DETERMINANTS OF PROFITABILITY OF DOMESTIC AND FOREIGN COMMERCIAL BANKS IN TANZANIA
A CASE OF COMMERCIAL BANKS LISTED IN DSE

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By

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A dissertation submitted in partial fulfilment of the requirements for Masters of Science in Accounting and Finance (MSc A & F) of Mzumbe University.

2013

CERTIFICATION

We, undersigned, certifies that we have read and hereby recommend for acceptance by the Mzumbe University a Dissertation titled **“Determinants of Profitability of Domestic and Foreign Commercial Banks in Tanzania: A Case of Commercial Banks Listed in DSE”** in partial fulfillment of the requirements for the Degree of Master of Science in Accounting and Finance (Msc A & F) of Mzumbe University.

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DECLARATION AND COPYRIGHT

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

Signature______________________________

Date__________________________________

ACKNOWLEDGEMENTS

My deepest and warmest thank goes to the Almighty God and his mother Sanity Marry, who help me in all aspect of my life including the achievement of this masters program.

Apart from the efforts of myself, the success of any dissertation depends largely on the encouragement and guidelines of many others. I take this opportunity to express my gratitude to the people who have been instrumental in the successful completion of this dissertation.

I would also like to show my greatest appreciation to my supervisor Prof. C. Prem Chander. I cannot express the extent to which his patience and understanding allowed me to reach the end of this journey. His encouragement, support, and, above all, his prompt, constructive and greatly appreciated criticism and feedback, were invaluable to the research, writing, and completion of this study.

I highly appreciate the contribution of my wife Glory J. Natto, my classmates, my friends wherever they are and my house mates for being my real friends in various aspects of my life.

Lastly, I would also extend my sincere thanks to my parents Ignace Mrema and Emerensiana Sunguya for raising me up and for making my dreams come true. The entire family: brothers Adelard, Gabriel, Ephraim, Philip, Luca and Emmanuel and Sisters Domina, Kasiana (Sr. Stephania), Irene (Sr. MaryHalisi) and Julieth deserve thanks for their moral support.

DEDICATION

I dedicate this work to the Lord Jesus Christ who gives me strength to do all things and my father who taught me that the best kind of knowledge to have is that which is learned for its own sake. It is also dedicated to my mother, who taught me that even the largest task can be accomplished if it is done one step at a time.

ABBREVIATIONS AND ACRONYMS

ACB	Akiba Commercial Bank
BANK ABC	African Bank Corporation
BEP	Basic Earning Power
BOA	Bank of Africa
BOT	Bank of Tanzania
CBA	Commercial Bank of Africa
DANIDA	Danish International Development Agency
DCB	Dar Es Salaam Community Bank
DSE	Dar Es Salaam Stock Exchange
EBIT	Earnings Before Interest And Tax
EBITDA	Earnings Before Interest ,Tax, Depreciation and Amortization
EBT	Earnings Before Tax
FBME	Federal Bank of the Middle East Ltd
FNB	First Nation Bank
GDP	Gross Domestic Product
ICB	International Commercial Bank
IPO	Initial Public Offer
KCB	Kenya Commercial Bank
NBC	National Bank of Commerce
NIC BANK	National Industrial and Commercial Bank Tanzania Limited
NMB	National Microfinance Bank
PPF	Parastatal Pensions Fund
ROA	Return On Asset
ROE	Return On Equity
SME	Small and Medium Enterprises
TATO	Total Asset Turn Over
UBA	United Bank Of Africa
USA	United States Of America

ABSTRACT

This study examines the determinants of commercial bank's profitability in Tanzania. These determinants have been categorized into internal factors which are bank-specific characteristics and external factors which can further be divided into macroeconomic factors and financial structure factors. The main objective of the study is to determine the factors that influence commercial banks profitability in Tanzania and to make recommendations for management decision making and policy objectives.

A panel data of commercial banks in Tanzania was analyzed taking into consideration of 4 Banks listed in DSE. Two key measures of profitability (dependent variables) were taken into consideration, but the purpose of making a regression analysis and analyze the relationship between the parameters, the researcher analyzed only ROA in his study. Bank-specific factors, which were incorporated, were capital adequacy, deposits, liquidity, asset quality, loans and advances. In addition, macroeconomic factors and financial structure factors including inflation, GDP, money supply and banking industry concentration.

The results for the ROA model indicate that loans and advances to total deposits, customer deposits to total assets (liquidity) are positively significant to bank profitability while shareholders equity to total assets are negatively significant to bank profitability. Moreover, inflation and GDP were positively significant to bank profitability. Also, highly capitalized banks were seen to be more profitable compare to less capitalized one. The study recommended on reduction of expenses, Government policies on employment and investments should be intensified to increase the profitability, Efficient and effective liquidity management should be adopted and there should be a set of direction guideline to manage properly bank-specific determinants. The study made a researcher to learn that financial performance performed by banks plays a significant role in assuring and maintaining stability of the countries' economic systems.

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CHAPTER ONE

INTRODUCTION

Financial sector play a vital role in the economic development of any country. The existence of Banking Financial Institutions and Non-Banking Financial Institutions, supported by efficient money market and capital market keeps the financial system complete, while enhancing the overall growth of the economy. Financial institutions play the role of financial intermediation by collecting and mobilizing resources to finance business and development projects that are essential for economic development. An efficient financial system is a prerequisite for proper financial intermediation leading to sustainable private sector investment and the promotion of entrepreneurship. As such, an understanding of the determinants of the profitability of financial institutions such as the banks is essential and crucial to the stability of the economy.

Given the relation between the well-being of the banking sector and the growth of the economy (Rajan & Zingales, 1998; Levine, 1998), knowledge of the underlying factors that influence the financial sector's profitability is therefore essential not only for the managers of the banks, but also for numerous stakeholders such as the central banks, bankers associations, governments, and other financial authorities. Knowledge of these factors would be useful in helping the regulatory authorities and bank managers formulate future policies aimed at improving the profitability of the Tanzanian banking sector.

The determinants of profitability are empirically well explored although the definition of profitability varies among studies. Disregarding the profitability measures, most of the banking studies have noticed that the capital ratio, loan loss provisions and expense control are important drivers of high profitability. In this study, the drivers that were considered are in two categories; endogenous (internal) and exogenous (external) drivers or factors of profitability.

Internal drivers of bank performance or profitability can be defined as factors that are influenced by a bank‘s management decisions. Such management effects will definitely affect the operating results of banks. Although a quality management leads to a good bank performance, it is difficult, if not impossible, to assess management quality directly. In fact, it is implicitly assumed that such a quality will be reflected in the operating performance. As such, it is not uncommon to examine a bank‘s performance in terms of those financial variables found in financial statements, such as the statement of financial position (balance sheet) and statement of comprehensive income(income statement).

External determinants of bank profitability are factors that are beyond the control of a bank‘s management. They represent events outside the influence of the bank. However, the management can anticipate changes in the external environment and try to position the institution to take advantage of anticipated developments. The two major components of the external determinants are macroeconomic factors and financial structure factors.

Due to the changing banking environment, profitability which is one of the most important criteria to measure performance of banks has come under intense pressure. Profitability is critical to the survival of commercial banks. Firstly, dividends are paid from profits (cash profits) and secondly, profit is an important source of retained earnings. Retained earnings are residual profits after dividends are paid. These earnings are important component of bank capital.

Failure in the banking system may have deep economic repercussion for the economy at large. Secondly, banking sector reforms are likely to affect the way banks operate and thus their performance. Finally, bank profitability is an important source of retained earnings; a very important component of bank capitalization, providing a margin of protection during recessionary periods, and enabling the banks to be more resilient against external shocks.

This study examined the profitability of the selected commercial banks in Tanzania listed in DSE (CRDB, NMB, KCB and DCB) and investigated the key value drivers of profitability of the commercial banks in Tanzania. It was believed that both endogenous and exogenous variables cannot be disjointed when considering strategic policies aimed at improving upon the performance/profitability of commercial banks.

1.1 Background.

The Tanzania banking sector embarked on a plan for financial liberalization in 1992 in order to sustain its economic growth. This has been accomplished through the mobilization of financial resources as well as by increasing competition in the financial market and by enhancing the quality and efficiency of credit allocation. As a result of the liberalization, the banking sector in Tanzania has been booming. The total assets have increased by 60 percent, from $ 1.7 billion at the end of 1999 to $ 2.7 billion at the end of June 2004.

Because of this, new merchant banks, commercial banks, bureau de change, insurance companies, a stock exchange and related financial units have entered the market. With a total of 27 banks and a few non-banking financial institutions, which are not allowed to open current accounts, the market is characterized by a few big players and several small banks. In Tanzania, 90 percent of deposits are in the hands of eight banking institutions, namely three local banks and five foreign banks. Local banks primarily service local customers while foreign banks tend to operate as subsidiaries of large groups, such as Citigroup and Barclays, using strategies oriented to the international market.

As a consequence, foreign banks focus on international customers and national clients who prefer to keep their deposits in foreign currencies. There are four categories of banks, oriented towards different markets and clientele operating in Tanzania: local private banks, regional banks, international banks and multinational banks. Overall, the outlook for the banking industry in Tanzania is very positive and there are appealing opportunities for new comers to the sector.

Currently, there is a positive trend in lending to SMEs that is producing greater confidence in their growth potential among financial institutions and, more generally, in the economy as well, which is generating a positive spiral. In addition, the government is also introducing new laws that are expected to enhance lending activities. (http://www.tanzaniainvest.com/tanzania-banking-sector).

1.2 Statement of the problem

A lot of studies conducted in the area of commercial banking profitability and its determinant by considering the importance of the area at international level. (Rajan & Zingales, 1998; Eichengreen & Gibson, 2001; Bourke, 1989) verified that there is a direct association between profitability of commercial banking industry and it's both internal and external determinants. Even though, all these and other researchers conducted study on this area, the determinants of profitability have been debated for many years and still unsolved issues in the corporate finance literature. According to (Flamini et al., 2009) said that what makes the profit determinants debate exciting is the determinant of profit is dynamic through time to time and differ with the nature of operating of the firm from place to place.

To sum up, there is no universally accepted findings to the determinants of profitability of the banking sector. Countries differ from each other by their economic systems, financial systems, political systems and operating environments. Thus in this study, the researcher examined some bank specific (internal), microeconomic and financial structure factors as determinants of profitability of Tanzanian commercial banks, and a variety of variables that are potentially responsible for determining profitability of banks have been selected based on the selected theoretical literatures and previous empirical works. Although, numbers of earlier studies have made to add their own contribution to the theory of profitability and stated their own policy implication, they were inclined towards to the developed economy, and less developed countries including Tanzania received little attention in various literatures on this issue.

This thesis seeks to research into the main factors influencing profitability and survival of the commercial Banking industry in Tanzania. What are the main determinants of profitability of domestic and foreign commercial banks in Tanzania?

1.3 Research questions.

Based on my study the following questions were answered:

1) What are the determinants of profitability in Tanzanian Banking industry?
2) What are the bank-specific, industry specific, macroeconomic and financial structure factors of determinants of profitability of commercial banks in Tanzania?
3) Which factors are controllable by management to impact profitability of commercial banks in Tanzania?

1.4 Research objectives

The objectives of a research project summarize what was to be achieved by the study. These objectives should be closely related to the research problem. The general objective of a study states what researchers expect to achieve by the study in general terms. It is possible (and advisable) to break down a general objective into smaller, logically connected parts. These are normally referred to as specific objectives. Specific objectives should systematically address the various research questions. They should specify what you will do in your study, where and for what purpose.

In commercial banking industry of Tanzania no sufficient study was conducted on the both internal and external determinants of commercial banks profitability. Because of this, the Tanzanian commercial banks managers and policy makers have not clearly identified and understand the determinants of banks profitability. So, the objective of this paper can be stated as follows;

i) Main objective

The main objective of the study was to find out about the main determinants of commercial banks profitability in Tanzania.

ii) Specific objectives

1) To access and analyze the extent of bank-specific (internal) determinants effect on profitability of commercial banking industry in Tanzania.

2) To check the effects of external (both industry specific and macroeconomic) determinants on profitability of Tanzanian commercial banks.
3) To identify the behavior of market structure of Tanzanian commercial banking over the past four years from 2009 to 2012.
4) To know the significant determinants of profitability across the government owned and private commercial banks.

1.5 Scope and significance of the study

The study based on the commercial banks listed on DSE. The study explored to determine the factors that influence profitability of Domestic and Foreign commercial Banks in Tanzania.

The scope of the study was limited for studying the impact of internal and external factors that impact on the profitability of banks, comprising of expenses management, capital adequacy, liquidity, asset quality, Bank size, GDP, inflation, and money supply. But not only these, there were other factors that impacted on profitability of commercial banks which were also discussed in this study but not limited to corporate governance, political stability, taxation, regulation indicators, quality of services and technological advancement.

Therefore, this study has ultimate significance to show the degree of the bank-specific, industry specific and macroeconomic determinants in what extent it affected the profitability of the commercial banks, by identifying and showed the main determinants of profitability and to suggest policy implications after critical examination of the profitability determinants of the commercial banking industry in Tanzania. Particularly this study has importance for the following body.

The following are the significance of the study;

1. The findings of the study save as a guide for the future reference to scholars other researchers in case they endeavor into conducting further study on a similar problem.

2. The information provided by this thesis could also offer investors some background information on investment in the Tanzanian banking sector and to measure the performance of their portfolios and proceed with readjustments as required.
3. This thesis may offer banks some solution to their challenges by unraveling the mystery surrounding the survival and the profitability of the banks in a third world country like Tanzania.
4. It will give direction for economic policy makers to measure the impact of the bank industry performance on the economy and its implications on the issues of policy.
5. It will create awareness to the public on how banks are making profit and some of the hindrance towards on their way of profit making as well as where to deposit their money.
6. It enables policy makers and management body of the commercial banks to adjust the bank management system and mechanisms.
7. It gives all stakeholders in the area of the opportunity to gain deep knowledge about the relationship of internal and external factors and profitability.
8. The research adds knowledge to the researchers.

1.6 Limitation and delimitation of the study

Limitation of the study

Due to their busy working environment the respondents to the questionnaire did not spend enough time to enable the researcher get the correct responses. Some respondents required a lot convincing in filling the questionnaire since they were be afraid of divulging the information which could possibly be used against them by competitors. Other respondents did not understand the kind of answers which were required and a great deal of time was spent trying to explain what was actually necessary. Limitations faced include;

1. Most of respondent were too busy for answering the interview question or filling out the questioner due to their activity and time limit.

2. Reluctant. Since the topic touches economic affairs majority of them were reluctant in responding and some gave wrong answers fearing for competitors capturing their business ideas.
3. It was hard to meet with everyone to make conversation with because of many factors like cost.
4. It was also hard to access other information as they were for confidential purposes.

Delimitation of the problem

1. The researcher prepared the questioner in the way that the answers were with ended answers. For example the questioner have questions of multiple choices to avoided open ended (where possible) questions to save time and capture the attention of the respondents.
2. Researcher utilizes internet to access banking information.
3. It was easy for researcher to give a trust of confidentiality of the data obtained that will on be used for writing academic research thesis.
4. Researcher asked for more familiar persons who have a clear knowledge rather than taking time to interview each and every body or every unit.

1.7 Organization of the dissertation

This dissertation consists of five chapters with different sections and sub-sections and it is structured as follows. Chapter one presents the introduction for the main part of the dissertation. Chapter two reviews the most significant theoretical and empirical studies. Chapter three is about the methodology of the study. Chapter four provides data presentation, analysis and discussion of the findings for this study and the final chapter is Chapter five which gives summary, conclusion, recommendation and further research study direction.

CHAPTER TWO

LITERATURE REVIEW

The literature review tries to give the theoretical base of the study. It should explain what the previous researcher does about the topic of the study and describes the current state of the knowledge in the field of study. In this chapter, literature theoretical and empirical reviewed are presented together with conceptual framework.

