change in ownership structure and the set of incentives that affect management behavior will also evolve.

Under State ownership, the choice of ownership structure after privatization, particularly foreign versus local investors, is important. A local or a foreign investor may be subject to bank becomes a financing instrument of these groups. The group management may have the incentives to expropriate banks and all other corporate assets in order to maximize their own wealth. Another potential risk of banks falling into the industrial group' hands is reducing the effective equity invested in the bank (Jeff, 2012). That is why the industrial group participation in banks must be legally controlled. Banks must respect prudential and legal implementations (Bonginiand etal., 2001).

Foreign investors: A recent study of Bonin et al., (2005a) and Christopher, (2012) demonstrated that privatization is not necessarily the only available solution, but there is foreign investor's participation in the bank capital especially in the developing countries coming from the developed ones. In fact, these investors also have an easy access to high data and telecommunications technologies, human

resources skills, currency and new means of risk management. Besides, it gives an easier access to the international financial market (Haber, 2005). Foreign-owned banks generally belong to the banking holdings, profit from their economies of scale and give local banks a foreign customer portfolio. Haber, (2005) also investigated the impact of privatization on bank risk, and founds that the entry of foreign investors and the enactment of the accounting reforms in the second round of privatization in Mexico led to a more stable and efficient banking sector (e. g., a decline in the level of non-performing loans). Boubakri et al., (2005) documented the post privatization corporate governance of formerly government-owned firms in a large sample of countries. Contrary to what is documented in Bonin et al., (2005b) for transition countries, foreign penetration is less important in those countries. In any event, the banking environment has changed completely in the recent years.

The emergence of new prudential standards, the progressive disappearance of specific regulations, the strong evolution of new information technologies and communication and competition increasingly supported, show that banks are moving towards new strategies to meet the multiple constraints facing them, among these constraints we can isolate technological, regulatory constraints, counterparty risk, interest rate risk, liquidity risk and market risk. Recent studies show that the presence of the State is a determinant of the liquidity risk, credit risk and solvency risk. In this paper, we will try to analyze, through an empirical study, the ability of the Tunisian banks to withstand these risks in this new and turbulent environment. We will focus particularly on bringing some answers to the following question: What is the impact of privatization on the bank risks in Tunisia?

Since the early 1980s, the banking systems of many countries have experienced a crisis of considerable magnitude, caused by the "suddenness of deregulation, the inefficiency of the internal control system, the lack of market discipline, and the presence of a majority shareholder’s status marking disabilities in government banks. This made the role of internal audit committee insufficient and non-existent. Dysfunctions in sign if cannot develop in the banking market mainly come from the sudden change in its environment and the characteristics of the system. Indeed, the

banking system was more effective in its regulatory environment; more adaptation to new rules is long and expensive. Several studies (Standard & Poor's 2011; Fitch ratings 2011) have been proposed to assess the risk of the banking system (the interest rate risk, credit risk, liquidity risk). The results showed that the Tunisian banking system suffers from the credit risk and bankruptcy, particularly in the presence of the State banks (IMF 2006).

However, the result of this new banking policy is conspicuous. Indeed, the GDP growth in Tunisia rose from an average of 3. 5% to 6%. However, despite mergers and privatization, the banking landscape remains publically dominated and the State controls 47% of the sector. Indeed, three public banks: The Tunisian banking company, National Agriculture Bank and the bank of housing has taken 47% market share in terms of loans. In 2006, 20 banks in the market recorded a growth rate of 7.5% of their outstanding loans. This growth is mainly due to the dynamism recorded by consumer credits and special credits. The increase in special appropriations, including appropriations for housing, cars and consumer goods, has contributed to the expansion of bank assets thereby helping to reduce the substantial loss recorded in terms of loans for private investment.

The decline in loans for private investment is explained by the financial fragility of the Tunisian banks and the under-capitalization of some industrial groups. However, the Tunisian businesses that suffered financial problems lament the reluctance of the Tunisian banks to finance investment projects. However, the financial fragility of firms cannot be an excuse for restricting the affected assets to the private investment to boost the pace of new businesses and jobs. Banks avoid the risk of bad loans or bad debt, which bear heavily on the Tunisian banks especially, when the insolvency or the risk of default affects both groups known as "small investors. Hence, banks are obliged to improve their risk management in order to comply with the recommendations of Basel 1. The cost of risk by banking sector was estimated at 27% in 2008.

The adoption of an internal rating system of the internal audit and risk is essential for banks to enable them to fully play their role in financing the economy while preserving their basic capital. However, the rate of claims was reduced to 19% in 2006. This rate was considered insufficient to ensure the expansion of banks and enable them to face foreign competition. Hence the priority was given to the strengthening of the banking provisions. The Central Bank of Tunisia has set a target to reduce the NPL ratio to 15% and achieve a minimum coverage rate of 70% of credits. In addition, banks have to ensure a minimum provision rate of 40% required by the BCT. Banks are also requested to improve their coverage of credits. The average coverage rate of the sector stood at 54% in 2006 while the goal was to reach 70% in 2009. Indeed, the most difficult problem faced by the Tunisian banks is that of bad loan rate which remained very high: 17.9% for the private banks, 24.1% for the public banks, while the international standard is 6%. The international rating agency "Fitch Ratings report, (2011) on the evaluation of growth of the Tunisian banking sector, shows that this sector remains a major weakness of the Tunisian economy. Additional measures are needed to prepare the financial system to the liberalization of the Tunisian dinar scheduled in the coming years.

The Tunisian banks suffer low profitability of their assets and equity. In 2006, the return on assets and return on equity were respectively set at 0.7% and 7.17%. Apart from the Bank of Tunisia, which recorded by local banks remain below the international standards. Regarding the rate of return on equity, the Tunisian banks are still struggling to reach the required level of profitability. In any event, the Tunisian banks have succeeded in supporting the capacity provisioning to the detriment of their profitability and risk management. The process of restructuring and modernizing the banks is not completed. The consolidation of the financial basis and building equity into finding the claims attached are the main challenges faced by the banks. This makes us to try to answer the question: what the impact of privatization on bank

2.3.2 Evidence from West Africa

Cross-country and bank-level evidence has shown the poor performance of government-owned banks, especially in developing countries (La Porta et al, 2001, Dinc, 2005), so that privatization could be expected to improve performance and thus boost efficiency of financial intermediation. Evidence from individual countries that have undertaken large privatization programs, however, has been mixed (Cull,Clarke, and Shirley, 2005; Megginson, 2005). For example, in Mexico in the early and mid-1990s, privatization outcomes were bad enough to prompt re-nationalization of the banking sector in the wake of the Tequila crisis (Haber, 2005).

Banking sector performance eventually improved, but only after a second round of privatization in the late 1990s in which foreign ownership participation was encouraged. Initial attempts at bank privatization in the Czech Republic, and to a lesser extent Poland, were also not fully successful, at least in part because the state maintained relatively large shareholdings in the privatized banks and discouraged ownership by foreign investors (Bonin, Hasan, and Wachtel, 2005). Assessing the effects of privatization across countries is made difficult by country-specific circumstances that are hard to control for. Researchers have therefore turned to country-level studies, which offer natural experiments if data availability allows the performance assessment of privatized banks before and after privatization, relative to other banks in the financial system and controlling for other bank and country-level but time-variant characteristics. Otchere (2005) examines the effects of share issue bank privatizations for twenty-one banks in nine developing countries using pooled econometric tests. In the case of direct sales to strategic investors, this type of cross-country analysis is more difficult, because share prices cannot be used as performance indicators and listed banks are generally subject to lower disclosure standards.