2.1 Theoretical Literature Review

There is an extensive body of literature that seeks to identify the determinants of bank performance. While some studies focus on the understanding of bank profitability in a particular country, others concentrate their analysis on a panel of countries. No matter whether it is a single country or a panel of countries study, the determinants of bank profitability can be divided into two main categories, namely internal factors and external factors.

2.1.1 Internal determinants

According to Husni (2011) the internal determinants of banks profitability are normally consisting of factors that are within the control of commercial banks. They are the factors which affect the revenue and the cost of the banks. Some studies classified them into two categories namely the financial statement variables and non-financial variables. The financial statement variables include factors that are directly related to the bank's balance sheet and income statement. Whiles, the nonfinancial statement variables include factors like the number of branches of a particular bank, location and size of the bank etc; Haron, Sudin (2004).

The internal determinants of profitability can be defined as those factors that are influenced by the banks management decisions and policy objectives. The internal determinants may include but not limited to the size and location of branches, operational efficiency, marketing competencies, management competencies, motivation, quality and strategy. While it may be difficult if not impossible to assess some of these variables, they are implicitly reflected in the operating performance of the banks which can be derived from statement of financial position (Balance sheet) and statement of comprehensive income (income statements) of the firms under study. It is therefore not surprising that earlier studies have employed financial ratios as proxies to measure internal determinants. In this study, the relationships and impacts of Operating Efficiency, Capital Adequacy, Liquidity, Asset Quality, loan and advances and Bank size on profitability are analyzed.

Operating Efficiency

The Expense to Income ratio is used as proxy for operating efficiency. The Expense to Income ratio is defined as the operating costs over total generated revenues. The major elements of operating cost are staff salaries and administrative cost. It is used to measure the impact of efficiency on bank profitability. It is also used to provide information on the variation of bank cost over the banking system. A negative correlation is expected between the operating cost and profitability implying that higher operating cost means lower profit and vice-versa. However, this may not be the case as higher amounts of operating cost could also reflect higher volume of banking activities.

Capital Adequacy

The ratio of Equity to total Asset is employed as a measure for bank Capital Adequacy. This measures the percentage of the total asset that is financed with equity capital. Capital adequacy therefore describes the sufficiency of the amount of equity that can absorb shocks that banks may experience. It is expected that the higher the Equity to Asset ratio, the lower the need for external funding and therefore the higher the profitability of the bank. In addition, well capitalized banks face a lower cost of going bankrupt which reduces their cost of funding (Kosmidou, 2008).

But that is not all Banks with higher capital to asset ratio are considered relatively safer and tend to have a better margin of cushion, remaining profitable even during economically difficult times. Conversely, banks with lower capital adequacy are considered riskier relative to highly capitalized banks. Thinking in line with the conventional Risk Return Hypothesis, we anticipate an inverse relationship between capital adequacy and profitability. Considering the fact that capital adequacy may have an ambiguous effect on profitability, theoretical expectation of capital adequacy remains a puzzle to be answered by empirical investigation.

Deposits

Banks are said to be heavily dependent on the funds mainly provided by the public as deposits to finance the loans being offered to the customers. There is a general notion that deposits are the cheapest sources of funds for banks and so to this extent deposits have positive impact on banks profitability if the demand for bank loans is very high. That is, the more deposits commercial bank is able accumulate the greater is its capacity to offer more loans and make profits; Devinaga Rasiah (2010). However, one should be aware that if banks loans are not high in demand, having more deposits could decrease earnings and may result in low profit for the banks. This is because deposits like Fixed, Time or Term deposits attract high interest from the banks to the depositors, Devinaga Rasiah (2010). Investigation done by Husni (2011) on the determinants commercial banks performance in Jordan disclosed that there is significant positive relationship between ROA and Total liability to total Assets. To capture deposits in the model Anna P. I. Vong et al (2009) presented the effect of deposits (DETA) on profitability as deposits to total assets ratio.

Liquidity

Liquidity measures the ability of banks to meet short-term obligation or commitments when they fall due. Traditionally, banks take deposit from customers and give out loans. For this reason, the ratio of bank’s advances to customer deposits is used as proxy for liquidity. Liquidity is a prime concern for banks and the shortage of liquidity can trigger bank failure. Banking regulators also view liquidity as a major concern. This is because banks without sufficient liquidity to meet demands of their depositors risk experiencing bank run. Holding assets in a highly liquid form tends to reduce income as liquid asset are associated with lower rates of return. For instance, cash which is the most liquid of all assets is a non earning asset. It would therefore be expected that higher liquidity would negatively correlates with profitability. Indeed, Molyneux et al., (1992) and Guru et al. (1999) discovered that negative correlation exists between the level of liquidity and profitability. However, Bourke (1989), and Kosmidou et al. (2005) found a significant positive relationship between liquidity and bank profit.

Asset Quality

The ratio of provision for bad debt to advances is adopted as proxy for asset quality. This measure reflects changes in the health of the bank loan portfolio and credit quality. Thus, it is also an indication of credit risk of banks. According to Heffernan (1996), credit risk is the risk that an asset or a loan becomes irrecoverable in the case of outright default, or the risk of delay in the servicing of the loan. Credit risk can have rippling effect thus leading to insolvency (Bessis, 2002). The higher the provision for bad debt to advances ratio, the higher the credit risk and the higher the accumulation of unpaid loan and interest. Additionally, present value of the asset declines, thereby undermining the solvency of a bank. The Risk-Return Hypothesis implies that high risk should be associated with high profitability indicating a positive relationship. However, according to Kosmidou (2008), poor asset quality can have adverse impact on bank profitability, reducing interest income revenue, and by increasing the provisions cost.

Loans and Advances

It is needless to emphasize that extending loans is one of the most other internal determinants of commercial banks. The interest raised from the loans is the most important source of the banks' income. However, inherent with bank's loan is liquidity risk as well as credit risk. In this respect, in extending loans, banks should properly manage such risks. According to Sastrosuwito and Suzuki (2011), it is expected that the more loans, the more interest income, and the more profitable the bank. Loans are the most important indicators of banks performance in the bank financial statements because they reflect the bank's primary activity. Assumed, other variables constant, the higher the rate of transforming deposits into loans, the higher the profitability will be. For that, a positive relation between the loans and banks profitability are expected. On the other hand, if increasing loans leads to higher funding requirements, a negative impact of the loan ratio on the banks profitability may accrue. In their study, Moin (2008) found a significant positive relation between asset composition and profitability.

One of the principal activities of commercial banks is to grant loans to borrowers. Because loans are among the highest yielding assets a bank can add to its balance sheet, and they provide the largest portion of operating revenue. In this respect, the banks are face with liquidity risk since; loans advanced from funds deposited by customers. Following the raising of loan by the bank to generate large interest income, the liquidity risk problems face the bank. Regarding to this Rasiah (2010) describe as follows, ‘‘However, the higher the volume of loans extended the higher the interest income and hence the profit potentials for the commercial banks. At this point, it is also worth noting that banks with a high volume of loans will also face with higher liquidity risk. Thus, the commercial banks need to strike a balance between liquidity and profitability. In addition to the volume of the loans, the quality of the loans would also contribute towards higher profitability. To this extent, it is worth nothing that the non-performing loans can used as an indicator of the loans quality. Hence, the non-performing loans must take into account as a factor. Because this may affect a bank’s interest income and profitability. Furthermore, it must also be noted that higher interest income are not merely a function of higher volume of loans but are in fact also dependent on the lending rates and the interest rate elasticity of loans as well. The interest rate elasticity of loans will depend on the national affluence or national income Moin (2008). Loan and advance is the ratio of loans to total assets. It measuring what percent of total assets is comprises by loans and it gauges the percentage of total assets the bank has invested in loans (or financings). It is also another important ratio that measures the liquidity condition of the bank in terms of its total assets.

Bank Size

In most studies of bank profitability determinants, the total asset is used as a measure for bank size. Bank size is usually used to account for potential economies or diseconomies of scale in the banking sector. Additionally, bank size is associated with diversification which may impact favorably on risk and product portfolio.

Economies of scale will reduce the cost of gathering and processing information (Boyd et al., 1993) so that a positive effect of bank size is associated with profitability. Akhavein et al. (1997) and Smirlock (1985) found a positive and significant relationship between size and bank and profitability. Short (1979) argues, size is closely related to the capital adequacy of a bank since relatively large banks tend to raise less expensive capital and hence, appear more profitable. Haslem (1968), Short (1979), Bourke (1989), Molyneux et al., (1992) Bikker et al., (2002) and Goddard et al., (2004) have all linked bank size to capital ratios, which they claim to be positively related to size. These results imply that as size increases, profitability increases. This is especially true in the case of small to medium-sized banks. On the other hand, increased diversification can reduce risk in the credit portfolio thereby reducing returns. Banks that have become extremely large may exhibit negative relationship between size and profitability as a result of bureaucracy and agency cost. According to Berger et al., (1987), little cost saving can be achieved by increasing the size of a banking firm which suggests that eventually very large banks could face scale inefficiencies.

2.1.2 External determinants

External determinants of bank profitability are factors that are beyond the control of a bank's management. They represent events outside the influence of the bank. However, the management can anticipate changes in the external environment and try to position the institution to take advantage of anticipated developments. The two major components of the external determinants are macroeconomic factors and financial structure factors.

a) Macroeconomic Variables

Macroeconomic conditions may affect banking performance in a number of ways. Firstly, there will be a higher demand for bank credit in times of economic boom than in times of recession. A high aggregate growth rate may strengthen the debt servicing capacity of domestic borrowers, and therefore, contribute to less credit risk. Alternatively, adverse macroeconomic conditions hurt banks by increasing the amount of non-performing loans. Thus, it is expected that an improvement in economic growth helps bank performance. Bourke (1989) presents evidence that economic growth, if particularly, associated with entry barriers to the banking market, would potentially lift banks' profits. Guru et al. (2002), Gerlach et al. (2004), Bashir (2000) and Nier (2000) were other studies that recognize the importance of market growth on banking performance include

Secondly, it is generally believed that a rising interest rate should lead to higher banking sector profitability by increasing the spread between the saving and the borrowing rates. Hanweck and Kilcollin (1984) found that this relationship is particularly apparent for smaller banks in the USA during the 1976-1984 periods. They notice that falling interest rates during recession lead to slower growth in loans and increase in loan loss. Consequently, banks, particularly the small ones, may have difficulty in maintaining profit as market rate drops. Further studies by Demirguc Kunt and Huizinga (1999), Staikouras and Wood (2003) and Cheang (2005) all notice a positive relationship between interest rates and bank profitability. Finally, the effect of inflation is also another important determinant of banking performance. In general, high inflation rates are associated with high loan interest rates and thus high income. Perry (1992), however, asserts that the effect of inflation on banking performance depends on whether inflation is anticipated or unanticipated. If inflation is fully anticipated and interest rates are adjusted accordingly, a positive impact on profitability will result. Alternatively, unexpected rises in inflation cause cash flow difficulties for borrowers, which can lead to premature termination of loan arrangements and precipitate loan losses. Indeed, if the banks are sluggish in adjusting their interest rates, there is a possibility that bank costs may increase faster than bank revenues. Hogarth et al. (1998) even conclude that high and variable inflation may cause difficulties in planning and in negotiation of loans.

The findings of the relationship between inflation and profitability are mixed. Although the studies of Guru et al. (2002) in Malaysia and Jiang et al. (2003) in Hong Kong show that higher inflation rate leads to higher bank profitability, the study of Abreu and Mendes (2000), nevertheless, reports a negative coefficient for the inflation variable in European countries. In addition, Demirguc-Kunt and Huizinga (1999) notice that banks in developing countries tend to be less profitable in inflationary environments, particularly when they have a high capital ratio. In these countries, bank costs actually increase faster than bank revenues.

b) Financial Structure Variables.

Many studies in the banking literature investigate whether financial structure, which is defined as the relative importance of banks, plays a role in determining banking performance. In general, a high bank asset to GDP ratio implies that financial development plays an important role in the economy. This relative importance may reflect a higher demand for banking services, which in turn, attracts more potential competitors to enter the market. When the market becomes more competitive, banks need to adopt different strategic moves in order to sustain their profitability. Demirguc-Kunt and Huizinga (1999) present evidences that financial development and structure variables are very important. Their results show that banks in countries with more competitive banking sectors, where bank assets constitute a large portion of GDP, generally have smaller margins and are less profitable. Also, they notice that countries with underdeveloped financial systems tend to be less efficient and adopt less-than-competitive pricing behaviors. In fact, for these countries, greater financial development can help to improve the efficiency of the banking sector. Consequently, the market structure of the banking industry shows important implications for profitability.

Furthermore, studies by Smirlock (1985), Bourke (1989) and Staikouras and Wood (2003) suggest that industry concentration has a positive impact on banking performance. The more concentrated the industry is, the greater the monopolistic power of the firms will be. This, in turn, improves profit margins of banks. However, there are also some studies that report conflicting results. For example, Naceur (2003) reports a negative coefficient between concentration and bank profitability in Tunisia. Also, Karasulu (2001) finds that the increasing concentration does not necessarily contribute to profitability of the banking sector in Korea.

According to Michael Porter there are certain competitive forces that impact on profitability in every industry. These forces are said to be the drivers of competition and profitability in every industry which as well include banking industry around the world. He further stressed that it is difficult for firms which operates in highly competitive industries to earn favorable returns on investment. On the basis of this statement it obvious that commercial banks profitability is highly influence by certain competitive forces and even some studies have argue that intensive competition within commercial banking industry tends to decrease profits (Smith, 1984). Among these forces is what Michael E. Porter termed as *"Rivalry among Existing Competitors"* with which some of its forms make it appropriate to consider in this study because of the possibility that they could be quantified hence their inclusion in the profitability model. He documented that higher rivalry among existing competitors which takes many forms including the fight for higher market share erodes profitability of an industry. Especially in slow growth markets with numerous competitors who are equal in size and power (Harvard Business Review 2008). There are two variables from this discussion with which some researchers have included in their studies and these include the market shares or the size of various commercial banks and market growth rate of commercial banking industry in particular country.

2.1.3 Roles of Commercial Banks

Commercial banks play an important role in the process of economic development, which is clear from the following points:

Capital Accumulation

Capital formation refers to the increase in the existing stock of capital goods in an economy. Commercial banks remove the capital deficiency by encouraging saving and investment. The commercial banks can promote capital formation in the country by moving the resources to the productive uses.

Mobilization of Savings

There operates vicious circle of poverty in developing countries like Tanzania. So, savings remain at the lowest level. Banks are playing important role in the mobilization of saving by introducing a variety of saving schemes. Banks induce the people to earn interest through saving and it provides various facilities in a country to create a will and power to save.

Availability of Funds

An additional point of role of banks is more availability of funds. Poor population has poor resources for the economic development in poor countries. The activities like inventions and innovations, research and development and initiatives (effectiveness in responding to challenges) are impossible due to insufficiency of funds in these countries. Banks remove the deficiency of capital by providing different types of funds that leads to economic development.

Attaining Self Sufficiency

A major problem faced by the developing countries is burden of foreign debts and dependence on other countries. Commercial banks provide incentive for the entrepreneurs to take risks and to use idle resources for more and better production. So, banks are helpful in attaining self-sufficiency. Banks provide loan to develop the various economic sectors. It results in reduction in imports and increase in exports. Accordingly, banks are very important to achieve the self-sufficiency.

Implementation of Modern Technology

Economic development without use of advanced and the most up-to-date technology is impossible. Almost in all the economic sectors backward techniques of productions are used due to poverty in third world countries like Tanzania. Commercial banks provide more funds to people to make it possible to use the modern techniques of production. Due to implementation of modern technology, there is increase in production level, decrease in cost and save in time.

Development of Agriculture Sector

All the regions and all the sectors of the economy are not equally efficient and developed in an economy. There is big need to develop the backward regions and sectors for the economic development. Rural areas and agricultural sector is still backward in Tanzania. Banks are playing an important role in the development of rural and agriculture sector.