This paper assesses the effect of privatization on bank performance in Nigeria over the period 1990-2001. Nigeria undertook a major privatization program in the early 1990s, divesting a total of 14 banks, constituting more than 50% of total banking system assets. However, this period was also characterized by other major changes in

the financial system. The privatizations were part of a larger liberalization process that included interest rate and entry liberalization and the loosening of credit allocation quotas. At the same time, a multi-tiered exchange rate market offered plenty of arbitrage and rent opportunities for licensed banks. Consequently, the late 1980s saw a massive entry of new banks specializing in foreign exchange operations. While the number of banks multiplied during this period and the financial sector boomed, financial intermediation, as measured by credit to the private sector and deposits, decreased. Finally, economic recession and political instability brought the boom to a halt in 1992, with a major banking crisis crippling the financial system until the late 1990s.

The volatile macroeconomic and financial environment, in which the privatization took place, makes it difficult to compare the effects of the Nigerian privatization program to privatization in other countries. We therefore evaluate the effects of privatization on bank performance relative to the same banks before privatization and to other privately owned banks in Nigeria. Specifically, we assess the performance of privatized banks, i.e. the return on assets and equity as well as the share of non-performing loans (NPL), relative to other banks in the Nigerian financial system and relative to their performance before privatization. Given the large reliance of banks on foreign exchange revenue during the sample period, we use profit measures both including and excluding foreign exchange profits. We apply different robustness tests and estimation techniques.

Our results indicate some performance improvement due to privatization. While privatized banks performed significantly worse than privately owned commercial banks before privatization, this gap was effectively closed by privatization.This is remarkable given the macroeconomic and regulatory environment that was very inhospitable to true financial intermediation during our sample period. However, there were no further performance gains beyond the performance of other private banks in the Nigerian banking system. In addition, our results give evidence of the poor performance of banks that continued with minority government ownership during the sample period.

Our results also provide microeconomic evidence on the distorted incentives that banks faced in Nigeria during the sample period. Long established banks that focused on retail banking performed significantly more poorly than new wholesale banks that focused on lending to the government and on fee-based business. These results are the microeconomic complement to the aggregate picture of declining financial intermediation that Nigeria suffered during this period.

Our results are subject to some caveats. First, poor data quality makes it difficult to find significant relationships between bank characteristics such as ownership and bank performance. The fact that we find significant and robust relationships in spite of these shortcomings makes us more confident in our findings. Second, limited information on the privatization transactions and the individual banks limit our analysis to a primarily statistical one. We try to offset these hurdles with a thorough sensitivity analysis. This paper makes several contributions to the literature. First, it shows the effects of privatization on performance in the context of a financial system that went through a boom and bust cycle with perverse incentives for true financial intermediation. Second, it analyzes the performance of Nigerian banks over an important period of recent economic history and thus complements a large, mostly qualitative literature on banking sector development in this African economy, which is second only to South Africa in size.

Third, to our knowledge this is the first detailed quantitative analysis of bank privatization for an African nation, despite substantial recent reductions in state ownership of banks (Clarke, Cull, and Shirley, 2005). Fourth, we study share issue privatizations (SIP) in which the government fully divested its shareholdings. In other developing countries where governments attempted SIP of banks, they also tended to retain sizable shareholdings, and post-privatization performance improvements did not materialize (Clarke, Cull, and Shirley, 2005). In those cases, it is difficult to identify whether poor outcomes should be attributed to the government’s failure to fully relinquish its shareholding, or to attempting an SIP where stock markets and the associated monitoring of firms by investors were not

fully developed. To the extent that our empirical tests reveal that the SIP in Nigeria was unsuccessful, the SIP method itself is called into question

2.3.3 Evidence from East Africa

Commercial banks play a vital role in resource allocation of countries. They channel funds from depositors to investors continuously. They can do so, if they generate necessary income to cover their operational cost they incur in the due course. In other words for sustainable intermediation function, banks need to be profitable. Beyond the intermediation function, the financial performance of banks has critical implications in economic growth of countries. Good financial performance rewards the shareholders for their investment. This, in turn, encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth.

Thus, financial performance analysis of commercial banks has been of great interest to academic research since the Great Depression Intern the 1940’s. In the last two decades studies have shown that commercial banks in Sub-Saharan Africa (SSA) are more profitable than the rest of the world with an average Return on Assets (ROA) of 2 percent (Flamini et al., 2009). One of the major reasons behind high return in the region was investment in risky ventures. The other possible reason for the high profitability in commercial banking business in SSA is the existence of huge gap between the demand for bank service and the supply thereof. That means, in SSA the number of banks are few compared to the demand for the services; as a result there is less competition and banks charge high interest rates. This is especially true in East Africa where the few government owned banks take the lion’s share of the market.

The performance of commercial banks can be affected by internal and external factors (Al-Tamimi, 2010; Aburime, 2005). These factors can be classified into bank specific (internal) and macroeconomic variables. The internal factors are individual bank characteristics which affect the bank's performance. These factors are basically influenced by the internal decisions of management and board. The external factors

are sector wide or country wide factors which are beyond the control of the company and affect the profitability of banks. Studies show that performance of firms can also be influenced by ownership identity (Ongore,2011). To study the effect of ownership identity, we introduced the concept of moderating variable. In this study the ownership identity is classified into foreign and domestic. The domestic vis-àvis foreign classification is based on the nature of the existing major ownership identity in Kenya.

According to Central Bank of Kenya (2011) Supervision Report of December 2011, out of the 43 commercial banks 30 are domestically owned and 13 are foreign owned. In terms of asset holding, foreign banks account for about 35% of the banking assets of 2011. In Kenya the commercial banks dominate the financial sector. In a country where the financial sector is dominated by commercial banks, any failure in the sector has an immense implication on the economic growth of the country. This is due to the fact that any bankruptcy that could happen in the sector has a contagion effect that can lead to bank runs, crises and bring overall financial crisis and economic tribulations.

Despite the good financial performance of banks in Kenya, there are a couple of banks declaring losses (Oloo, 2011). Moreover, the current banking failures in the developed countries and the bailouts thereof motivated this study to evaluate the financial performance of banks in Tanzania. Thus, to take precautionary and mitigating measures, there is dire need to understand the performance of banks and its determinants. Although there has been much debate over the theoretical advantages and disadvantages of state ownership, empirical evidence mostly supports the idea that privately owned firms perform better than similar state-owned firms (Megginson, 2005b); Megginson and Netter, 2001; Shirley and Walsh, 2000).Empirical studies that have looked at private and state-owned banks have reached similar conclusions. Credit growth, portfolio quality, profitability, and productivity are higher in systems dominated by private banks.

The comparisons between private and state-owned firms suggest that privatization should improve bank performance. But critics of privatization have noted that privatized firms do not always act like firms that have always been privately owned (Caves, 1990; Cook and Kirkpatrick, 1988; Kay and Thompson, 1986; Stiglitz, 2000a, 2000b). Limits placed on privatized firms, such as limits on layoffs, price controls to keep products affordable for other state-owned entities or low-income households, and, for banks, lending requirements and restrictions on branch closings might harm their performance.

Moreover, if problems in the institutional environment that prevent voters from holding politicians accountable are the reasons why state-owned enterprises perform poorly, then the privatization process—and regulation after privatization—might be as flawed as the management of state-owned enterprises was (Stiglitz, 2000a, 2000b). Privatized banks might therefore be unable to act like fully private banks. The empirical evidence on the effect of privatization on bank performance in developing countries is in fact mixed. But the evidence does not suggest that outcomes are random. Performance improvements are greater when the government fully relinquishes control, and preferably fully divests its entire shareholding;

The privatization of Uganda Commercial Bank (UCB), the focus of this study, satisfies all three criteria. Stanbic Bank of South Africa acquired 80 percent of UCB's shares in late 2001, with the remaining 20 percent were transferred to a trust to be held for sale to Ugandan residents. In these respects, the privatization would appear to be a likely candidate for success. Two things, however, set the privatization of UCB apart from most of the bank privatizations looked at in previous studies. The first is that Uganda is a low-income economy. Empirical analyses of bank privatizations in developing countries have focused on middle-income countries, mostly in Latin America and the transition countries of Eastern Europe.Given that bank privatization has been less successful in the (mostly middle-income) developing economies that have been the focus of previous studies than in high-income OECD economies (Megginson, 2005a), it seems plausible that privatization might be even less successful in low-income economies. Institutional constraints that reduce

performance gains in developing economies are likely to be even more binding in low-income economies than in middle-income developing economies. Consistent with this, Senbet and Otchere (2006) find that the performance of privatized banks in Africa actually deteriorated after privatization. It is important to note, however, that these privatizations were share-issue privatizations of only a portion of the governments' ownership stakes—as noted, both of those features are associated with reduced gains in developing countries (Clarke et al., 2005a; Megginson, 2005a).
A second, and potentially greater concern, is the importance of UCB in the Ugandan banking sector. The privatized bank, Stanbic, holds about 30 percent of loans and deposit accounts.

Moreover, none of the 68 branches operated by UCB were closed after privatization, and thus Stanbic maintains the most geographically extensive branch network of any bank. As of 2005 Stanbic had 74 branches, 54 outside of Kampala. Only one other commercial bank, the agriculturally oriented Centenary Rural Development Bank, has more than four branches outside Kampala. Stanbic, therefore, faces little or no direct competition in most areas in which it operates.

This could affect the success of the privatization in at least two ways. First, it might affect the way the government treats privatization. The privatization of a large bank with a dominant rural network is likely to be fraught with political difficulty, and, as described below, this was true for the privatization of UCB. Political accommodations that make a deal palatable to the government, but which handcuff the new owners, might have negative consequences for post privatization performance. Moreover, although Stanbic is now the largest bank in Uganda, it is still a small bank by the standards of industrialized countries, and therefore not able to reap the economies of scale that one might associate with size in other contexts. Second, because of its extensive network outside of Kampala, UCB faced little competition in many areas of the country. Although few studies of bank privatization have looked at the effect of competition on privatization outcomes, studies in other sectors have often suggested that privatizations are more successful when the privatized firms face competition. For example, although privatization appears to be

associated with performance improvements in the telecommunications sector, many studies have found that competition is at least as important as privatization and that the gains from privatization are significantly greater when the privatized firm faces more competition.

Although there is little evidence on the interaction between competition and privatization in the banking sector, the privatized banks have faced significant competition in most studies looking at bank privatization. The situation in Uganda, with the privatization of a large public bank in a relatively small sector, is probably representative of many of the privatizations that have occurred in Sub-Saharan Africa in recent years.

Throughout the region, banking sectors tend to be highly concentrated with few private banks having large rural networks. Thus, the experience in Uganda is likely to be more representative of the experience in other countries in Sub-Saharan Africa than the experience in other countries that have been the focus of past studies. We should note that that this analysis would not have been possible without the extraordinary effort of Bank of Uganda (BOU) staff in collecting, cleaning, and organizing the data. In addition, we are fortunate that branch-level financial and income statements are available for Stanbic. These data enable us to test whether performance improvements are greater in areas where Stanbic faces more competition. They also enable us to test whether geographic factors such as population density and income are linked to changes in Stanbic's activities since privatization. This should provide a more detailed description of access to financial services for disadvantaged groups.

The rest of the paper is organized as follows. Section II provides background on the historical evolution of the Ugandan banking sector, UCB's role in it, and UCB's privatization process. Section III uses bank-level data to benchmark post privatization profitability, portfolio quality, and cost management. Access issues are also touched upon by focusing on credit growth and portfolio composition

2.4 Review of Relevant Literature on Bank Performance

Since the introduction of Structural Adjustment Programs (SAP) in the late 1980's, the banking sector worldwide has experienced major transformations in its operating environment. Countries have eased controls on interest rates, reduced government involvement and opened their doors to international banks (Ismi, 2004). Due to this reform, firms of the developed nations have become more visible in developing countries through their subsidiaries and branches or by acquisition of foreign firms. More specifically, foreign banks' presence in other countries across the globe hasbeen increasing tremendously. Since 1980's, many foreign banks have established their branches or subsidiaries in different parts of the world. In the last two decades or so, the number of foreign banks in Africa in general and Sub-Saharan Africa in particular has been increasing significantly. On the contrary, the number of domestic banks declined (Claessens and Hore, 2012.) These have attracted the interests of researchers to examine bank performance in relation to these reforms. There has been noticed a significant change in the financial configuration of countries in general and its effect on the profitability of commercial banks in particular. It is obvious that a sound and profitable banking sector is able to withstand negative shocks and contribute to the stability of the financial system (Athanasoglou et al. 2005).

Moreover, commercial banks play a significant role in the economic growth of countries. Through their intermediation function banks play a vital role in the efficient allocation of resources of countries by mobilizing resources for productive activities. They transfer funds from those who don't have productive use of it to those with productive venture. In addition to resource allocation good bank performance rewards the shareholders with sufficient return for their investment. When there is return there shall be an investment which, in turn, brings about economic growth. On the other hand, poor banking performance has a negative repercussion on the economic growth and development. Poor performance can lead to runs, failures and crises. Banking crisis could entail financial crisis which in turn brings the economic meltdown as happened in USA in 2007(Marshall, 2009). That is why governments regulate the banking sector through their central banks to foster a sound and healthy banking system which avoid banking crisis and protect the depositors and the

economy (Heffernan, 1996; Shekhar and Shekhar, 2007.) Thus, to avoid the crisis attention was given to banking performance.

A more organized study of bank performance started in the late 1980's (Olweny and Shipho, 2011) with the application of Market Power (MP) and Efficiency Structure (ES) theories (Athanasoglou et al., 2005). The MP theory states that increased external market forces results into profit. Moreover, the hypothesis suggest that only firms with large market share and well differentiated portfolio (product) can win their competitors and earn monopolistic profit. On the other hand, the ES theory suggests that enhanced managerial and scale efficiency leads to higherconcentrations and profitability. According to Nzongang and Atemnkeng in OlwenyanShipho (2011) balanced portfolio theory also added additional dimension into the study of bank performance. It states that the portfolio composition of the bank, its profit and the return to the shareholders is the result of the decisions made by the management and the overall policy decisions.

From the above theories, it is possible to conclude that bank performance is influenced by both internal and external factors. According to Athanasoglou et al., (2005) the internal factors include bank size, capital, management efficiency and risk management capacity. The same scholars contend that the major external factors that influence bank performance are macroeconomic variables such as interest rate, inflation, economic growth and other factors like ownership.