Development of Industrial Sector

Industrial sector is the backbone of their economies in rich nations. It is still backward in Tanzania and other poor countries. Commercial banks provide different types of loans for the development of industrial sector. Industrial development leads to agricultural development and it results in economic development.

Expansion of Market

Commercial banks help in the expansion of market. They help in the formation of sound economic infrastructure in order to raise living standards and to expand trade and commerce of an economy. Commercial banks cause development of industrial as well as agriculture sector. Accordingly, there is expansion of market that results in economic development.

Research and Development

Commercial banks, sometimes, provide finances for research and development, which leads to inventions and innovations. Various institutes operate by the loan provided by the banks. Modern techniques are established and these are applied to economy in research institutes. Due to use of modern techniques of production, better quality and more quantity is produced which leads to improve the living standard of population.

Essential for Foreign Trade

Foreign trade is one of the most important needs of all the countries of the world. Today international trade, without involving banks, is so difficult. International trade is necessary for the economic development. Commercials banks are helpful in increasing international trade through following ways:

- Provision of credit facilities
- Low rate of interest for the exporters
- Opening of letter of credit (L/C)

- Arrangement of foreign exchange
- Opening of foreign currency accounts
- Commercial banks have billions of foreign exchange reserves

Remove Budget Deficits

The commercial banks are very helpful for the government. Now a day, the government has to face the budget deficits because of increased expenditures and falling revenues. In this situation, government has to depend upon deficit financing to meet the budget deficits. To cover the gap between the expenditures and revenues, government borrows from the banks. As a result, the development process can be started through borrowed money from banks

Creators and Distributors of Money

Creation of money and distribution of money are the two main objectives of commercial bank. Commercial banks move the finances toward productive uses. There are a lot of problems in the way of economic development like inflation, deflation, low investment and saving etc. All these problems are possible to remove through creation and distribution of money by commercial banks. So, fluctuation in the supply of money can attain the economic development.

2.1.4 Risks Faced By Commercial Banks

Risk Management Guidelines for Banks and Financial Institutions, Directorate of Banking Supervision, Bank of Tanzania Dar es Salaam, August, 2010 covered six most common risks in banking i.e. credit, liquidity, market, operational, strategic and compliance risks. Description of these risks is as follows:

Liquidity Risk:

Liquidity risk is the potential for loss to an institution arising from either its inability to meet its obligations as they fall due or to fund increases in assets without incurring unacceptable cost or losses. Liquidity risk includes inability to manage unplanned decreases or changes in funding sources. Liquidity risk also arises from the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

Credit Risk:

Credit risk arises from the potential that an obligor is either unwilling to perform on an obligation or its ability to perform such obligation is impaired resulting in economic loss to the institution

Market Risk:

Market risk is the risk of losses in on and off balance sheet positions as a result of adverse changes in market prices i.e. interest rates, foreign exchange rates, equity prices and commodity prices. Market risk exists in both trading and banking book. A trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book.

Operational Risk:

Operational risk is the current and prospective risk to earnings and capital arising from inadequate or failed internal processes, people and systems or from external events.

Strategic Risk:

Strategic risk is the current and prospective impact on earnings, capital, reputation or good standing of an institution arising from poor business decisions, improper implementation of decisions or lack of response to industry, economic or technological changes. This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve these goals, the resources deployed to meet these goals and the quality of implementation.

Compliance Risk:

Compliance risk is the current or prospective risk to earnings, capital and reputation arising from violations or non-compliance with laws, rules, regulations, agreements, prescribed practices, or ethical standards, as well as from incorrect interpretation of relevant laws or regulations. Institutions are exposed to Compliance risk due to relations with a great number of stakeholders, e.g. regulators, customers, counter parties, as well as, tax authorities, local authorities and other authorized agencies.

2.1.5 Risk Management by Commercial Banks

Under Risk Management Guidelines for Banks and Financial Institutions, Directorate of Banking Supervision, Bank of Tanzania Dar es Salaam, August, 2010, Risk management is a discipline at the core of every institution and encompasses all the activities that affect its risk profile. Risk management as commonly perceived does not mean minimizing risk; rather the goal of risk management is to optimize risk reward trade-off. This can be achieved through putting in place an effective risk management framework which can adequately capture and manage all risks an institution is exposed to. Risk Management entails four key processes which are;

Risk Identification:

In order to manage risks, an institution must identify existing risks or risks that may arise from both existing and new business initiatives for example; risks inherent in lending activity include credit, liquidity, interest rate and operational risks. Risk identification should be a continuing process, and should occur at both the transaction and portfolio level.

Risk Measurement:

Once risks have been identified, they should be measured in order to determine their impact on the institution's profitability and capital. This can be done using various techniques ranging from simple to sophisticated models. Accurate and timely measurement of risk is essential to effective risk management systems. An institution that does not have a risk measurement system has limited ability to control or monitor risk levels. An institution should periodically test to make sure that the measurement tools it uses are accurate. Good risk measurement systems assess the risks of both individual transactions and portfolios.

Risk Control:

After measuring risk, an institution should establish and communicate risk limits through policies, standards, and procedures that define responsibility and authority. Institutions may also apply various mitigating tools in minimizing exposure to various risks. Institutions should have a process to authorize exceptions or changes to risk limits when warranted.

Risk Monitoring:

Institutions should put in place an effective management information system (MIS) to monitor risk levels and facilitate timely review of risk positions and exceptions. Monitoring reports should be frequent, timely, accurate, and informative and should be distributed to appropriate individuals to ensure action, when needed.

2.2. Empirical Literature Review

Guru, B. K., J. Staunton, et al. (2000) conducted research to find out determinants of profitability of commercial banks in Malaysia concluded that efficiency in managing the expenses of banks and market interest rate plays vital role to determine profitability of commercial banks. Further they concluded that to increase the profit and to reduce expenses banks must increase current account deposit on which no interest is applicable. While advancing loans to any one, commercial banks must be extremely careful and must have vigilant eyes on the business risk indicators.

Ali, K., M. F. Akhtar, et al. (2011) argued that profitability of banks can be enhanced through efficient asset management and through economic growth. Further they argued that high credit risk of advances result in lower profitability of banks. As micro variable GDP has positive impact on the profitability of banks. As micro indicators profitability of banks is positively affected by size of bank, operating efficiency and profitability is negatively affected by credit risk.

Angbazo (1997) summarized in his research that net interest margin of banks in not affected by interest rate risk where as it more affected by default risk and this higher interest margin leads towards higher profitability of banks. The banks that have small scale of operations they are affected by both default risk and interest rate risk this ultimately affect their results.

Pasiouras and Kosmidou (2007) discussed that how commercial banks profit is affected by some factors that are considered as determinants of profitability of domestic and foreign banks. Banks solvency chances increases due to higher default and interest rate risk that have an adverse impact on the economy as well and reduces the profits of banks. Equity and assets growth both have positive impact on the profitability of both domestic and commercial banks. Further, cost impact on return on assets was significant and negative for both foreign and domestic banks. The relationship of size of operations was negative to for both the domestic and foreign banks and this relationship also give support to this concept that larger operation for financial institution result in diseconomies of scale. The GDP and inflation have positive and significant impact on the return on assets of both foreign and domestic banks.

Naceur (2003) conducted research and concluded that huge amount of overheads earnings and huge capital has positive impact on the profitability of banks. The net interest margin and loans advances by bank have significant and positive impact on the profitability of banks. Further, from the macroeconomic indicators size and growth have a negative impact on the profitability of commercial bank. Financial markets developments also have significant impact on the profitability of commercial banks. Kosmidou (2008) concluded that banks which are well capitalized and have less operating cost earn higher ROA. Bank size only matters when macroeconomic variable are included in the model.

(Walter 1991) concluded that creating provision about the loan loss reverse is amongst the most important factors that affect the profitability of banks. Loan loss provision provides true picture to the stake holders about the profits/losses to the banks. If loan loss provision will not be created than profits will be overstated. Loan loss ratio must be maintained by keeping in mind all micro and macro factor rather than depending upon past trends.

Mamatzakis and Remoundos (2003) finalized by saying that, some of the important variables that explain banks profitability are ratio of loans to assets, ratio of equity to assets and personal operating expense of banks. These variables are also directly considered as in relation of directly to strategic planning. Further, economies of scale have positive impact on the profitability of banks and bank size is considered as economies of scale. As an external variable the size of the market is considered as having positive impact on the profitability of banks. (Goddard, Molyneux et al. 2004)

The ownership is not significantly associated with the profits of banks. Capital to assets is measure of strength of ratio of banks and increases the profitability of banks. Liquidity ratio is also positively associated with profitability of banks.

Naceur and Goaied (2005) in their research concluded that banks profitability is highly associated with how much cash bank holds. Banks advances to total assets have positive impact on the profitability of banks where as size of banks has negative significant impact on the profitability of banks. Banks profitability is also affected by stock markets because if stock market will grow then demand of advances will increase and also Williams (2003) concluded that profitability of domestic banks is negatively related with the market share of host country competitors whereas profitability is positively associated with GDP growth.

2.2.1 Profit Measures of Commercial Banks

In most research papers relating to this study the profitability is measured in the form of ratios which are normally reported by commercial banks in their annual reports. Devinaga Rasiah (2010) claims that the use profitability ratios are not influence by changes in price levels. And it is said to be the most appropriate way of measuring profitability as one make use of time series analysis. This is because the real value of profits cannot be affected by the varying inflation rates. According to Devinaga Rasiah (2010), for one to realize how well a bank is performing it is much more useful to consider return on assets (ROA) and return on equity (ROE)

Other findings in different researchers found that different views of how profit of the company is treated, measured, classified and the most factors affecting the industries. Profit has been defined as the excess of the amount of sales and other income after deducted by all costs. Profit is the term used as the net income performed by the company. Profit can be classified into several categories such as:

1) Sales or revenues used to show the income gained before it is subtracted by costs.
2) Earnings before interest, tax, depreciation, and amortization (EBITDA) which shows the operational income before it is deducted by other non operational costs.

3) EBIT, one of the commonly used to reflect the operational income instead of EBITDA. EBIT is usually used by most financial companies to measure the ability of a company to pay the liabilities.
4) EBT, which is usually used to compare with EBIT to measure the amount of interest cost contributed to the net income.
5) Net income, that is the bottom line of income after it is deducted by all costs that enjoyed by the equity holders.

The best category of profit that will be used in this research is net income. For net income is the profit that is enjoyed by the equity holders, and it shows the ability of the company to give them returns (Brigham and Houston, 2007). There are different ways of analyzing net income, and it depends on the ratios used. Brigham and Ehrhardt, 2005 wrote that, in calculating the profitability ratio, net income is commonly used to measure the performance of the company in using its assets, equity, investment, and to compare with the sales that the company can achieve. One of the ways to measure the profit enjoyed by shareholders is by using ROE ratio. The reason is that ROE ratio is comparable between one companies to the other and can indicate the profitability of one industry with the other (Helfert, 2001). ROE ratio indicates the profitability of the company. ROE measures the rate of return on common stockholder's investment.

$$ROE = \frac{\text{Net Income}}{\text{Common Equity}}$$

According to Brigham and Ehrhardt (2005), the value of ROE is affected by profit margin ratio, total assets turnover and equity multiplier or so called asset to equity ratio. Equity multiplier ratio is one of the financial ratios that can describe the availability of debt in making profit.

ROE = Profit margin × Total Assets Turnover × Equity multiplier

Therefore, one way to increase ROE is by increasing total assets turnover. The equation also explains that if equity multiplier increases, while the other factors are constant, ROE will increase. This means that the change in the value of total assets turnover will positively change the value of ROE. Debt on the other hand is usually defined as a contractual obligation to make a fixed payment or to make series of payments (Williams, Smith, and Young, 1998). Therefore, debt can also be defined as the liabilities mentioned in the balance sheet. Debt is used in many companies to leverage its financial performance. The companies increase its financial performance by using debt to finance the companies' operation. The increase in companies' operation is expected to increase the net income. The increase in net income will impact on the increase of return on equity. Therefore, the equity holder expected that by using more debt, it will increase the ROE (Brigham and Houston, 2007).

There are several previous researches regarding the effect of debt to the value of ROE. One of them is Husnan (2001) that described that the use of debt statistically significant to the change in the value of non-multinational companies ROE, while it is not significant to the multinational companies. However, the research made by Harjanti and Tandelilin (2007) to all manufacture companies listed in Jakarta Stock Exchange from 2000 to 2004 indicated that profitability which was proxy by ROE, BEP, and gross profit ratio had negative significance. Equity multiplier describes the value of all assets compare to the value of equity of the company. It can also be considered as the amount of debt used over the total assets that the company has. The formula for equity multiplier is:

$$\text{Equity Multiplier} = \frac{\text{Total Assets}}{\text{Total Equity}}$$

It can also be:

$$\text{Equity Multiplier} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

The debt indicates all the current liabilities and long term debt. While the assets which is used in calculating debt ratio, are the total assets mentioned on the balance sheet. This ratio indicates the size of debt in accordance to the assets owned. Theoretically the increase in the value of debt ratio will also trigger the increase value of ROE ratio (Brigham and Ehrhardt, 2005). Total assets turnover indicates the operational decision made by the management. It is measured by dividing sales with total assets. Total assets can show the management's performance based on the amount of sales that they can produce by investing into several amount of assets.

$$TATO = \frac{\text{Total Sales}}{\text{Total Assets}}$$

The research made by Listiadi (2007) on PT. Merck T. annual report between 2003 and 2004 found that TATO ratio gives direct impact to ROE. This shows that operational decisions have direct impact to company's profitability. Firm size indicates the value of assets that the company has. When a company has more assets than the other related company it indicates not only it is bigger than the other one but also it has better production capacity. When a company has better production capacity than the other related company, then it has potential to generate more profit better than other related company. However, at a certain amount of assets, the productivity will might reach its maximum to meet the demand. As Kotany (1922) research found that every different industry presents its optimum size such as shoe manufacturing and tanning industry. They have optimum size when the companies have capital or assets in the value between $ 100,000 and $ 250,000. While for meat packing industry the optimum size is between $ 10,000,000 and $ 25,000,000. This research is strengthened by Ammar, Hanna, Nordheim, and Russell (2003) findings that for electrical contractor industry the profitability of a company drops as it grows larger than $ 50,000,000 in sales. To determine the effect of debt to the company's profitability there should be external factors that needed to be considered which affect the management decision on debt.

Different industry presents different profitability. One of the old researches by Kotany (1922) found that different industry generates different level of profitability. Each industry requires different amount of capital and generates different amount of return such as the rates of profit in shoe manufacturing industry is greater than tanning, commercial wheat flour mill, meat packing, milk and milk products, and agriculture industry. This is supported by Helfert (2001) on his book that financial performance measures and its meanings vary by industry segments. Type of industry indicates risk, and tenacity to economic and political condition that affect the companies' profitability. Therefore different industry might presents different rate of profitability. The research on the use of Du Pont analysis to measure the profitability of a company has been used by many researchers. One of them is Listiadi (2007) who described that Du Pont analysis to investigate the company's profitability that uses return on equity analysis is best used to measure the return on stockholder's capital.