2.4.1 Bank Performance Indicators

Profit is the ultimate goal of commercial banks. All the strategies designed and activities performed thereof are meant to realize this grand objective. However, this does not mean that commercial banks have no other goals. Commercial banks could also have additional social and economic goals. However, the intention of this study is related to the first objective, profitability. To measure the profitability of commercial banks there are variety of ratios used of which Return on Asset, Return on Equity and Net Interest Margin are the major ones (Murthy and Sree, 2003;Alexandru et al., 2008).

2.4.1.1Return on Equity (ROE)

ROE is a financial ratio that refers to how much profit a company earned compared to the total amount of shareholder equity invested or found on the balance sheet. ROE is what the shareholders look in return for their investment. A business that has a high return on equity is more likely to be one that is capable of generating cash internally. Thus, the higher the ROE the better the company is in terms of profit generation. It is further explained by Khrawish (2011) that ROE is the ratio of Net Income after Taxes divided by Total Equity Capital. It represents the rate of return earned on the funds invested in the bank by its stockholders. ROE reflects how effectively a bank management is using shareholders' funds. Thus, it can be deduced from the above statement that the better the ROE the more effective the management in utilizing the shareholders capital.

2.4.1.2Return on Asset (ROA)

ROA is also another major ratio that indicates the profitability of a bank. It is a ratio of Income to its total asset (Khrawish, 2011). It measures the ability of the bank management to generate income by utilizing company assets at their disposal. In other words, it shows how efficiently the resources of the company are used to generate the income. It further indicates the efficiency of the management of a company in generating net income from all the resources of the institution (Khrawish, 2011). Wen (2010), state that a higher ROA shows that the company is more efficient in using its resources.

2.4.1.3Net Interest Margin (NIM)

NIM is a measure of the difference between the interest income generated by banks and the amount of interest paid out to their lenders (for example, deposits), relative to the amount of their (interest earning) assets. It is usually expressed as a percentage of what the financial institution earns on loans in a specific time period and other assets minus the interest paid on borrowed funds divided by the average amount of the assets on which it earned income in that time period (the average earning assets). The NIM variable is defined as the net interest income divided by total earnings assets (Gul et al., 2011).Net interest margin measures the gap between the interest income

the bank receives on loans and securities and interest cost of its borrowed funds. It reflects the cost of bank intermediation services and the efficiency of the bank. The higher the net interest margin, the higher the bank's profit and the more stable the bank is. Thus, it is one of the key measures of bank profitability. However, a higher net interest margin could reflect riskier lending practices associated with substantial loan loss provisions (Khrawish, 2011).

2.5 Determinants of Bank Performance

The determinants of bank performances can be classified into bank specific (internal) and macroeconomic (external) factors (Al-Tamimi, 2010; Aburime, 2005). These are stochastic variables that determine the output. Internal factors are individual bank characteristics which affect the banks performance. These factors are basically influenced by internal decisions of management and the board. The external factors are sector-wide or country-wide factors which are beyond the control of the company and affect the profitability of banks. The overall financial performance of banks in Kenya in the last two decade has been improving. However, this doesn't mean that all banks are profitable, there are banks declaring losses (Oloo, 2010). Studies have shown that bank specific and macroeconomic factors affect the performance of commercial banks (Flamini et al. 2009). In this regard, the study of Olweny and Shipho (2011) in Kenya focused on sector-specific factors that affect the performance of commercial banks. Yet, the effect of macroeconomic variables was not included.

2.6 Bank Specific Factors/Internal Factors

As explained above, the internal factors are bank specific variables which influence the profitability of specific bank. These factors are within the scope of the bank to manipulate them and that they differ from bank to bank. These include capital size, size of deposit liabilities, size and composition of credit portfolio, interest rate policy, labor productivity, and state of information technology, risk level, management quality, bank size, ownership and the like. CAMEL framework often used by scholars to proxy the bank specific factors (Dang, 2011). CAMEL stands for Capital

Adequacy, Asset Quality, Management Efficiency, Earnings Ability and Liquidity. Each of these indicators are further discussed below.

2.6.1 Capital Adequacy

Capital is one of the bank specific factors that influence the level of bank profitability. Capital is the amount of own fund available to support the bank's business and act as a buffer in case of adverse situation (Athanasoglou et al. 2005). Banks capital creates liquidity for the bank due to the fact that deposits are most fragile and prone to bank runs. Moreover, greater bank capital reduces the chance of distress (Diamond, 2000). However, it is not without drawbacks that it induce weak demand for liability, the cheapest sources of fund Capital adequacy is the level of capital required by the banks to enable them withstand the risks such as credit, market and operational risks they are exposed to in order to absorb the potential loses and protect the bank's debtors. According to Dang (2011), the adequacy of capital is judged on the basis of capital adequacy ratio (CAR). Capital adequacy ratio shows the internal strength of the bank to withstand losses during crisis. Capital adequacy ratio is directly proportional to the resilience of the bank to crisis situations. It has also a direct effect on the profitability of banks by determining its expansion to risky but profitable ventures or areas (SangmiandNazir, 2010).

2.6.2 Asset Quality

The bank's asset is another bank specific variable that affects the profitability of a bank. The bank asset includes among others current asset, credit portfolio, fixed asset, and other investments. Often a growing asset (size) related to the age of the bank(Athanasoglou et al., 2005). More often than not the loan of a bank is the major asset that generates the major share of the banks income. Loan is the major asset of commercial banks from which they generate income. The quality of loan portfolio determines the profitability of banks. The loan portfolio quality has A direct bearing on bank profitability. The highest risk facing a bank is the losses derived from delinquent loans (Dang, 2011). Thus, non performing loan ratios are the best proxies for asset quality. Different types of financial ratios used to study the performances of banks by different scholars. It is the major concern of all commercial banks to keep

the amount of nonperforming loans to low level. This is so because high nonperforming loan affects the profitability of the bank. Thus, low nonperforming loans to total loans shows that the good health of the portfolio a bank. The lower the ratio the better the bank performing (Sangmi and Nazir, 2010).

2.6.3 Management Efficiency

Management Efficiency is one of the key internal factors that determine the bank profitability. It is represented by different financial ratios like total asset growth, loan growth rate and earnings growth rate. Yet, it is one of the complexes subject to capture with financial ratios. Moreover, operational efficiency in managing the operating expenses is another dimension for management quality. The performance of management is often expressed qualitatively through subjective evaluation of management systems, organizational discipline, control systems, quality of staff, and others. Yet, some financial ratios of the financial statements act as a proxy for management efficiency. The capability of the management to deploy its resources efficiently, income maximization, reducing operating costs can be measured by financial ratios. One of this ratios used to measure management quality is operating profit to income ratio (Rahman et al. in Ilhomovich, 2009; Sangmi and Nazir, 2010). The higher the operating profits to total income (revenue) the more the efficient management is in terms of operational efficiency and income generation. The other important ratio is that proxy management quality is expense to asset ratio. The ratio of operating expenses to total asset is expected to be negatively associated with profitability. Management quality in this regard, determines the level of operating expenses and in turn affects profitability (Athanasoglou et al. 2005).

2.6.4 Liquidity Management

Liquidity is another factor that determines the level of bank performance. Liquidity refers to the ability of the bank to fulfill its obligations, mainly of depositors. According to Dang (2011) adequate level of liquidity is positively related with bank profitability. The most common financial ratios that reflect the liquidity position of a bank according to the above author are customer deposit to total asset and total loan to customer deposits. Other scholars use different financial ratio to measure liquidity.