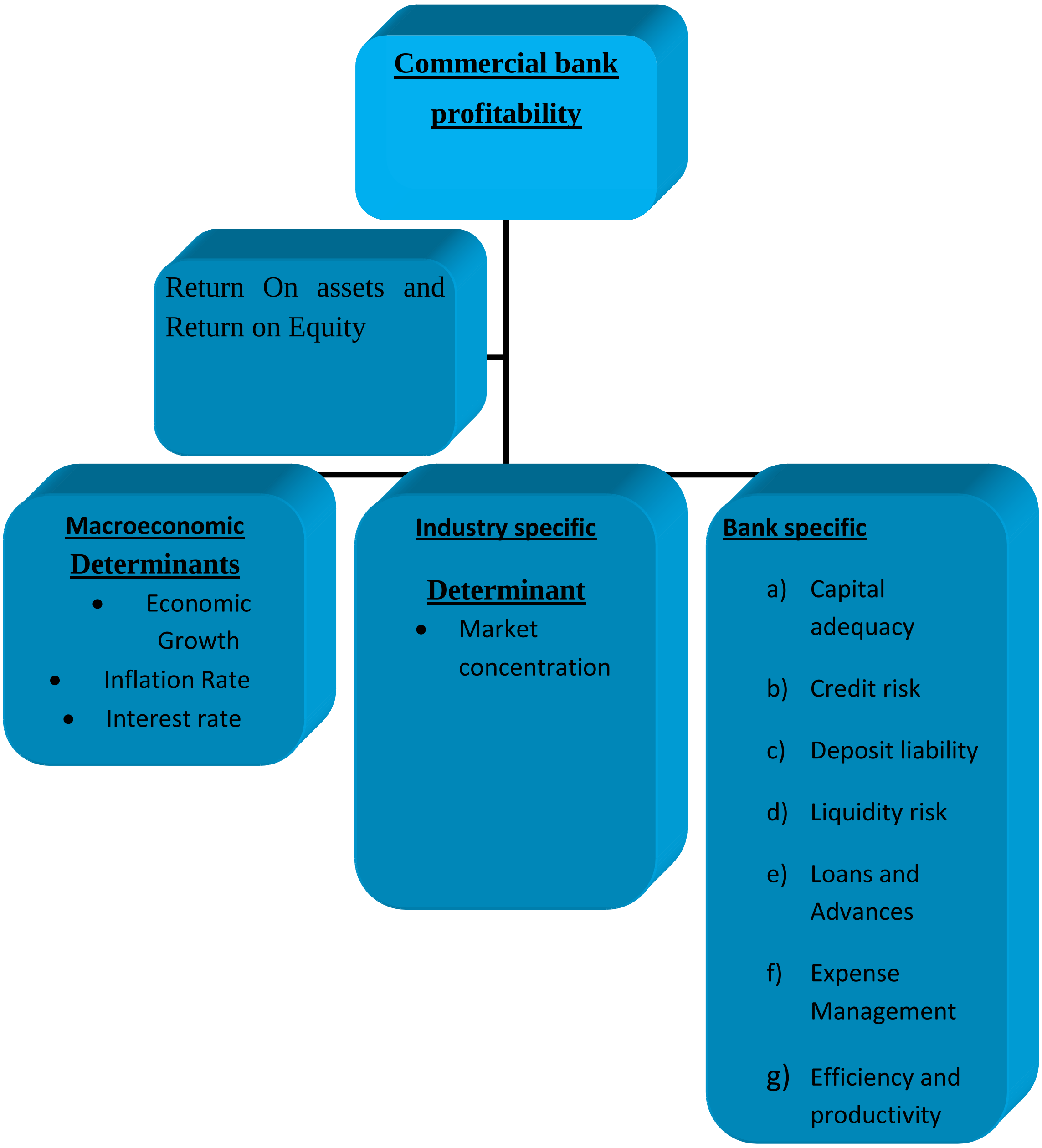
Chen and Mahajan (2008) investigated the effects of macroeconomic conditions on corporate liquidity in 45 countries from 1994 to 2005. The results show that macroeconomic variables such as gross domestic product growth rate, inflation, short term interest rate and government deficit affect corporate cash holdings. Company tends to hold more cash when the macro economy is eve loping, and reduce the cash for investment when the macro economy is declining. This means that when the macroeconomic condition is declining, then the value of return on equity ratio will also decline because the cash is used for investment.

The other findings made by Lawrence, Diewert, and Fox (2004) describe that firm's profit is affected by the change in productivity, price, and firm's size. Their research founds that when the companies increase their size to increase their productivity, the shareholders will enjoy higher return even though the product price decreases. This means that when the companies size increase, the profit of the companies will also increase. Also, McGahan and Porter (1997) used 72,724 observations or an average of 5,196 businesses segments per year from 1981 to 1994 on their research. It was found that the results of the research provide strong support for the idea that industry membership has an important influence on profitability. Their research represents all economic sectors other than finance and indicates that manufacturing industry accounts for a smaller of profit variance than lodging/entertainment, service, wholesale/retail trade, and transportation industry.

2.3 Conceptual framework and research model

This conceptual frame work describes the relationship of profitability with bank specific, industry specific and macroeconomic determinants based on the theoretical and empirical perspectives.

Figure 2.1 Conceptual framework



Source: Research Data

CHAPTER THREE
RESEARCH METHODOLOGY

Research methodology is a collective term for the structured process of conducting research. There are many different methodologies used in various types of research and the term is usually considered to include Type of the study, study area, study population, units of Analysis, variables and their measurements, sample size and Sampling techniques, types and sources of data, data Collection methods, validity issues, and data analysis methods design, data gathering and data analysis. Research methodologies can be qualitative and quantitative methodologies but this is not always possible, usually due to time and financial constraints.

Research methodologies are generally used in academic research to test hypotheses or theories. A good design should ensure the research is valid, i.e. it clearly tests the hypothesis and not extraneous variables, and that the research is reliable, i.e. it yields consistent results every time.

3.1 Type of the study

This research was Exploratory, where exploratory research involves a literature search or conducting focus group interviews. The exploration of new phenomena in this way helped the researcher's need for better understanding, tested the feasibility of a more extensive study, or determined the best methods used in a subsequent study. For these reasons, exploratory research was broad in focus and rarely provided definite answers to specific research issues on determinants of commercial bank profitability for both local and foreign commercial banks in Tanzania. The objective of exploratory research was to identify key issues and key variables

3.2 Study Area

The area of this study is on the determinants of commercial banks' profitability. For the purposes of the study, the researcher clearly evaluated and analysed the internal and external factors which affected the profit trend of the commercial banks in Tanzania. Where the researcher's findings were later analysed and sees if the main objective of the study has being archived or the research gap compared to other previous researcher if it real exists.

3.3 Study Population

From the total of 32 National Commercial Banks (Access Bank, Advanced Bank Tanzania, ACB, Azania Bank, Bank ABC, Bank M, Bank Of Africa, Bank of Baroda(Tanzania), Bank Of India(Tanzania), Barclays Bank (Tanzania), Citibank, CBA, CRDB, DCB, DTB, ECO Bank, Equity Bank(Tanzania), Exim, FNB, FBME, Habibu African Bank, I&M, ICB, KCB, Mkombozi Commercial Bank, NBC, NMB, NIC Bank, People's Bank Of Zanzibar, Stanbic, Standard Charted and UBA), 8 regional commercial banks and 5 licensed financial institutions.

3.4 Variables and their Measurements

Dependent variable

Numbers of factors stand as proxy to profitability of the bank; two ratios were commonly used to describe bank profitability: ROE and ROA. ROA indicates how effectively a bank manages its assets to generate income. It indicates income earned on each unit of assets. The problem of ROA was that it excluded off-balance sheet items of the bank creating a positive bias in evaluating bank performance. ROE measured the return to shareholders on a unit of their capital. The drawback of ROE was that banks with lower level of capital generated a higher ratio. These banks had a high level of financial leverage which was undesirable and associated with high degree of risk. Moreover, ROE was not an optimal measure of profitability since degree of capitalization was often established by the regulatory authority. The view in favor of ROA versus ROE was also supported in the literature. Golin (2001) concluded that ROA was the key measure of profitability for commercial banks.

Independent Variables

The "independent variables" represent the inputs or causes, or are tested to see if they are the cause. Here are some of the independent variables listed which have already been discussed in the literature review as the internal determinants of commercial banks, Interest Rate Policy, Market concentration, Capital Adequacy, Credit Risk, Bank Size, Expense Management, Liquidity risk, inflation, Loans and Advances, Economic Growth and Efficiency, and Productivity. For the purpose of my empirical study I will test Loans and advanced to total assets, Deposits to total assets, Shareholders equity to total assets, customers' deposits to total assets, loans and advances to total deposits, Non-performing loan to total assets and Inflation rates.

Empirical Model

To test the impact of bank specific, industry specific and macroeconomic factors on the profitability of the commercial banks in Tanzania, the below stated linear regression model has been estimated:

$Yjt = C + \alpha Xjt + \beta Zt + \varepsilon jt$………………………..... (1)

The j refers to an individual commercial bank; t refers to year; Yjt is an dependent variable (ROA) of a bank j in a particular year t; the C is the intercept/constant; X represents the internal factors (determinants); Z represents the external factors (determinants); α and β are co-efficient and εjt represent the error term.

Extension of the Model

The model is extended to involve internal and external factors as follows:

$ROAjt = C + \alpha_1 CDTA\ jt + \alpha_2 LOATAjt + \alpha_3 NLTLjt + \alpha_3 LOATD_{jt} + \alpha_4 SETA_{jt} + \beta_1 INFLt + \varepsilon jt$………………………….... (2)

Where:

ROAjt**:** return on assets for bank j in year t

CDTAjt : ratio of customer deposits to total assets for bank j in year t

LOATAjt: ratio of Loans and advances to total assets for bank j in year t

NLTLjt: ratio of non-performing loans to total assets for bank j in year t

INFLt: annual inflation rate for year t

LOATDjt: Loans and advances to total assets for bank j in year t

$SETA_{jt}$: Shareholders equity to total assets for bank j in year t

3.5 Sampling size and Sampling Technique

A sample is a unit from the population. The sampling size consisted of four (4) banks listed in DSE from the population mentioned above.

3.6 Types and Sources of Data

The source of data for this research was mainly from secondary sources. The secondary data was acquired from internal and external sources. The internal sources were the balance sheet and income statement of the selected banks and the external sources were on the general condition prevailing in the market together with the macroeconomic factors.

3.7 Data Collection Methods

Data collection techniques and instruments which were used include face to face interviews, telephone, mail, Internet, documentary review and observation. These data collection techniques and instruments were employed as follows.

Documentary Sources

The researcher reviewed various banking policies, procedures manuals, files, publicized materials, monthly and annual banking reports as well as evaluation and research reports of the banks. The aim was to get understanding of the policies and procedures established by for survival and expansion in the future time. The review enabled the researcher to obtain the information necessary to provide sufficient evidence as to whether the prescribed procedures concerning banking activities are being carried out on source commercial basis in conformity with the BoT policy as well as established acts for the purpose of profit maximization.

Interviews

The qualitative research interview seeks to describe and the meanings of central themes in the life world of the subjects. The main task in interviewing was to understand the meaning of what the interviewees said. (Kvale, 1996) Interviews were inter-personal conversations which are planned and the outcomes are expected to satisfy interview participants (Barongo, 2006).

The interview was conducted by using guided questions which assisted to check the validity of the information given in both to solicit the findings.

Observation

Observation made to see the impact of financial institution to the society and most especially for the commercial banks, how people are motivated by commercial banks' activities and their percentage of participation in obtaining services offered by these banks as compared to other financial institutions.

3.8 Data Analysis Methods.

Data analysis is an important step towards finding solution of a problem understudy. Guba and Lincholin (1994) describe data analysis as being a systematic process involving working with data, organizing them and dividing them into small manageable parts

Dr J. Mark Tippett says most research projects need data in order to answer a proposed research objective/problem. The data that need to be acquired, and the sources of such data, must be identified as a matter of utmost importance. No amount or depth of subsequent data analysis can make up for an original lack of data quantity or quality.

Research problems and objectives (or hypotheses) need to be very carefully constructed and clearly defined, as they dictate the data that need to be obtained and analyzed in order to successfully address the objectives themselves. In addition, the quantity of data, their qualities, and how they are sampled and measured, have implications for the choice and effectiveness of the data analysis techniques used in subsequent analysis. By doing this it has reduced data into small manageable and analytical packages which will be used for analysis and drawing the conclusion as well as putting forward the recommendations for immediate action and further research.

Since the data collected were qualitative and quantitative then the methods of data analysis and presentation were description for qualitative, then the quantitative data was analyzed and presented on statistical ways.

Bell, 1983 said that, both qualitative and quantitative research approach were used during the study. Qualitative research approach is the approach which is multi-method in focus involving an interpretive and naturalistic approach to the subject matter understudy. Reasons for using qualitative research approach, the approach is flexible in data collection and research plan in such a way that the researcher was able to use different research methods of data collection such interviews, observation, documentary review, and research questions and lead to achieve the objective of the study. On the other hand, quantitative approach was also applied especially in knowing the statistical movement/trend of profitability of commercial banks.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCUSSION

This chapter is about data presentation, analysis and discussion using listed banks in DSE as a case study. The study was aimed to explore the determinants of profitability of Local and foreign commercial banks in Tanzania.

4.1 Type of ownership and the time it has being in Operation.

Types of ownership of each bank under the study were analyzed and the time it has being in operation. The reason for looking for the ownership and time it has being in Operation was to get a deep analysis if the Bank was privately owned or jointly owned or other type of ownership. The following results were obtained;

i. CRDB Bank Plc

CRDB Bank Limited is a private commercial bank. The Bank was established on July 1st 1996 to succeed the former Cooperative and Rural Development Bank (CRDB), which was a public institution with majority of shares held by the Government of the United Republic of Tanzania. The succession was a result of the liberalization of the banking industry in Tanzania**.** Shareholding diversification was one of the aspects of the CRDB financial restructuring. In an unprecedented exercise CRDB became the first successful major Tanzanian privatization that involved the sale of shares to the public. CRDB Bank Limited is owned by over 11,000 shareholders under the following major groups (by value of shares):

Table 4.1 CRDB Bank Limited Stock Ownership

Name of Owner	Percentage Ownership
Private individuals	37.0
Co operatives	14.0
Companies	10.2
DANIDA investment fund	30.0
Parastatals (NIC & PPF)	8.8
TOTAL	**100**

The authorized share capital of CRDB Bank Limited is Tshs 20.0 billion and presently the paid up capital is Tshs 12.3 billion.

Source: CRDB Bank Website

From table 4.1 indicates that the majority of shares are held by private individuals by 37 percent followed by DANIDA investment fund, which hold 30 percent and the remaining 33 percent are owned by other companies (10.2 percent) Parastatals (PPF 8.8 percent) and corporations (14 percent).

ii. NMB Bank

Following the breakup of the old National Bank of Commerce in 1997, by act of Parliament, three new entities were created: NBC Holdings Limited, National Bank of Tanzania (1997) and NMB. Initially NMB could only offer savings accounts, with limited lending capabilities. In 2005, NMB was privatized and the Government of Tanzania, the sole owner of NMB until then, divested 49 percent shareholding to Rabobank of the Netherlands. Over the years since that time, further divestiture by the Tanzanian Government and subsequent listing of the bank's stock has led to a diversified ownership structure, as outlined under "Ownership". NMB is owned by institutions and private individuals as detailed in the table below

Table 4.2 NMB Bank Stock Ownership

Name of Owner	**Percentage Ownership**
Rabobank of the Netherlands	34.9
Government of Tanzania	30.0
Private Investors via DSE	21.0
National Investment Company Limited (NICOL)	6.6
Exim Bank (Tanzania)	5.8
TCCIA Investment Company Limited	1.7
TOTAL	**100.0**

Source: NMB Bank Website

From table 4.2 indicates that the majority of shares are held by Rabobank of Netherlands by 34.9 percent followed by Government of Tanzania, which hold 30 percent of the total shares and the remaining 35.1 percent are owned by other companies, Exim bank and private individuals via DSE. This indicates that the shareholder who has more interests in NMB bank is Rabobank of Netherlands (34.9 percent) followed by Government of Tanzania (30 percent) and private investor (21 percent) living others holding shares below 10 percent (NICOL 6.6 percent, Exim bank 5.8 percent, TCCIA 1.7 percent) just having minority interest.

iii. KCB Bank

KCB Bank is a foreign Bank with its head quarters in Nairobi, Kenya. The Government of Kenya owns 17.74 percent of KCB Bank. The remaining 82.26 percent is owned by institutional and private investors.

iv. DCB Bank

DCB is small, private, publicly traded, microfinance bank established to serve the banking needs of the poorest of the poor in the city of Dar es Salaam and its suburbs. The stock of the bank is listed on the DSE. As of June 2011, the total asset base of DCB was valued at approximately US$63 million (TZS: 98.9 billion), with shareholders' equity of US$10.7 million (TZS: 16.8 billion).