For instance Ilhomovich (2009) used cash to deposit ratio to measure the liquidity level of banks in Malaysia. However, the study conducted in China and Malaysia found that liquidity level of banks has no relationship with the performances of banks (Said and Tumin, 2011).

2.7 External Factors/ Macroeconomic Factors

The macroeconomic policy stability, Gross Domestic Product, Inflation, Interest Rate and Political instability are also other macroeconomic variables that affect the performances of banks. For instance, the trend of GDP affects the demand for banks asset. During the declining GDP growth the demand for credit falls which in turn negatively affect the profitability of banks. On the contrary, in a growing economy as expressed by positive GDP growth, the demand for credit is high due to the nature of business cycle. During boom the demand for credit is high compared to recession (Athanasoglou et al., 2005). The same authors state in relation to the Greek situation that the relationship between inflation level and banks profitability is remained to be debatable. The direction of the relationship is not clear (Vong and Chan, 2009).

2.8 Ownership Identity and Financial Performance

The study of the relationship between ownership and performance is one of the key issues incorporate governance which has been the subject of ongoing debate in the corporate finance literature.The relationship between firm performance and ownership identity, if any, emanate from Agency Theory. This theory deals with owners and manager’s relationship, which one way or the other refers to ownership and performance. In relation to performance according to Javid and Iqbal (2008), the identity of ownership matters more than the concentration of ownership. This is so because ownership identity shows the behavior and interests of the owners. Ongore (2011) argues that the risk-taking behavior and investment orientation of shareholders have great influence on the decisions of managers in the day-to-day affairs of firms. According to Ongore (2011),

Developing countries in the 1980s were confronted with fiscal crises that put considerable constraints on the capacity of the State to invest in SOEs. This had

negative repercussions at the macroeconomic level that in turn adversely affected firms in both the public and private sectors. Often, reforms were part and parcel of structural adjustment programmes that emphasized speedy
Privatization, not necessarily privatization that would promote efficiency and equity. Given these sets of circumstances, considerations of efficiency have been less important for many Governments than the need to overcome resource constraints. For those countries where public enterprises represented a substantial drag on the fiscal balance, the outcome of privatization can be deemed positive if it shifted the weight of financing investment from the public to the private sector.

Recent empirical research on the impact of privatization on financial and operating performance, labour, fiscal balances and distributional equity largely confirms the view that privatization can be beneficial for firms operating in competitive market structure in middle-income countries. While it is difficult to quantify the fiscal and distributional impact of privatization, the evidence points to increased efficiency.

The concept of ownership can be defined along two lines of thought: ownership concentration and ownership mix. The concentration refers to proportion of shares held (largest shareholding) in the firm by few shareholders and the later defines the identity of the shareholders. Morck et al. in Wen (2010) explained that ownership concentration has two possible consequences. The dominant shareholders have the power and incentive to closely monitor the performances of the management. This in turn has two further consequences in relation to firm performance. On the one hand close monitoring of the management can reduce agency cost and enhance firm performance. On the other hand concentrated ownership can create a problem in relation to overlooking the right of the minority and also affect the innovativeness of the management (Ongore, 2011; Wen, 2010).

Concerning the relationship between ownership identity & bank performance differentscholars came up with varying results. For instance according to Claessens

et al., (1998) domestic banks' performance is superior compared to their foreign counterparts in developed countries.

According to the same scholars the opposite is true in developing countries. Micco et al. in Wen (2010) also support the above argument in that in developing countries the performances of foreign banks is better compared with the other types of ownership in developing countries. However, Detragiache (2006) presented a different view about the foreign bank performance in relation to financial sector development, financial deepening, and credit creation in developing countries. He found that the performances of foreign banks compared to their domestic owned banks are inferior in developing countries. Ownership is one of the variables that affect the performance of banks.

Specifically, ownership identity is one of the factors explaining the performances of banks across the board yet the level & direction of its effect remained contentious. There are scholars who claimed that foreign firms perform better with high profit margins and low costs compared to domestic owned banks (Farazi et al., 2011). This is so because foreign owned firms are believed to have tested management expertise in other countries over years. Moreover, foreign banks often customize and apply their operation systems found effective at their home countries (Ongore, 2011). It is also assumed that, banks crossing boundaries are often those big and successful ones. For instance in countries such as Thailand, Middle East and North Africa region, it was found that foreign banks performance is better than domestic counterparts (Azam and Siddiqui, 2012; Chantapong, 2005; Farazi et al. 2011). The study conducted in Pakistan by Azam and Siddiqui (2012) concluded that "...foreign banks are more profitable than all domestic banks regardless of their ownership structure by using regression analysis." They further suggest that "...it is better for a multinational bank to establish a subsidiary/branch rather than acquiring an “existing player” in the host country." Moreover, Chantapong (2005) studied domestic and foreign bank performance in Thailand and concluded that foreign banks are more profitable than the average domestic banks profitability. It is also supported by Okuda and Rungsomboon (2004) that foreign owned banks in Thailand are found to be efficient

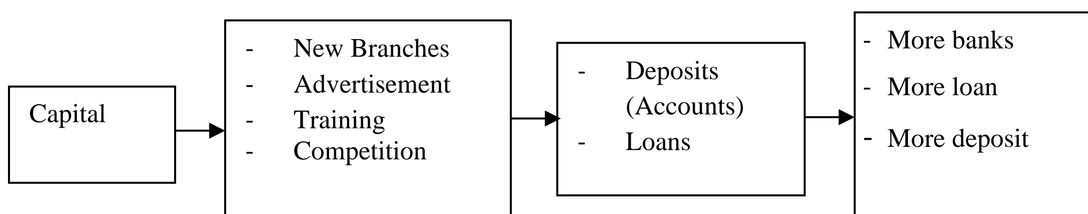
compared to their domestic counterparts due to modernized business activities supported by technology, reduced costs associated with fee-based businesses and improved their operational efficiency. These indicate that in the area studied above foreign banks were found to be more profitable than their domestic counterparts. The major reason behind these assertions is that foreign banks were believed to be strong & efficient.

However, there are scholars who argue that domestic banks perform better then foreign banks. For instance (Cadet, 2008) stated that "foreign banks are not always more efficient than domestic banks in developing countries, and even in a country with low income level." Yildirim and Philippatos in Chen and Lia (2009) also support the above view that foreign owned banks performed not better, even less than the domestic banks in relation to developing countries especially in Latin America. The study conducted in Turkey by Tufan et al. (2008) also found that domestic banks perform better than their foreign counterparts. There are also other scholars who argue that the performance of domestic and foreign banks varies from region to region. Claessens et al. (1998), for example, stated that foreign banks perform better in developing countries compared to when they are in developed countries. Thus, they conclude that domestic banks perform better in developed countries than when they are in developing countries. They further assert that an increase in the share of foreign banks leads to a lower profitability of domestic banks in developing countries. Thus, does ownership identity influence the performance of commercial banks? Studies have shown that bank performance can be affected by internal and external factors (Athanasoglou et al. 2005; Al-Tamimi, 2010; Aburime,2005.) Moreover, the magnitude of the effect can be influenced by the decision of the management. The management decision, in turn, is affected by the interests of the owners which is determined by their investment preferences and risk appetite (Ongore, 2011). This implies the moderating role of ownership identity. This study attempted to examine whether ownership identity significantly moderate the relationship between commercial banks' financial performance and its determinants in Kenya or not.