DCB Bank was incorporated in September 2001. In October 2001, DCB received a provisional banking license from the BOT, the national banking regulator. DCB commenced commercial banking services in April 2002. In 2003, the BOT issued DCB with an unrestricted banking license as a regional unit bank, whose services are restricted to serving the Dar es Salaam area only. In 2008, the stock of DCB was floated on the DSE through the issuance of an IPO. In April 2012, the bank received a national commercial banking license, authorizing DCB to expand its operations nationwide. The bank plans to rebrand and to open up branches outside Dar es Salaam. The shares of the bank's stock are listed on the DSE. The bank's stock is owned by the following corporate entities and individuals:

Table 4.3 DCB Commercial Bank Stock Ownership

Name of Owner	Percentage Ownership
Dar es Salaam City Council (DCC)	8.86
Ilala Municipal Council (IMC)	8.25
Kinondoni Municipal Council (KMC)	8.11
Temeke Municipal Council (TMC)	7.40
Unit Trust of Tanzania (UTT)	9.05
Private Individuals and Corporations	58.33
Total	**100.0**

Source: DCB Commercial Bank Website

From table 4.3 it indicates that the majority of shares are held by private individuals and corporation by 58.33 percent living others holding shares below 10 percent, where DCC 8.86,IMC 8.25, KMC 8.11, TMC 7.4, UTT 9.05

4.2 Bank's Statement of Financial Position

Table 4.4 CRDB Bank Plc Statement of Financial Position

(Amounts in Million Shillings)

	2012	2011	2010	2009
ASSETS				
Cash	120,157	100,416	93,010	70,330
Balances with Bank of Tanzania	352,484	347,034	255,528	243,315
Investment in Government Securities	527,618	493,735	426,546	252,977
Balances with other Banks and Financial Institution	117,757	210,702	295,413	252,605
Cheques and items for Clearing	19,325	23,520	22,442	16,687
Bills Negotiated	123	224	350	249
Investment in other Securities	-	200	600	1,617
Loans, Advances and Overdrafts(Net Of Allowances for probable Losses)	1,806,865	1,429,262	1,123,348	949,505
Other Assets	51,530	45,593	31,644	26,889
Equity Investments	1,200	1,200	600	-
Property, Plant and Equipment	77,757	61,755	55,921	40,694
TOTAL ASSETS	**3,074,816**	**2,713,641**	**2,305,402**	**1,854,867**
LIABILITIES				
Deposits from other Banks and Financial Institutions	135,580	2,901	16,830	3,776
Customer Deposits	2,591,033	2,408,676	2,019,394	1,603,955
Special Deposits	-	-	-	17,064
Payment Orders / Transfers Payable	8,338	2,474	6,681	6,606
Bankers' Cheques and Drafts Issued	3,340	15,181	9,477	4,364
Accrued Taxes and Expenses Payable	6,004	5,691	3,419	2,462
Unearned Income & Deferred Charges	2,057	719	426	396
Other Liabilities	11,032	23,235	15,664	8,469
TOTAL LIABILITIES	**2,757,384**	**2,458,877**	**2,071,891**	**1,647,093**
NET ASSET/(LIABILITIES)	**317,432**	**254,764**	**233,511**	**20,774**
SHAREHOLDERS' FUNDS				
Paid Up Share Capital	54,413	54,413	54,413	54,413
Share Premium	18,765	18,765	18,765	18,765
Retained Earnings	159,023	142,066	112,129	86,763
Profit /(Loss) Account	80,543	37,710	47,246	45,825
Others (Regulatory, Revaluation and Translation Reserve)	4,688	1,810	958	2,008
TOTAL SHAREHOLDERS EQUITY	**317,432**	**254,764**	**233,511**	**207,774**
Nonperforming Loans & Advances	124,586	134,783	121,338	60,612
Allowances for Probable Losses	32,475	45,607	30,179	26,846

Sources: CRDB Audited Financial Accounts

Table 4.4 is the tabulated representation of assets, liabilities and shareholders' funds/equity of CRDB bank for four years from 2009-2012. From table 4.4 which represents CRDB bank financial position for the period of four years, considered for study period, it was observed that the assets component which significantly contributes towards profitability were loans, advances and overdrafts. From table 4.4, Customer deposit has positive and significant effect on loans, advances and overdrafts, and interest margin of CRDB Bank because the primary function of the commercial banks are collecting deposits and giving loan to the public from these deposits. So, the competitiveness and the profitability of the CRDB bank depend on the degree of well performing of this activity. From the CRDB statement of financial position the following items seems to have a very high contribution towards performance of the bank. The table below (Table 4.5) show the movement of the key items selected from the statement of financial position of CRDB bank.

Table 4.5 Percentage change of key Financial Position Indicator for CRDB Bank

	2012	**2011**	**2010**
Loans, Advances and Overdrafts(Net of allowances for probable losses)	26%	27%	18%
Total Assets	-12%	18%	24%
Deposits from Other Banks and Financial Institutions	4574%	-480%	346%
Customer Deposits	8%	19%	26%
Retained Earnings	12%	27%	29%
Profit/(Loss)	114%	-20%	3%
Nonperforming Loans to Gross Loan	7%	9%	11%
Allowances for Probable Losses	-29%	51%	12%

Source: Research Data

Loans, Advances and Overdrafts: From table 4.5 it indicates that the loans, advances and overdrafts of CRDB bank were increasing at different rates from 2009 to 2012. In 2009 the bank offered TZS 949,505 million to lenders, compared to year 2010 where the amount given to lenders was TZS 1,123,348 million indicating an increase of 18 percent from previous year (table 4.5) and an increase of 27 percent was noted in 2011 compared to 2010 making loans offered to be TZS 1,429,269 million. The amount of loan offered in 2012 was 1, 806,865 indicating an increase of 26 percent over 2011,thereafter it went down by 1 percent as compared to increase in 2011 which was 27 percent.

Total Assets: Assets of CRDB bank showed a continuously increase from 2009 to 2011 with an exception of year 2012 where the total assets dropped from TZS 2,713,641 million recorded in 2011 to TZS 2,383,223 million recorded in 2012 indicating a 12 percent decrease in total assets. This happened either due to some disposal of some of the existing assets or there were no any asset bought during the year, then the decrease was may be due to depreciation of the existing assets

Deposits from other banks and financial institutions: These are reserves or amounts deposited by other banks or financial institutions to the respective banks, for the side of CRDB bank it is seen that in 2009 the deposit was TZS 3,776 million compared to 2010 where the deposits from other banks and financial institutions improved to TZS 16,830 million indicating 346 percent increase. Suddenly in 2011, the figure dropped to TZS 2,901 million and indicated a decrease of 480 percent from the previous year. But in 2012, the verse versa was true as the CRDB Bank marked a tremendous increase of about 4574 percent. The up and down of these deposits were either subjective to the real economic situation of the country, political factors, social factor, or any other factor mentioned but a few.

Customer deposits: Among other factors which contribute to the determinant of profitability of commercial banks are customer deposits. When customers deposit their money into banks, banks use the customer deposits to give out as loan to public and finally generate revenues/income from the interests charged from those loan or overdrafts given to the public. The higher the customers' deposits the higher the bank can offer more loans to public and hence can generate more profit and make it stands well to the eyes of the public. In the side of CRDB Banks, it is seen that the customer deposits have being continuous increasing with minor variation of increase as calculated in table 4.5 above. although the amounts of customers deposit as shown in CRDB Statement of financial position presented in table 4.4, the percentage increase of customer deposit was not satisfactory as the percentage increase from year to year was falling for example the increase from 2010 to 2011 was on 19 percent compare to the increase in 2011 to 2012 which was 8 percent. This indicates that the amount which increased in 2012 was lower by 11 percent (19-8 percents) compared to 19 percent increase in 2011

Retained earnings: Part of profit which is carried forward from one year to another is what is termed as retained profit. When the retaining profit is higher, this indicates that the dividends paid to share holders were just small amount and the balance was carried forward for capital increase and more investments. For the case of CRDB bank the amount of retained earnings was increasing in each year under review although with a very minor increment. This was either caused by low profits generated in the respective year or high payments of dividends to share holders.

Nonperforming loans to Gross Loans: CRDB bank shows that the rate of Nonperforming loans to gross loans is decreasing from year to year The rates recorded for such decrease were 11 percent in 2010, 9 percent in 2011 and 7 percent in 2012. This is a good sign that the bank is giving out loans with effective and efficient management manner which allows it to obtain better performance.

Allowances for probable losses: Allowances for probable losses for CRDB bank indicates a good trend as it was continuously decrease showing that CRDB bank was well performing in loan collections, for decrease in allowances of probable losses it indicating that the bank earnings in revenues from interest rates are high and the performance of loan portfolios are attractive.

Table 4.6 NMB Bank Plc Statement of Financial Position

(Amounts in Million Shillings)

	2012	2011	2010	2009
Cash	185,545	186,638	164,153	115,857
Balances With Bank of Tanzania	336,113	243,606	235,073	217,523
Investment in Government Securities	617,347	361,943	631,290	523,084
Balances with other Banks And Financial Institution	19,118	159,949	132,755	81,572
Cheques and Items for Clearing	11,944	12,791	7,145	14,588
Inter-branch oat Item	88	1	162	179
Loans, Advances and Overdrafts(Net of Allowances for Probable Losses)	1,345,932	1,123,518	857,784	672,579
Other Assets	38,609	19,198	27,281	12,096
Equity Investments	14,612	3,805	2,831	-
Property, Plant and Equipment	54,570	58,804	48,604	31,855
TOTAL ASSETS	**2,795,878**	**2,170,250**	**2,107,079**	**166,933**
LIABILITIES				
Customer Deposits	2,272,534	1,797,479	1,804,006	1,452,719
Special Deposits	17,445	7,220	16,131	6,680
Bankers' Cheques and Drafts Issued	3,433	7,036	2,621	2,242
Accrued Taxes and Expenses Payable	22,946	15,184	9,997	5,577
Other Liabilities	50,103	27,001	1,441	9,877
Borrowings	70,646	31,970	29,364	-
TOTAL LIABILITIES	**2,439,118**	**1,885,890**	**1,863,560**	**1,477,095**
NET ASSET/(LIABILITIES)	**356,760**	**284,360**	**230,519**	**192,239**
SHAREHOLDERS' FUNDS				
Paid Up Share Capital	20,000	20,000	20,000	20,000
Share Premium	-	-	2,205	2,205
Retained Earnings	239,359	190,795	154,334	122,484
Profit /(Loss) Account	97,401	71,839	53,980	47,550
Others (Regulatory, Revaluation and Translation Reserve)	-	1,726	-	-
TOTAL SHAREHOLDERS EQUITY	**356,760**	**284,360**	**230,519**	**192,239**
Contingent Liabilities	106,756	57,068	72,874	57,462
Nonperforming Loans & Advances	32,705	18,128	32,288	25,811
Allowances for Probable Losses	30,055	15,689	16,965	16,598
Other Non Performing Assets	379	161	743	263

Sources: NMB Audited Financial Accounts

Table 4.6 is the tabulated representation of assets, liabilities and shareholders' funds/equity of NMB commercial bank for four years from 2009-2012. Highest growth in assets, liabilities and shareholders' funds were observed in 2012. It was also observed that the assets component which significantly contributes towards profitability were loans, advances and overdrafts. This may be so due to the volatility of the DSE market and hence the risk associated with the investment in securities and also the regulatory constraints imposed on loans, advances and overdrafts to finance securities, which may make investment in securities less profitable. On the face of liability, the most profitable component was the customer Deposits probably due to the fact that no direct interest is paid on deposits. From table 4.6, Customer Deposit liability has positive and significant effect on loans, advances and overdrafts, and interest margin of NMB bank because the primary function of the commercial banks are collecting deposits and giving loan to the public from these deposits. So, the competitiveness and the profitability of the NMB bank depend on the degree of well performing of this activity. From NMB statement of financial position the following items seems to have a very high contribution towards performance of the bank. The table below (Table 4.7) show the movement of the key items selected from the statement of financial position of NMB bank.

Table 4.7 Percentage change of key Financial Position Indicator for NMB Bank

	2012	2011	2010
Loans, Advances and Overdrafts(Net of allowances for probable losses)	20%	31%	28%
Total Assets	29%	3%	1162%
Customer Deposits	26%	0%	24%
Retained Earnings	25%	24%	26%
Profit/(loss)	36%	33%	14%
Nonperforming Loans to Gross Loans	2%	2%	4%
Allowances for Probable Losses	92%	-8%	2%

Source: Research Data

Loans, Advances and Overdrafts: From table 4.7 it indicates that the loans, advances and overdrafts of NMB bank were increasing at different rates from 2009 to 2011. In 2009 the bank offered only TZS 672,579 million to lenders, compared to year 2010 where the amount given to lenders was TZS 857,784 million indicating an increase from previous year of 28 percent (see table 4.7) and an increase of 31 percent was noted made loans offered to be TZS 1,123,518 million in 2011. The amount of loan offered in 2012 was 1,345,932 million indicating a percentage increase of 20 percent, where in went down by 11 percent as compared to percentage increase in 2011 which was 31 percent.

Customer deposits: Among other factors which contribute to the determinant of profitability of commercial banks are customer deposits. When customers deposit their money into the bank, banks use this customer deposits to give out loans to public and finally generate revenues/income from the interests charged from those loan or overdrafts given to the public. The higher the customers' deposits the higher the bank can offer more loans to public and hence can generate more profit and make it stands well to the eyes of the public. In the side of NMB Bank, it is seen that the customer deposits have being continuous increasing with minor variation of increase as calculated in table 4.7 above. NMB showed a big percentage increase in 2012 of 26 percent from year 2011.

Retained earnings: Part of profit which is carried out from one year to another is what is termed as retained earnings. When the retaining profit is higher, this indicates that the dividends paid to share holders were just small amount and the balance is carried out for capital increase and more investments. For the case of NMB bank the amount of retained earnings was increasing in each year under review although with a very minor increment. This was either caused by low profits generated in the respective year or high payments of dividends to share holders.

Profit/ (Loss): NMB bank showed a good movement of profit increase from year to year, where in 2010 the profit increased by 14 percent, 2011 the increment was 33 percent and 36 percent in 2012. This was good indicator for good performance of NMB bank.

Nonperforming loans to gross loans: NMB bank shows that the rate of Nonperforming loans to gross loans in 2011 was 2 percent from TZS 32,288 million to 18,128 million in 2010, but for 2012 the bank maintained the rate of 2 percent making the nonperforming loan of TZS 32,705 million. This is a bad indications sign that indicates the bank is giving out loans without effective and efficient manner which makes the NMB bank obtain bad performance and finally the profits might be low.

Allowances for probable losses: Allowances for probable losses for NMB bank indicates a good trend in 2010 to 2011 before the increase by 92 percent leaving aside the decreased of 8 percent from year 2010 to 2011. For the bank to have a increasing trend of allowances for probable losses indicates that the performance on loan portfolio management is not well managed and hence it can lead the bank to make some losses rather than generating profit.