2.9 Conceptual Framework

The conceptual framework is developed from the review of literature discussed above and presented relationship between the dependent (ROA, ROE, NIM) and explanatory (bank specific and macroeconomic) variables. It also demonstrates the moderating role of ownership identity.

Figure 2.1: Conceptual Framework



Source; The Researcher’s Analysis, 2013

2.10 The Study Gap

The studies and findings of the above authors conclude that privatization of banks which are previous own by government result into increase in performance and efficiency after being privatized but the authors did not talk about how this performance and efficiency increase or decrease in terms of products offered by these banks as a result of privatization. Thestudies by Cornett et al. (2000) examine performance differences between privately owned and government-owned-banks (GOBs) in South Korea, Indonesia, Malaysia, Philippines and Thailand for the period 1994–1999,also (Clarke and Culls 2002), the study in Argentina, and (Unal and Navarro_s 1999) in Mexico. A first multinational study on the performance of newly privatized banks (NPBs) is by (Verbrugge et al. 1999). The authors find that privatization yields limited bank performance improvements, (Galal*et al.* 1994; World Bank 1995; La Porta and Lopezde-Silanes 1997), this support the view that privatization helps improve performance.

This study will try to analyze the gap left by mentioned left open by these studies, as the study will try to analyze both positive effect of the performance and efficiency of banks in terms of products and service offered for example Retail, Corporate, Treasury products

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Research is thorough, orderly, organized, efficient and logically investigation of an area of knowledge or of a problem. Research begins with abroad question that needs an answer. Research creates a theory (hypothesis) to be proved from the questions. The researcher maintains an awareness of the limitations of budget, time and technology needed to answer the questions.

Research comprises defining and redefining problems, formulating hypothesis or suggesting solutions; collecting, organizing and evaluating data, making reductions and researching conclusions and at last carefully testing the conclusions to determine whether they fit the formulating hypothesis (Wood2001).

3.2 Research Design

According to Aaker et al (2002), a research design as the detailed blue print used to guide a research study towards its objectives. According to the definition a research design is a detailed plan of work to be done to achieve the research objectives. Similarly, it is the conceptual structure within which research is conducted; it constitutes the blueprint for the collections measurement and analysis of data. Kothari (2004) research design is the arrangement of conditions for collections and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure.

This research was guided by a descriptive research design as defined by Churchill (1976), that a descriptive study is concerned with either determining the frequency with which something occurs or relationship between variables. Here both desk research and field research have been employed. The data for this research was collected, sampled, analyzed and eventually research report was written basing on the research finding.

The study uses the quantitative data and description analysis and demonstration.

3.3 Area of the Study

The study examined the extent to which banking privatization, are affected by rules, policies and regulations when such strategy is applied. Either, the researcher analyzed possible ways to help to show the impact of privatizing banks and used NBC Bank as a case study.

3.4 The Population of the Study

In this study the population comprised of banks which are previously being state owned and later privatized.

3.5 Variables and their Measurements

The researcher examined various variables such as loan and advance loan, interest rate, customer deposit, number of employees, cost of operation and number of branches.

3.6 Sample size and Sampling Techniques

The researcher started with a broad number of banks operating at the moment and screened to get the bank available before privatization. The researcher sampling strategy was to have the privatized bank operating currently and was present before privatization. The researcher ended up with NBC 1997 limited which was initial National bank of commerce. It was split into two banks the current NBC 1997 limited and National microfinance bank. The bank was privatized in 2000 and the two banks occurred National microfinance bank was later being privatized in 2005.

3.7 Types and Sources of Data

In accordance to the nature of the study and aim of collecting data that met the objective of the study, 2 (two) methods of data collection was employed. These included documentary review and library search.

3.8 Data Collection Techniques and Instruments

Since the data for this study fell under both sources of data i.e. Secondary and primary data, the following methods were employed for collecting data.

3.9 Data Collection Techniques

3.9.1 Documentary Review

Document review (also known as doc review) is the process whereby each party to a case sorts through and analyzes the documents and data they possess (and later the documents and data supplied by their opponents through discovery) to determine which are sensitive or otherwise relevant to the case. Document Review is a valuable main staple of the type of work performed by attorneys for their clients, though it is increasingly common for the work to be performed by specialized document review attorneys.

Also this technique involved activities which include; identifying, reading, evaluating, describing, summarizing, discussing, sighting and synthesizing various documents with information related to the problem under investigation. The aim is to incorporate them in the study. In this study, desk research is used to collect information from different sources such as bylaw that govern banks operation, internal regulations of banks and Financials of these banks.

3.9.2 Library Search

Library search was done at NBC library, Bank of Tanzania library and Institute of finance and management (IFM).also search was done on internet for various website and World bank website, IMF website and other thesis already done in Mzumbe Dar es salaam branch library, also review was done on various published journals for finance and accounts in national board of accountants and auditors (NBAA) and also other review was done at Tanzania instate of bankers (TIB).also the library of university of Dar-es saalam.

3.10 Data Analysis Methods

The study design stated above demanded this research to cover historical records and currently published materials. Therefore, it would be very helpful for the research to use excels and strata 11 to do the analysis and the strata output was the statistical description other results outputs. Moreover, since part of information was in the form of description such as regulations and policies, other analyzing methods other than computer were utilized. Data analysis has multiple facets and approaches, data presentation were done using tables and graphs.

CHAPTER FOUR

FINDINGS AND DISCUSSION

4.1 Introduction

This chapter presents results and discussion of the study. The result is in two parts, information description and statistical description.

4.2 Performance of Banking Sector

The study find out that as a results of privatization and privatization policy in place the number of banks and financial institutions increases significantly from four (4) state owned banks prior to the privatization policy up to thirty two (32) by the year 2012 (Table4.1). This is a significant increase in number of banks and financial institutions which provide a wide range of services and financial products to a wider population, also number of branches increases for both bank being privatized and that being established after the government step aside and let the private sector to deal with business of bank and government to remain as the supervisor,

Customer deposit increases as the citizen get knowledge of importance of using banking service for their own benefit, as they have to make their saving so reduce the risk of being stolen in their houses, Loan and Advance are the product that generate revenue to banks, since the bank industry has been privatized this product increase dramatically as the competition between the bank increase too, so banks offer loan with good rate of return than what has been offered before. Operation cost increases due to expansion of banks from urban to the place where there were not before such as rural areas, also due to recruited of new staffs for working in the new branches . From his picture privatization has a positive impact in bringing banks services close to wider population.