Table 4.8 KCB Bank Plc Statement of Financial Position

(NOTE: The figures for KCB Commercial bank has been converted to Tanzanian shillings for comparative meaning, rate 1KSH=19TZS)

(Amounts are in Million Shillings)

	2012	2011	2010	2009
Cash	283,894	298,248	360,606	134,265
Balances due from Central bank of Kenya	217,027	219,561	152,352	166,269
Kenya Government Securities	970,813	646,444	798,975	404,415
Foreign Currency Treasury Bills	367,759	45,768	25,589	12,284
Balance due from Other Banks and Local Institutions	-	149,623	54,720	32,300
Balance due from Other Banks and Foreign Institutions Abroad	389,067	634,450	139,289	217,001
Kenya Government and Other Securities Held Dealing Purpose	55,542	6,991	16,110	49,948
Tax Recoverable	201	391	209	9,678
Loans and Advances	4,021,620	3,775,773	2,814,154	2,330,523
Investment Securities	302,421	174,886	111,387	36,504
Property and Equipment	169,016	152,334	157,161	147,186
Prepaid Lease Rentals	2,792	2,808	2,772	2,811
Intangible Assets	22,305	28,817	25,999	25,729
Deferred Tax	44,272	20,054	21,399	2,038
Other Assets	133,477	127,459	95,043	129,821
TOTAL ASSETS	**6,980,206**	**6,283,607**	**4,775,768**	**3,700,773**
LIABILITIES				
Balance Due from Bank of Kenya	-	-	28,492	-
Customers Deposit	5,472,710	4,926,868	3,742,518	3,097,558
Deposit from Local Banking	118,933	177,826	152,487	57,924
Deposit from Banking Abroad	58,406	90,171	29,103	68,775
Borrowed Funds	169,543	161,975	-	-
Tax Payable	34,449	2,268	34,917	2,097
Differed Tax Liability	-	-	2	254
Other Liabilities	112,715	81,562	44,782	45,356
TOTAL LIABILITIES	**5,966,755**	**5,440,672**	**4,032,302**	**3,271,945**
SHAREHOLDERS FUNDS	-	-	-	-
Assigned Capital	56,436	56,406	56,055	42,138
Share Premium	359,510	358,933	352,745	138,662
Revaluation Reserve	(11,005)	(48,921)	(3,280)	4,332
Retained Earnings	441,402	336,710	265,110	199,576
Statutory Loan Reserve	59,879	35,456	2,767	1,989
Proposed Dividends	107,229	104,351	70,069	42,138
TOTAL SHAREHOLDERS' FUNDS	**1,013,452**	**842,936**	**743,466**	**428,834**
TOTAL LIABILITIES AND SHAREHOLDERS FUND	**6,980,206**	**6,283,607**	**4,775,768**	**3,700,779**

Sources: KCB Audited Financial Accounts

Table 4.8 is the tabulated representation of assets, liabilities and shareholders' funds of KCB commercial bank for four years from 2009-2012.

Table 4.9 Percentage change of key Financial Position Indicator for KCB Bank

Loans, Advances and Overdrafts(Net of allowances for probable losses)	7%	34%	21%
Total Assets	11%	32%	29%
Deposits from other banks and financial institutions	-33%	17%	163%
Customer deposits	11%	32%	21%
Retained earnings	31%	27%	33%

Source: Research Data

Loans, Advances and Overdrafts: From table 4.9 it indicates that the loans, advances and overdrafts of KCB bank were increasing at different rates from 2009 to 2011. In 2009 the bank offered only TZS 2,330,523 million to lenders, compared to year 2010 where the amount given to lenders was TZS 2,814,154 million indicating an increase from previous year of 21 percent (see table 4.9) and an increase of 34 percent was noted made loans offered to be TZS 3,775,773 million in 2011. The amount of loan offered in 2012 was 4,021,620 million indicating a percentage increase of only 7 percent, where in went down by 27 percent as compared to percentage increase in 2011 which was 34 percent.

Total Assets: Assets of KCB Bank showed a continuously increase in each year from 2009 to 2010. But the grow in 2012 increased only by 11 percent

Customer deposits: Among other factors which contribute to the determinant of profitability of commercial banks are customer deposits. When customers deposit their money to banks, banks use these monies to give out as loan to public and finally generate revenues/income from the interests charged from those loan or overdrafts given to the public. The higher the customers' deposits the higher the bank can offer more loans to public and hence can generate more profit and make it stands well to the eyes of the public. In the side of KCB Bank, it is seen that the customer deposits have being continuous increasing with minor variation of increase as calculated in table 4.9 above.

Table 4.10 DCB Bank Plc Statement of Financial Position

(Amounts in Million Shillings)

	2012	2011	2010	2009
Cash and Balances with BOT	12,970	15,304	15,775	14,198
Loans and Advances to Banks	8,600	8,893	9,048	8,143
Government Security Held to Maturity	23,260	10,848	11,150	10,035
Loans and Advances to Customers	65,096	57,440	55,987	50,388
Equity	1,120	1,100	-	-
Other Assets	1,455	1,800	2,255	2,030
Property and Equipment	4,751	3,771	871	784
Intangible Assets	181	187	127	114
Differed Income Tax Asset	7	16	-	-
TOTAL ASSETS	**117,440**	**99,359**	**95,213**	**85,692**
LIABILITIES				-
Deposit from Banks	19,287	16,108	14,224	12,802
Deposits from Customers	71,646	64,964	64,941	58,447
Income Tax Payable	349	516	455	410
Differed Income Tax Liability	-	-	96	86
Other Liabilities	1,955	1,246	678	610
Total Liabilities	93,238	82,834	80,395	72,356
Equity				
Share Capital	9,637	8,098	8,098	7,288
Advanced toward Right Issues	5,850	-	-	-
Share Premium	552	552	552	497
Proposed Dividend	954	1,620	1,555	1,400
Staff Loan Special Reserve	-	-	450	405
Retained Earnings	7,210	6,255	4,163	3,747
TOTAL EQUITY	**24,203**	**16,525**	**14,188**	**12,769**
TOTAL LIABILITY AND EQUITY	**117,440**	**99,359**	**95,213**	**85,692**

Sources: DCB Audited Financial Accounts

Table 4.10 is the tabulated representation of assets, liabilities and shareholders' equity of NMB commercial bank for four years from 2009-2012. The trend of loans and advances to public showed a frequent increase. The deposits from other banks and from customers showed a continuously positive increase for the all four years under the study. The bank also showed continuous increase in retained earnings. small increase of assets and liabilities where due to the fact that the DCB Banks is still a small bank operating only in Dar es Salaam region.

4.3 Selected Financial Position Indicators

Table 4.11 Selected Financial Position Indicators

	CRDB				NMB			
INDICATORS	**2012**	**2011**	**2010**	**2009**	**2012**	**2011**	**2010**	**2009**
Shareholders' Equity to Total Assets	10%	9%	10%	11%	12%	13%	11%	12%
Nonperforming Loans to Total gross Loans	7%	9%	11%	6%	2%	2%	4%	4%
Gross Loans and advances to Total deposits	67%	62%	57%	61%	61%	63%	48%	47%
Loans and Advances to Total assets	59%	53%	49%	51%	48%	52%	41%	40%
Earnings Assets to Total assets	80%	79%	80%	79%	77%	73%	77%	76%
Deposits growth	8%	18%	25%	27%	27%	-.4%	8%	22%
Assets growth	13%	18%	24%	28%	29%	3%	9%	21%
	KCB				**DCB**			
INDICATORS	**2012**	**2011**	**2010**	**2009**	**2012**	**2011**	**2010**	**2009**
Shareholders' Funds to Total assets	12%	11%	12%	10%	12%	8%	9%	12%
Nonperforming loans to Total gross loans	5%	7%	11%	6%	2%	1%	4%	4%
Gross Loans and advances to Total Deposits	70%	68%	57%	51%	58%	58%	48%	30%
Loans and Advances to Total Assets	58%	53%	49%	55%	48%	52%	41%	30%
Earnings assets to Total Assets	86%	79%	80%	79%	77%	63%	67%	57%
Deposits growth	25%	18%	25%	27%	27%	-.4%	8%	22%
Assets growth	23%	16%	24%	29%	16%	3%	9%	21%

Sources: Audited Financial Accounts

Table 4.11 is the tabulated representation of financial indicators of four selected commercial bank in the period of 2009-2012. From the table 4.11 it indicates that both banks maintained a well rate of shareholders fund to total assets. All the banks maintained an average rate of not below 10 percent with an exception of CRDB bank and DCB banks which their rates went below 10 percent in 2011CRDB and DCB and 2010 for DCB. In other hand all the four banks showed a well trend of deposit growth with an exception of DCB Bank which showed -4perecent in 2011, but it showed improvement in 2012 by recording the percentage of 27 percent. For the case of asset growth all banks maintained positive percent increase although it was not continuous increase due to up and down trend of increase.

4.4 Statements of Comprehensive Income

Table 4.12 Statement of Comprehensive Income Figures

(Amounts in Million Shillings)

CRDB BANK	**2012**	**2011**	**2010**	**2009**
Net Interest Income	206,276	153,385	125,005	109,968
Noninterest Income	99,035	65,720	71,203	55,882
Noninterest Expenses	(171,206)	(136,876)	117,717	(86,108)
Operating Income/(Loss)	107,702	51,013	64,134	61,922
Net Income(Loss) After Income Tax	80,543	37,710	47,146	48,825
NMB	**2012**	**2011**	**2010**	**2009**
Net Interest Income	278,576	185,173	130,409	127,518
Noninterest Income	94,589	82,277	71,173	41,773
Noninterest Expenses	202,573	152,912	(121,464)	(94,227)
Operating Income/(Loss)	144,741	102,786	78,445	68,038
Net Income(Loss) After Income Tax	97,401	71,839	53,981	47,550
KCB	**2012**	**2011**	**2010**	**2009**
Net Interest Income	582,088	453,818	351,469	274,906
Noninterest Income	296,797	304,431	100,932	105,251
Operating Income/(Loss)	326,955	287,458	219,213	119,707
Net Income(Loss) After Income Tax	231,867	208,640	167,558	77,594
DCB	**2012**	**2011**	**2010**	**2009**
Net Interest Income	10,531	11,433	9,186	6,466
Noninterest Income	2,283	1,263	1,775	1,239
Operating Income/(Loss)	2,841	4,437	4,243	2,481
Net Income(Loss) after Income Tax	1,908	3,262	3,166	1,844

Source: Audited Financial Accounts

Table 4.12 is the tabulated representation statement of comprehensive income statements for the selected commercial banks under the period of 2009-2012; the statements present only key important figures. CRDB, NMB and KCB showed a continuous growth of Net income with an exception of DCB where it’s net income dropped from 3,262 million in 2012 to 1,908 million in 2012 indicating a decrease of 42 percent. The following items from table 4.12 are here under discussed,

i. Interest Income

CRDB bank

In 2010, the Bank's interest income increased 14 percent to TZS 125,005 million, compared with TZS 109,968 million in 2009. The increase was mainly the result of the Bank's expanded business and loan portfolio and Customer lending contribution

NMB bank

In 2010, NMB Bank's interest income increased 2 percent to TZS 130,409 million compared with TZS 127,518 million in 2009. In 2011, the net increase was 23 percent and 34 percent in 2012. The increase was mainly the result of the Bank's expanded business and loan portfolio and Customer lending contribution

KCB bank

In 2010, KCB Bank's interest income increased 28 percent to TZS 351,469 million compared with TZS 274,906 million in 2009. In 2011, the net increase was 29 percent and 28 percent in 2012. The increase was mainly the result of the Bank's expanded business and loan portfolio and Customer lending contribution

DCB bank

In 2010, DCB Bank's interest income increased 42 percent to TZS 9,186 million compared with TZS 6,466 million in 2009. In 2011, the net increase was 24 percent and -8 percent in 2012. The decrease was mainly the result of the Bank's being on trading in Dar es Salaam region only and loan portfolio as well as Customer lending low contribution.

ii. Non Interest Income

All four banks showed an increase in noninterest income with an exception of KCB bank in 2010 where the non interest income decrease by 4 percent to 100,932 million from 105,251 million in 2009. In year 2012 the noninterest income of KCB bank also decreased to 296,797 from TZS 304,431Million in 2011 indicating a negative decrease of 3 percent

iii. Operating Income/(Loss)

The banks operating incomes were highly influenced by administrative and operating expenses include: rental payments, administrative costs, expenses for professional services, security, transportation and postal and other expenses. In 2011, both Banks showed an increase in operating income with an exception of DCB bank where it income dropped from TZS 4,437 million to TZS 2,841 million indicating a decrease of 36 percent. The increase was principally caused by the growth of revenues and decrease in costs related to maintaining the Bank's expanding business.

4.5 Key Performance Indicators (KPIs)

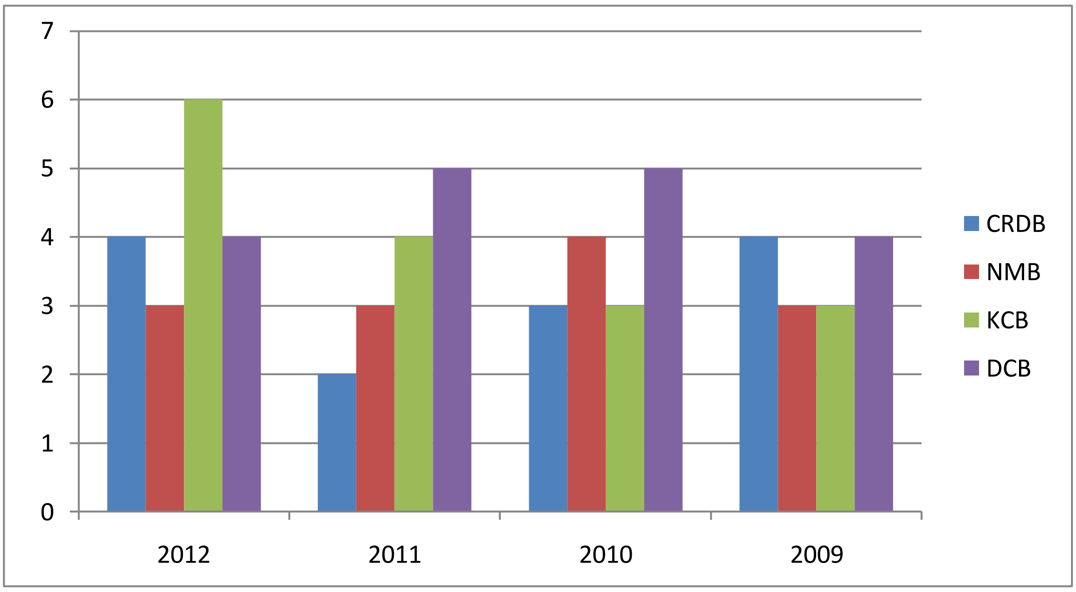
Table 4.13 Selected Key Performance Indicators (KPIs)

	CRDB				NMB			
Performance Indicator	**2012**	**2011**	**2010**	**2009**	**2012**	**2011**	**2010**	**2009**
ROA	4%	2%	3%	4%	3%	3%	4%	3%
ROE	28%	21%	29%	25%	27%	25%	35%	27%
Noninterest Expense to Gross Income	47%	54%	48%	43%	53%	56%	57%	51%
Net Interest Income to Average Earning Assets	10%	9%	9%	10%	14%	12%	13%	11%
	KCB				**DCB**			
	2012	**2011**	**2010**	**2009**	**2012**	**2011**	**2010**	**2009**
ROA	6%	4%	3%	3%	4%	5%	5%	4%
ROE	37%	32%	34%	27%	22%	22%	23%	15%
Noninterest Expense to Gross Income	54%	52%	45%	49%	43%	43%	36%	40%
Net Interest Income to Average Earning Assets	12%	10%	12%	9%	14%	14%	13%	15%