Table 4.1: Number of Banks

Prior privatization	NBC
	THB
	CRDB
	People banks of Zanzibar
After privatisation	(32 Banks) AccessBank Tanzania,Advans Bank Tanzania,Akiba Commercial Bank,Azania Bank,BancABC,Bank M,Bank of Africa,Bank of Baroda (Tanzania),Bank of India (Tanzania),Barclays Bank Tanzania,Citibank,Commercial Bank of Africa (Tanzania),CRDB,Bank,DCB Commercial Bank,Diamond Trust Bank Tanzania,Ecobank,Equity Bank (Tanzania),Exim Bank (Tanzania),First National Bank of Tanzania,FBME Bank,Habib African Bank,I&M Bank (Tanzania),International Commercial Bank,Kenya Commercial Bank,Mkombozi Commercial Bank,National Bank of Commerce (Tanzania),National Microfinance Bank,NIC Bank Tanzania,People's Bank of Zanzibar,Stanbic BankStandard, Chartered Bank,United Bank for Africa.
	(8 Region) banks,Kilimanjaro Co-operative Bank,KageraFarmers Co-operative Bank,Mbinga Community Bank,Mufindi Community Bank,Mwanga Community Bank,Njombe Community Bank,Uchumi Commercial Bank,TandahimbaCommunity Bank
	5 Listed financial institutions– Tanzania Investment Bank,Tanzania Postal Bank,Twiga Bancorp Limited,Efatha Bank Limited,Tanzania Women's Bank LimitedA
	postal 3 banks – bank,
	TIB

Source: The Researcher’s Analysis, 2013

4.2 Financial Products

The study reveals out that privatization has brought up a tremendously increase in number of financial products of NBC bank. This is due to increase competition with other banks which provide a number of innovative financial products to their customers and also due to technology advancement which allows banks to provide services which were not possible during the error prior privatization as automatic teller machine (ATM) serving customers for 24 hours (Table 4.2).

Table 4.2: Financial products and type of service (product)

Prio Privatization	Retail banking	Savings
		Fixed account
	Corporate	Saving
		Fixed account
		Current account
After privatization	Retail Banking	Savings
		Fixed account
		group loan
		personal loan
		unsecured loan
		internet banking
		on line payment
		payroll processing
	Corporate Banking	Terms loan
		SME business unit
		International trade,
		International banking
	Treasury Products	spot foreign exchange
		Foreign exchange forward money market deposit treasury bills & bonds buying foreign exchange option
		interest rates swaps

Source; The Researcher's Analysis, 2013

4.3 Key Banks Performance Indicators (KPIs)

The result shows that the operation cost increases from 2004 to 2011 as the banks expanded. The cost rises by 260% due to increasing in the number of branches by 71%. The increase in branches leads to the need of more employees, and from 2004 to 2011 the number of employee rises by 36%. This situation reveals that privatization lead increase in efficiency in provision of banking services to its customers, as the banks expands by opening new branches in strategic areas, the increase is 71% also and the number of employee increases by half of branches increase.

Table 4.3: Key Banks Performance Indicators

Category	% change 2004 - 2011
Operation Cost	260.4
Customer Deposit (Tshs)	244.4
Loan & Advance (Tshs)	11.3
Interest Rate	(14.5)
No. of Employee	36.5
No. of Branches	71.0
No. of Service (Products)	136.4

Source; The Researcher's Analysis, 2013

Expansion resulted from privatization increased customer deposit by 244%, loan and advance loan by 11% from 2004 to 2011. This is stipulated by the bank designing a number of new products. The number of bank product rises by 136% in a duration of 7 years. These new product are design to attract new customers and also to cater the requirements of time as technology advance and to enable the bank to compete with other banks in the market. Some of this product includes SIM banking, Islamic banking etc.

The most important advantage of privatization is the fall of cost of lending money from the bank. Interest rate falls by 14% in duration of 7 years, from 2004 to 2011.
Privatization is envisaged to foster competition, ensuring greater capital investment, competitiveness and modernization, resulting in enhancement of employment and provision of improved quality of products and services to the consumers and reduction in the fiscal burden.
Private sector bank loans growth is faster as compared to public sector banks. There was a great increase in the efficiency of the private banks as the control over bank employees increases.
Private sector banks provide many additional services to its customers.

There are less job security in case of private banks. Interference and manipulation by the politician and industrialist is in full swing. In some cases, bank loans were used to garner votes.

Previously the public money was safeguard through Deposit Insurance Corporation but now this corporation is abolished. Since now in the private banks government has less control over the bank activities, Private sector use private recovering agencies tore cover bad loans. These agencies uses wrong means and force tore cover loans from people .Some people even commit suicide under the pressure of the recovery agents.

4.5. Drivers for Privatizing Banking Industry

The basic driver that led the banking industry to be privatized in Tanzania is the impact of bank failure, if the impact of bank failure is large, if the failing bank is considered as a too big to fail because it trigger the collapse of the entire banking system of the economy as the whole. Considering the importance of the TBTB, it has been common for the government to intervene and bail out such failing banks for example in 1991 the government was forces to save the national bank of commerce (NBC) which was a too big to fail bank by advancing it a sum of 18,886,550,000 TSHS in the form of government bonds to cover for its nonperforming loans

As we know that loan are the sources of income for every bank, so if there is poor loan performance it result to bank fail, so the government decide to privatize the national bank because it was operated under loss, to secure failing of the entire banking system and the economy the government had no option rather than to privatize the bank so that it begin to run under profit.

4.6 Challenges Encountered in Performance Due to Privatization

Given the persistent fragility of Tanzania bank industry and difficult conditions for banks that are dependent on wholesale funding, we believe that the key challenges for a successful privatization are:

(i) Developing a viable business model in the face of changing regulatory requirements and an impaired franchise DEPFA's business model is impaired. DEPFA's business focus is public financing through covered bonds. The group's legacy business model was based on a long-term, low-yielding covered bond business, dependent on wholesale funding and the

aggressive use of leverage. Its assets comprised predominantly low risk-weighted public sector exposure. New regulatory requirements will impose a strict leverage cap, and capital and liquidity constraints on long-term lending, which could invalidate the future viability of DEPFA's legacy business model.

In addition, the bank is exposed to risks associated with the reliance of its business model on senior unsecured funding in the wholesale market for new business. Banks in the Tanzania area have faced severely restricted access to wholesale funding markets during the financial crisis, and markets only stabilized on the back of the ECB's large liquidity provision to banks, If the buyer chooses to reinvigorate the business model and broaden its scope, investment is needed.

To develop a business proposition that complies with future regulatory requirements will, in our view, require significant adjustment. Reinvigorating DEPFA's covered bond platform is likely to require a broader scope than just public finance which would require additional investments in technology and people.

Potential **c**onstraints imposed on the buyer by the Tanzania regulator and / or the Commission Tanzania regulators will have to approve ownership changes, thereby requiring any new owner to show the necessary commitment and financial strength to ensure long-term stability for DEPFA group as well as the Tanzanian banking system and its covered bond market. Such conditions add further impediments to the economic value of such transaction for a buyer, and compliance with these conditions may be difficult for all but the financially strongest interested parties. The Tanzania Commission would need to approve the sale too, in the case that DEPFA is reprivatised before year-end.

4.7 Impact on Performance of Banking Sector before and After Privatization

There is a major positive effect by privatizing bank industry due to great changes done by those who might have taken the business by expand the business which result increase in employment, increase number of branches which brought services near citizen, also they brought new technologies which facilitate the use of bank services without being in the bank premises for example the use ATM machine, Internet Banking, On line payment service example –purchase of Luku, Telephone credits and the payroll processing service

4.7.1 Impact on Employment

One of the most common fears associated with privatization worldwide is certainly job destruction. Given the size of the public sector in Sub-Saharan Africa, similar fears have and continue to be nurtured. Here again, data is scarce and incomplete, and exhibits large variation across sectors and countries. Available studies and information point to the following observations:

Employment has been adversely affected mainly in the period leading up to privatization or in case of liquidation Even if the work force of privatized/liquidated firms diminished in relative terms, there has not been massive layoffs in absolute terms. In some countries, retrenchment packages have become a serious issue, however. e Although the general trend is a continuous decline in employment levels over time, there are a few cases where employment increased in the years following privatization, reflecting good performance and new business opportunities

The first observation reflects the expected pre-sale "cleaning up" of many parastatals, where overstaffing and redundant labor force was a major issue. The second observation reflects the fact that first and foremost, government have deliberately delayed privatizing enterprises where a high social cost could be expected31, which also explains why privatizations have targeted by and large small and medium-sized SOEs. Employment of the privatized Banking sector increase by about 36.5% between 1997 and 2012, interestingly, although the layoffs were largely

concentrated in the earlier years, employment increased on a continuous basis until 2012. As for firm performance, it is perhaps best to describe the employment effects in terms of "damage control" for the time being.

Workers and trade unions opposition to privatization has been a major factor behind the delay of the privatization process in a number of countries, and more particularly in, Tanzania in the mid-1990s. This has resulted in harsh negotiations about retrenchment benefits, which have not only deterred potential investors but also exhausted a sizable portion of privatization receipts in a number of cases. In some countries (e.g. Benin, Mozambique, Zambia), employment guarantees have been used as bidding conditions, with various degrees of success. The best-known failure in imposing employment guarantees is the case of the Luanshya and Baluba copper mines in Zambia

4.7.2 Impact on Deposits

Deposit has been increased dramatically each year as the customer of the bank got the knowledge and see the importance of put their money in the banks, by opening variety of account as they willing if you see the deposit from customer increase by more than 200% for the period of 2004-2012 this result to the good performance by the bank in the industry as well as the competition between the bank to offer services to their customer.

4.7.3 Impact on Technologies

Before privatization banks in Tanzania the technologies was very low, as we remember there was no electronic transfer for money the issue of clearing of cheques was very slow it takes 3-6 weeks to clear cheques,but after privatization we see there is huge change as the new technologies are being imported by the new owner of these bank, as we see there are new branches open with ATMs facilities than can help the customer of the bank to draw or deposit their money without being enter on the bank premises, also we see the discovery of sim banking introduced this days where the customer can have the power of control his account through his/her mobile phone,

Also there is a new system of salary payment introduced by banks so that they help the employer to pay salary by just click one button and every employee get his salary at time and without any inconvenience.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter is categorizing into four parts i.e. conclusion and remarks, recommendations, policy implications and areas for further research.

5.2 Conclusion

This paper has analyses the banking sector in Tanzania and the impact of privatization of the bank industry to the development of the economy, it has argued for the positive part of the process of privatizations for example the number of branches of banks increases, number of people who were able to get employment has been increases, number of service (products) offered also increases due to development of science and technologies imposed by the new owner of these banks.

In addition there has been improvement in other aspects also. To a common man this is most vividly visible in the operational improvement of the private banks with a pulling effect on public sector banks as well. There has been a modernization in the procedures which are being streamlined and upgraded. The transaction of accounts has been centralized so that the peripheral arms of the banks can concentrate on better service delivery. The procedures are also being automated through ever increasing establishments of ATM machines. This scramble was more efficient in early 2000s and now there is a sufficient network, especially in major urban centers.

I have emphasized the need for the regulatory Authority to continue create good environment and policy for investors and not to relax on criteria for entry and suggest that the Authority must keep its eye open to ensure smooth and stable banking system also create policy that would bun capital repatriation in order to use that capital for expansions purpose that can result in quickly economic development.

5.3 Recommendation

The researcher examined the problems encountered by privatized banks in their performance and relations with employees and come up with the following recommendation.

(i) The Government must conduct a thorough review on the policies related to the ways of leaving the banks to be privately operated and regulate and see to the possibility of removing some parts to that agreement, which have detrimental impacts to the local bank experts regarding their employment.

(ii) Stable and continuing aggressive portfolio management in a way that there should be a designated officer to review every few days approaching end of the month so as they observe the disparities for the clients who have not deposited the money in their accounts and call them to regularize their accounts before they default, 'prevention is better than curing.

(iii) Privatizing authorities should perform financial, legal and managerial due diligence ofthe prospective buyers. In its enthusiasm for prolific privatization, banking assets should not be sold to ill equipped and ill trained parties.

(iv) It is more prudent to have a few strong banks than a mushroom growth of very small banks; balkanization of the banking sector is not recommended.

(v) Normally the problems confronting the new owner of a privatized bank can be boiled down to a legacy of NPLs from old regime, poorly qualified and ill trained manpower (as a result of recruitment emanating from nepotism or favoritism by the bureaucrats and politicians) and a lousy and archaic equipment.

(vi) The problems can be solved by replacement of new manpower attuned to regular incremental training programmes. In Tanzania this change of management did not raise any employment related issues thanks to generous golden hand shake schemes. This also implies that it may not be possible if

privatization has been done through other than equity sale i.e. if privatization has been done through IPOs and GDRs etc.

(vii) However the single most important prerequisite for successful privatization is a Concurrent establishment of a strong regulatory regime. In its absence the financial sector can succumb to the vicious exploitation of the profit oriented private bankers. This in the end can be even more pernicious than the inefficiency of public sector banking.

5.4 Policy Implications

The Bank and Financial Institution policy is guided by a vision of achieving widespread access to the Banks throughout the country made possible by Financial Institutions operating on commercial principles. Only through a focus on long term sustainability will the majority of low income people have a chance of gaining access to financial service in more operational terms, best practice principles are compatible with the achievement of building strategies towards the policy vision.

With a view to meeting the demands of modern business practice and catering for the needs of the local and international banking sector, the government of Tanzania repealed the Banking and Financial Institution Act 1991, Cap 342 (the "**BFIA '91**") and replaced it with the Banking and Financial Institutions Act 2006 (the "**BFIA '06**"). The bill was presented to the National Assembly by the Minister for Finance on 28 March 2006 and passed by the National Assembly on 3 March 2006. The date this new law comes into force will be notified through the National Gazette. However, even though this new is 'not yet in force' it is quite likely that its effective date will be backdated to the date it was passed by the Parliament, failing which it will be the date it receives Presidential assent. Notwithstanding this legislative process, it is also sensible to assume that the Bank of Tanzania (the "**BoT**") and the financial institutions affected by this new law are most likely already conducting themselves with its existence in mind.

The primary objective of the BFIA '06 (as stated in its "objects" and "reasons") is to establish a framework for the comprehensive regulation and supervision of banks and

financial institutions in Tanzania , and to ensure the stability, safety and soundness of the financial system with the aim of reducing the risk of loss to depositors.

Being a fairly wide-ranging Act, there are a number of elements of the BFIA ’06 which will be of interest to those investing in Tanzania , the principal ones of which are listed below. The BFIA ‘06 vests a greater independence in the BoT than its predecessor, by granting the BoT certain powers relating to the licensing, regulating and supervising of banks and financial institutions in Tanzania. For instance, the power to ensure banks maintain a prescribed minimum core capital, to ensure that a bank’s total capital does not fall below 12% of its total risk, to prescribe and enforce a liquid assets ratio, to enforce financial reporting to the BoT, etc

5.5 Area for Further Research

Area for further research includes sources of financing to the foreign private investors and desired ways of running banking industry publicly.

Also thorough understanding of the impact of privatization would necessitate microeconomic studies that look at the effects of changes in ownership on firm performance and macroeconomic studies that study the overall impact of privatization programmes on fiscal balances, foreign direct investment and employment. The distributional implications of privatization also need to bead dressed, at both the firm level and the aggregate national level. It is obviousthat many more studies of this nature are needed to arrive at firm conclusions regarding the economic consequences of privatization in developing countries.

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