Source: Audited Financial Accounts

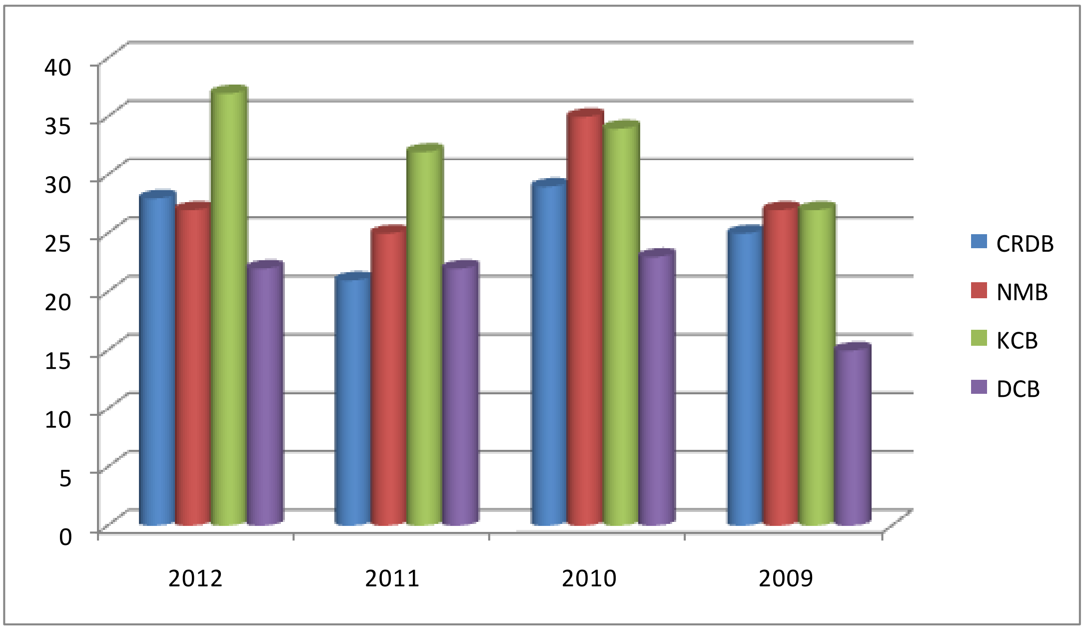
Table 4.13 shows key performance indicators of how well the Banks were performing. The indicators selected were ROA, ROE, non-interest Expenses to Gross Income and Net Interest Income to Average Earnings Assets ratio. But the two main indicators which are dependent variable to this study, ROA and ROE are the most indicators of performance in this study. According to Devinaga Rasiah (2010) for one to realize how well a bank is performing it is much more useful to consider ROA and ROE. All banks maintained a good level of ROA and ROE, where KCB bank showed a highest level of ROA of 6 percent in 2012 and DCB bank was having a 5 percent level of ROA in 2010 and 2011. CRDB was the only bank with a ROA 2 percent in 2011.For this scenario, the highest level was 6 percent followed by 5 percent, 4 percent, 3 percent and the lowest level was 2 percent. For the side of ROE, the banks maintained a range of 37 percent and 21 percent. Noninterest Expense to Gross Income and Net Interest Income to Average Earning Assets were highly at 57 percent and 15 percent respectively, while the lowest levels were 36 percent and 9 percent respectively.

Figure 4.1 ROA Bar Chart Presentations



Source: Audited Financial Accounts of Banks

Figure 4.2 ROE Bar Chart Presentation



Source: Audited Financial Accounts of Banks

From the statements of financial positions, it indicates that both banks performed well in different accepts, for example for the side of loan, advances and overdraft it was seen that each bank performed well with a continuous increase in each year from 2009 to 2012 although the percentage increase were moving up and down, also customers' deposits increased by different rate.

For non performing loans CRDB bank showed a decrease from 134,783 million in 2011 to 124,586 million in 2012, indicating decrease of 8 percent. NMB indicated an increase in nonperforming Loans from 18,128 million in 2011 to 32,705 million in 2012; this may result from poor management of loans offered to customers.

From selected financial indicators (table 4.11) showed that both banks performed well with an average of 10 percent shareholders' fund to total assets; CRDB bank in nonperforming loan was 7 percent in 2012 compared to the year 2011 which was 9 percent showing a decrease of 2 percent. NMB maintained the rate of 2 percent for nonperforming loan for two years 2011 and 2012. KCB also showed a decrease of nonperforming loans by 2 percent in 2012 from year 2011. All banks, for Loan and advances to total assets showed a continuous increase with an exception of DCB and NMB which both decreased by 2 percent in 2012 from 2011.

From table 4.12 showed that, CRDB, NMB and KCB showed a continuous growth of Net income with an exception of DCB where its net income dropped from 3,262 million in 2012 to 1,908 million in 2012 indicating a decrease of 42 Percent and showed that well capitalized banks are high profitable as compared to non-capitalized banks. Bank size was also seen among others to be a leading effect of profitability for commercial banks. Good example from table 4.8, KCB commercial bank, the international commercial bank in Tanzania, seen to have higher profit than any other bank under the study, this was contributed among other factors the size of the bank as it operates in many different countries like Uganda, Sudan and Tanzania. For the side of DCB the profits were not much higher as the bank it's still small and it operates only in Dar es Salaam region.

From Table 4.13, Figure 4.1 and Figure 4.2, the key performance indicators were compared; ROA indicated that CRDB, KCB and DCB banks were more profitable in 2012 indicating a 4 percent as compared to NMB which was only 3 percent. Otherwise all banks showed good results with a lower rate of 2 percent recorded by CRDB in 2011. ROE was also good for bank KCB which showed a good performance than other banks; this was possible because of it size and the number of customers deposit and many other factors.

4.6 Empirical Analysis

In this research most of data are collected from financial statements and other sources of all commercial banks listed in DSE for four years from 2009 – 2012. However other information such as inflation rates and Gross domestic product for Tanzania are collected from Bank of Tanzania directorate of bank supervision annual reports. As sampling criteria I decided to take commercial banks listed in DSE as representative of all other commercial banks in Tanzania, far more as the information access would be easy.

As stated earlier profitability of the banks in this context may be represented by the ROA or ROE, but for the purpose of this report the only test will base on ROA. The research concluded to use ROA in testing the correlation relationship of variables because it was found that, ROE was not an optimal measure of profitability since degree of capitalization was often established by the regulatory authority. The view in favor of ROA versus ROE was also supported in the literature, where Golin (2001) concluded that ROA was the key measure of profitability for commercial banks.

4.6.1 Descriptive statistics

The table below (Table 4.14) represents the summary statistics of sampled banks for four years period from 2009 to 2012. All figures are percentages.

Table 4.14 Descriptive statistics

Variables	Mean	SD	Maximum	Minimum
ROA	0.0375	0.0025	0.06	0.02
ROE	0.2681	0.0575	0.37	0.15
SETA	0.10875	0.0140	0.13	0.08
NLTA	0.05313	0.0309	0.11	0.01
GLATD	0.566	0.1003	0.7	0.3
LOTA	0.4869	0.0749	0.59	0.3
EATA	0.7556	0.07321	0.86	0.57
DG	0.1789	0.0993	0.27	-0.004
AG	0.7185	0.0857	0.29	0.03
INFL	11.575	4.3980	16	5.5
CDTA	0.79	0.0886	0.89	0.61

Source: research data

Table 4.14 presents the summary of descriptive statistics of the variables captured in the regression model. These statistics were generated to give overall description of the data used in the model and enable the researcher screen the data for any suspicious figure. The key descriptive measures are the mean, standard deviation, the minimum and the maximum values of the variables over the period under consideration.

The overall commercial banks seem to have smoothened paten of returns on total assets (ROA) as there is observed low standard deviation of 0.25% for all banks for the four years. This is consistent with Lintner (1965) reporting the tendency of managers' earnings and long term targets, This may give a good evidence to rely on

ROA as measure of profitability of the banks in this report, where the average industry profitability, ROA stands at 3.75 percent with 6 percent and 2 percent as minimum and maximum values respectively. But in other way round the average industry profitability ROE stands at 26.81 percent with 37 percent and 15 percent as minimum and maximum values respectively

4.6.2 Empirical Evidence

This section discusses the results of tests and regression analysis using multiple linear regression models as statistical instrument to analyze the impact of the selected determinants on profitability and the reason is that many researchers like William et al (1994), Molyneux et al (1994), P. I. Vong et al (2009), Karkrah and Aaron Ameyaw (2010) etc, used linear regression model as a tool for the analysis in their studies on the subject. Also, Short (1979) and Bourke (1989) in their studies consider several functional forms and arrived at a conclusion that it is appropriate to use linear regression model in the analysis of cross-section time series data because the result it produce is as good as any other functional forms; P. I. Vong et al (2009).

Table 4.15 ANOVA Resulting from Multiple Regressions

	df	**SS**	**MS**	**F**	**Significance F**
Regression	6	0.000779148	0.000129858	1.621307195	0.246850942
Residual	9	0.000720852	8.00946E-05		
Total	15	0.0015			

Source: research data:

From table 4.15 the model can best explain the reason why commercial banks in Tanzania have been making profit during these years. The results shows that the variables presented in the model deemed fit to be considered as the determinants of the commercial banks' profitability or ROA in the period.

Table 4.16: Model Summary of Multiple Regressions

R	**R square**	**Adjusted R Square**	**Std. Error of the Estimate**
0.72072	0.51943	0.199053	0.008949

Source: research data

The table 4.16 shows that the coefficient determination of both R-square and the adjusted R-square which is the explanatory power of the combined internal and external variables model for period and produces an explanatory power of about 52 percent (0.51943) of why the commercial banks in Tanzania have been making profit for the period. In other words about 52 percent of the profitability of commercial banks in Tanzania can best be explained by both internal and external variables that have been presented in the paper.

Table 4.17 Regression Results (ROA Dependent Variable)

	Coefficients	**Standard Error**	**t Stat**	**P-value**
Constant	0.075824967	0.031882223	2.378283534	0.041343845
SETA	-0.209149769	0.201843837	-1.036195963	0.32714859
NLTL	-0.079975586	0.090124838	-0.887386736	0.397964156
LOAD	0.083144282	0.066941347	1.242046738	0.245609545
CDTA	0.063431805	0.031624291	2.005793752	0.075840919
LOATA	-0.04683025	0.083049033	-0.563886757	0.586605388
INFL	0.001252694	0.00080309	1.559842429	0.153228364

Source: Research Data

ROA indicates how effectively a bank is managing its assets to generate income. ROA is the income earned on each unit of asset usually expressed as percentage. The ROA model is a multiple regression equation comprising of six explanatory variables. From the regression results, all six variables are statistically significant.

The variable, ratio of Share Equity to Total Asset (SETA) has a negative and statistically significant relationship with bank performance (ROA). This negative influence implies that the lower the capital adequacy of banks, the less profitable the banks become. This result is not consistent with the findings of Berger (1995), and Hassan *et al.,* (2003). The increase in bank capitalization by the Monetary Authority will not only provide a margin of protection in the advent of economic shocks but it will also ensure that banks remain profitable. It also implies that banks should ensure that they are well capitalized if they must remain profitable. Therefore basing on these results it indicates that the commercial banks should increase more efforts to ensure that they obtain low leverages so as to be sure of good profit all the time

The variable, Nonperforming loans to total loans (NLTL) or simply Provision for bad loans over loans was incorporated into the model to measure asset quality and credit risks. The result indicates that credit risk has negative and statistically significant relationship with bank profitability implying that the higher the credit risk of banks the lower the profitability. The higher the provision of nonperforming loans to loans ratio, the higher the credit risk and the higher the accumulation of unpaid loan and interest. This results is in line with that of Bessis (2002) who asserts that poor asset quality can have adverse impact on bank profitability reducing interest income revenue and increasing the provisions cost.

Customer Deposit to Total Assets (CDTA): Concerning CDTA, it has positive and significant effect on ROA of Tanzania commercial banks. This research finding is consistent with the prior empirical evidence (e.g. Rasiah, 2010 and Moin, 2008). They suggested that, the primary function of the commercial banks are collecting deposits and giving loan to the public from these deposits. So, the competitiveness and the profitability of the bank are depending on the degree of well performing of this activity. However, this finding is contradicted with the finding of some researchers (e.g Ommeren, 2011 and Belayeneh, 2011), they believed that, Since, time and savings, deposits represent a relatively higher cost source of funds, the more a commercial bank is committed to time and saving deposit, the higher would be the funding cost and hence the lower the profits.

The variable Loans and Advances to Total Assets (LOATA), has negative but statistically insignificant effect on ROA of the sampled commercial banks. This negative coefficient indicates, the commercial banks of Tanzania are affected by credit risk. This implies the existence of large non-performing loan from the total loan and advance.

The macroeconomic and financial structure variables, the result indicates that inflation (INF) variable which was captured in the model is significant and had a positive influence on bank profitability. This signals that bank managers are able to forecast accurately inflation and are proactive in managing anticipated inflation. By making accurate forecast of inflation, the manager can increase the rates on loan faster than the rate at which operating cost is increasing so that inflation favorably impacts on profitability. This result is consistent with most studies (Bourke, 1989; Molyneux *et al.*, 1992; Athanasoglou *et al*. 2005).

The Gross Domestic product (GDP) variable was not incorporated into the regression model to analyze the impact of economic activity on bank profitability. But if it was incorporated and the result turns out to be positive, this result could indicate that GDP has a positively significant influence on bank profitability. The results could be supported by the findings of Demirguc-Kunt *et al.,* (1998), Bikker *et al.,* (2002), and Athanasoglou *et al.,* (2005) who have concluded that there is a positive relationship between economic growth and bank profitability. The researcher didn’t test each and every variable, only the few listed above were tested.

4.7 BOT Report on Performance of the Banking Industry in Tanzania.

i. Overview of the Economy

According to BOT report for performance of the banking industry, Tanzania economic growth rate declined slightly in the year ended 31st December 2011. This was evidenced by a decrease in Real GDP at market price and basic price from 7 Percent recorded in 31st December 2010 to 6.65 percent in 31st December 2011. Annual headline inflation rate was 19.8 percent as compared to 5.6 Percent recorded in 2010. As at 31st December 2011, overall balance of payments remained positive. However, the current account balance was negative.

ii. Balance Sheet Structure of the Banking Sector

The total assets of the banking sector grew from TZS 12,570 billion to TZS 14,536.68 billion over the one year period ending 31st December, 2011. As at 31st December 2011, total liabilities reached TZS 12,790.19 billion compared to TZS

11,055.00 billion recorded in the previous year. Total capital as at 31st December 2011 reached TZS 1,746.50 billion compared to TZS 1,516 billion recorded in 2010. Similarly, aggregate off balance sheet items increased to TZS 2,543.08 billion during the year ended December 2011 from TZS 1,940 billion reported as at 31st December 2010. Trend in aggregate balance sheet positions from 2007 to 2011 and percentage changes over the years are indicated below;

Table 4.18: Aggregated Balance Sheet Positions

Period	**Total Assets (in TZS billions)**	**Percentage change (%)**
31st December 2009	10,038	18.89
31st December 2010	12,570	25.22
31st December 2011	14,537	15.65

Source: BOT Directorate of Banking Supervision Annual Report 2011

iii. Asset Structure

Major asset components of the banking sector continued to depict an upward trend, with the exception of investment in debt securities and interbank loans receivables, which declined by 15.18 percent and 5.32 percent respectively. Major drivers for the year 2011 assets growth were Cash balances (17.91 percent), and Loans, Advances and Overdrafts (29 percent)

iv. Liability Structure

As at 31st December 2011, total liabilities of the banking sector increased to TZS 12,790.19 billion from TZS 11,055 billion recorded in the previous year representing an increase of 15.70 Percent. Deposits were the major liability item accounting for 93.54 percent of total liabilities while borrowings and other liabilities accounted for 2.22 percent and 4.24 percent, respectively.

v. Capital Structure

Capital level of banking sector continued to record an upward trend during the year under review. Total capital of the banking sector as at 31st December 2011 stood at TZS 1,746.50 billion compared to TZS 1,516 billion recorded in the year 2010 representing an increase of 15.20 percent. Major components of capital were: paid up share capital, retained earnings and profits, share premium and general reserves.

vi. Banking Sector Performance

Generally, performance of the banking sector was good as reflected by the Financial Soundness Indicators covering Capital Adequacy, Asset Quality, Earnings and Profitability, Liquidity, Sensitivity to Market Risk and Access to Bank Lending. The sector continued to be adequately capitalized with Total Capital growth of 15.23 percent recorded during the year under review. The sector's Core and Total Capital Adequacy Ratios stood at 16.97 percent and 17.59 percent, respectively. Asset quality continued to be moderate with the ratio of Non-performing Loans to Gross Loans recording significant improvement from 9.32 percent recorded in the preceding year to 6.81 percent. During the year, profit before tax amounted to TZS 343.00 billion was recorded compared to TZS 244.00 billion recorded in the previous year. The sector continued to be liquid with the ratio of Liquid Assets to Demand Liabilities standing at 40.10 percent. Sensitivity to Market Risk was minimal as reflected by the ratio of Net Open Position to Total Capital, which stood at 0.00 percent. Lending to Private Sector as a percentage of GDP increased from 21.51 percent to 21.96 percent.

vii. Capital Adequacy

As at 31st December 2011, the banking sector on average was adequately capitalized with the ratio of Core Capital and Total Capital to total risk weighted assets and off balance sheet exposures of 16.97 percent and 17.59 percent as compared to 18.18 percent and 18.53 percent recorded in December 2010, respectively.

viii. Asset Quality

The quality of assets of the banking sector was satisfactory. Total assets of the banking sector increased by 15.65 percent, from TZS 12,570 billion to TZS 14,537 billion which, is an increase at a decreasing rate, compared to 25.22 percent recorded in the previous year. Loan portfolio was the major component accounting for 49.23 percent of total assets. For the year ended 31st December 2011, loan portfolio increased by 28.99 percent as compared to 19.36 percent recorded in the previous year. The Non-performing loan ratio decreased to 6.81 percent from 9.32 percent recorded in the previous year. Distribution of loans in the economy was as follows: Personal loans (20.71 percent), Trade (20.39 percent), Manufacturing (12.24 percent), Agriculture, Fishing, Hunting and Forestry (13.69 percent), Building, Construction and Real Estate (8.30 percent), Transport and Communication (7.38 percent) and other sectors (18.47 percent).

ix. Management

Management of banking institutions was considered satisfactory during the period. Adequate oversight was provided by the boards of directors. Corrective actions were taken timely to respond to challenges that were brought about by dynamism in the business environment. Indicators of this assertion included adequate capital, satisfactory asset quality, good earnings and adequate liquidity. Generally, banks and financial institutions complied with banking laws, regulations, guidelines, circulars and directives issued by BOT.

x. Earnings

The banking sector remained profitable during the year. For the year ended 31st December 2011 the sector reported profit before tax of TZS 343.00 billion which was an increase of 40.45 percent from TZS 244.22 billion reported in the previous year. Interest income was the major source of the sector's income accounting for 67.72 percent of total income as compared to 65.86 percent recorded in 2010. The ratio of Non-interest Expense to Gross Income was 56.08 percent as compared to 54.47 percent recorded in the previous year. As at 31st December 2011, banking sector's Return on Assets and Return on Equity ratios were 2.53 percent and 14.47 percent compared to 2.16 percent and 12.13 percent, recorded in the previous year respectively.

Table 4.19: Earnings Ratios

RATIO	2009 %	2010 %	2011 %
Net Interest Income to Earning Assets	7	6.46	7.17
Non-Interest Expenses to Net Interest Income	92	109.14	107.52
Return on Assets	3.22	2.16	2.53
Return on Equity	18.44	12.13	14.47
Net Interest Income to Gross Income	73.32	50.07	52.57
Non-Interest Expenses to Gross Income	47.60	54.64	56.08
Personnel Expenses to Non-Interest Expenses	42.60	40.56	41.72
Non-Interest Income to Total Income	26.98	33.94	32.28
Interest Rate Earned on Loans and Advances	14.85	18.00	19.00

Source: BOT Directorate of Banking Supervision Annual Report 2011

xi. Liquidity

Liquidity position of the banking sector as at 31st December 2011 was considered satisfactory. The Liquidity Ratio and Lending Ratio were 40.10 percent and 64.34 Percent, as compared to 45.23 percent and 58.93 percent recorded in 2010 respectively. These ratios were within the prescribed regulatory limits of 20 percent and 80 percent for liquidity and lending ratio respectively. Deposits, as the major source of the sector’s funding accounted for 93.54 percent of total funding.

xii. Risk Assessment

The Directorate of Banking Supervision continued to assess risk management practices in the banking institutions. Banking institutions are then directed to improve their risk management practices whenever inadequate risk management practices are observed. Boards of directors of banking institutions have the ultimate responsibility for management of risks in their institutions. Management should comply with Risk Management Guidelines to all banks and financial institutions, which was reviewed in 2010 and became effective in January 2011. The major risks which are in the Guideline are Operational Risk, Market Risk, Liquidity Risk and Credit Risk (All were presented in literature review chapter)

4.8 Factors motivated the Banks to be listed in DSE

i. Raising capital

The Stock Exchange provide companies mostly commercial banks with the facility to raise capital for expansion of their capital through selling shares to the investing public

ii. Mobilizing savings for investment

When people draw their savings and invest in shares, it usually leads to rational allocation of resources because, funds which could have been consumed, or kept in idle deposits with banks, are mobilized and redirected to help companies' management boards finance their organizations. This may promote business activity with benefits for several economic sectors such as agriculture, commerce and industry, resulting in stronger economic growth and higher productivity levels of firms. Sometimes it is very difficult for the stock investor to determine whether or not the allocation of those funds is in good faith and will be able to generate long-term company growth.

iii. Facilitating company growth

Companies view acquisitions as an opportunity to expand product lines, increase distribution channels, hedge against volatility, increase its market shares, or acquire other necessary business assets. A takeover bid or a merger agreement through the stock market is one of the simplest and most common ways for a company to grow by acquisition or fusion.

iv. Profit sharing

Both casual and professional stock investors, as large as institutional investors or as small as an ordinary middle-class family, through dividend and stock prices increases that may result in capital gains, share in the wealth of profitable businesses. Unprofitable and troubled businesses may result in capital loses for shareholders.

v. Corporate governance

By having a wide and varied scope of owners, companies generally tend to improve management standards and efficiency to satisfy the demands of these shareholders.

However, when poor financial, ethical or managerial records are known by the stock investors, the stock and the company tend to lose value. In the stock exchanges, shareholders of underperforming firms are often penalized by significant share price decline, and they tend as well to dismiss incompetent management teams.

vi. Creating investment opportunities

As opposed to other businesses that require huge capital outlay, investing in shares is open to both the large and small stock investors because a person buys the number of shares they can afford. Therefore the Stock Exchange provides the opportunity for small investors to own shares of the same companies as large investors.

4.9 Factors that lead to Commercial Bank's Profitability

i. Interest rate

Interest rates among other factors are the most factors which contribute in high volume the profit of commercial banks and any other financial institution involved in lending money to customers. Interest rates are charged not only for loans, but also for mortgages, credit cards and unpaid bills. The interest rate is applied to the total unpaid portion of a loan or bill. It's important to know what interest rate is, and how much it adds to outstanding debt. If interest rate adds more to debt than the amount which are paying, debt could actually increase even though they are making payments. Although interest rates are very competitive, they aren't the same. A bank will charge higher interest rates if it thinks there's a lower chance the debt will get repaid. Some types of loans, like credit cards, are always assigned higher interest rates because they are more expensive to manage. Banks also charge higher rates to people they consider riskier. That's why it's important to know what your credit score is, and how to improve it. The higher your score, the lower the interest rate you will have to pay.

ii. Lending

Another factor which contributes to the profit of the commercial bank is lending activities. A bank is 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. So when banks offers credit facilities to customers, it gives a room to boom up in its earning by charging different rates of interest for the loans offered.

iii. Bank Charges

The term bank charge covers all charges and fees made by a bank to their customers. In common parlance, the term often relates to charges in respect of personal current accounts or normal savings account. These charges may take many forms, including:

- monthly charges for the provision of an account
- Charges for specific transactions like transfers(other than overdraft limit excesses)
- Interest in respect of overdrafts (whether authorized or unauthorized by the bank)
- Charges for exceeding authorized overdraft limits, or making payments (or attempting to make payments) where no authorized overdraft exists.

All these contribute to the profit generation of commercial banks in Tanzania and any other bank of financial institution as obtained from researcher.

iv. Bank’s Size

Bank size is associated with diversification which may impact favorably on risk and product portfolio. Economies of scale will reduce the cost of gathering and processing information so that a positive effect of bank size is associated with profitability. Bank size was also found to be significant in affecting profit efficiency negatively or positively. This was also notified by the researcher when conducted interview with the selected commercial banks.

v. GDP

The GDP is one the primary indicators used to gauge the health of a country's economy. It represents the total value of all goods and services produced over a specific time period. Usually, GDP is expressed as a comparison to the previous quarter or year. For example, if the year to year GDP is up 3 percent, this is thought to mean that the economy has grown by 3 percent over the last year. As one can imagine, economic production and growth, what GDP represents, has a large impact on nearly everyone within that economy. For example, when the economy is healthy, you will typically see low unemployment and wage increases as businesses demand labor to meet the growing economy. A significant change in GDP, whether up or down, usually has a significant effect on the stock market. It's not hard to understand why: a bad economy usually means lower profits for companies, which in turn means lower stock prices. Investors really worry about negative GDP growth, which is one of the factors economists use to determine whether an economy is in recession.

vi. Political and Social Factors

Sometimes businesses compete not only in business but also vie for political and social powers. A bank or company can also be considered as politically connected if its large shareholders or top managers include a member of parliament, minister or head of state, or if managers are closely related to any of these top officials Since politics gives access to the economy and possibility to set the rules of the game, a strong political relationship could be considered as one of the most important intangible assets of any firm or company even for commercial banks.

vii. Foreign Exchange Market

The foreign exchange market assists international trade and investment by enabling currency conversation. For example, it permits a business people to import goods from foreign countries, especially using mainly US Dollar, Euros and pounds. It also supports direct speculation in the value of currencies, and the carry trade, speculation based on the interest rate differential between two currencies.

4.10 Major challenges faced by Commercial Banks in Profit Generation

Major challenges faced by commercial banks in Profit Generation differ due to various factors including but not limited to the followings;

i. **Economic factors**

The changing economic environment has a significant impact on banks and thrifts as they struggle to effectively manage their interest rate spread in the face of low rates on loans, rate competition for deposits and the general market changes, industry trends and economic fluctuations. It has been a challenge for banks to effectively set their growth strategies with the recent economic market. A rising interest rate environment may seem to help financial institutions, but the effect of the changes on consumers and businesses is not predictable and the challenge remains for banks to grow and effectively manage the spread to generate a return to their shareholders

.

ii. **Loan monitoring**

The management of the banks' asset portfolios also remains a challenge in today's economic environment. Loans are a bank's primary asset category and when loan quality becomes suspect, the foundation of a bank is shaken to the core. While always an issue for banks, declining asset quality has become a big problem for financial institutions. There are several reasons for this, one of which is the lax attitude some banks have adopted because of the years of "good times." The potential for this is exacerbated by the reduction in the regulatory oversight of banks and in some cases depth of management. Problems are more likely to go undetected, resulting in a significant impact on the bank when they are recognized. In addition, banks, like any business, struggle to cut costs and have consequently eliminated certain expenses, such as adequate employee training programs.

iii. **Changing in management team**

Banks also face a host of other challenges such as aging ownership groups. Across the country, many banks' management teams and board of directors are aging. Banks also face ongoing pressure by shareholders, both public and private, to achieve earnings and growth projections. Regulators place added pressure on banks to manage the various categories of risk. Banking is also an extremely competitive industry. Competing in the financial services industry has become tougher with the entrance of such players as insurance agencies, credit unions, check cashing services, credit card companies, etc. As a reaction, banks have developed their activities in financial instruments, through financial markets operations such as brokers and Securities Clearing services trading and become big players in such activities

iv. Market competition

A firm's profitability depends in part on whether other firms can easily enter its market and compete with it. When other firms are free to enter a market, economic profits tend to very low, even for well-managed firms. When firms are prevented from entering a market, economic profits can be quite high.

v. Political factor

Sometimes commercial banks face a lot of challenges when the political situation of the country is unstable. The turnovers of the banks tend to decline for unstable political situation and verse versa when the situation is stable, political issues occasionally come to influence the activities of the business community. Organizations like commercial banks often spend many billions of money lobbying to influence political decision makers for this reason. Businesses may get involved in politics, for example, when their international operations come under fire from human rights groups, or when a high-profile politician recommends an increase in corporate taxes. Also these were found to be a challenge for the commercial banks on their ways towards profit generation

4.11 BOT Regulations for Banks and Financial Institutions

BOT uses both on-site and off-site inspection in supervising banks and financial institutions.

On-site inspection:

Full scope or target examination on individual banks or financial institutions. The risk management framework of the individual bank or financial institution especially Credit, Liquidity, Interest Rate, Foreign Exchange and Operational Risks are reviewed. Apart from the risk framework review of the five key components of the institutions, that is Capital adequacy, Asset quality, Management quality, Earnings capability and Liquidity at least once a year for every institution done on site. In addition, supervisors do verify compliance with laws and regulations and assess the effectiveness of the institutions' internal control system.

Off-site inspection:

In the off-site inspection assessment of financial soundness through analysis of the statistical and other returns covering key areas of the institutions is done. From the analysis an Early Warning Report is produced. The statistical returns are submitted periodically (i.e. Daily, Weekly, Bi-weekly, monthly, quarterly, semi-annually and annually or on ad hoc basis if the circumstances so demand)

i. Foreign Exchange Exposure Limits

The main objectives of these Regulations are to ensure that banks and financial institutions have in place adequate policies and procedures to identify, monitor and manage foreign exchange risk and maintain risk management standards that conform to established international norms.

ii. Physical Security Measures

The principal objective of these Regulations is to prescribe minimum security measures to be instituted by all banks and financial institutions for the purpose of: - preventing acts of robbery and burglary, assisting in identifying and apprehending persons who commit acts of robbery or burglary, preventing injury and loss of life to staff and customers, preventing damage or loss of assets, which could result into major losses to individual institutions, the banking sector and the national income, and creating security awareness among management and staff in all banks and financial institutions thereby promoting a security conscious working environment.

iii. Credit Concentration and Other Exposure Limits

The main objectives of these Regulations are to encourage risk diversification and limit excessive concentration of risk by any bank or financial institution, promote arm's length relationship in dealing between a bank and its insiders, and prescribe limits for investment in equity and fixed assets. The Regulations provide for risk diversification and curtail excessive concentration of risk exposure of any bank or financial institution to one customer or group of customers, industry economic sector or activity, thereby stability of the financial system.

iv. Capital Adequacy

The Regulations provide minimum capital requirements for various forms of banking institutions in Tanzania (i.e. minimum capital for banks, other financial institutions, microfinance companies and microcredit activities). Further, the Regulations detail the capital adequacy requirements including items for consideration in core and total capital adequacy ratios.

v. Management of Risk Assets

The Regulations provide for the minimum conditions for credit and investment function in a bank or an institution. At a minimum putting in place risk management policies for risk assets administration (i.e. identify, measure, monitor and manage) the risk arising from their business and ensure timely and adequate action are taken on problem assets, maintain risk management standards that conform to internal norms and promote and maintain public confidence in the banking sector.

4.12 Summary of the Findings

It is generally agreed that a strong and healthy banking system is a prerequisite for sustainable economic growth. Commercial Banks in Tanzania have been undergoing major challenges in the dynamic operating environment over the past decade. In order to withstand negative shocks and maintain financial stability, it is important to identify the determinants that mostly influence the overall performance of banks in Tanzania. During the study period, the researcher came out with the following findings.

Regarding the determinant for profitability in Tanzanian commercial banking industry, this study revealed that Bank size and location of branches, operational efficiency, capital adequacy, deposits, liquidity, asset quality, bank size, management competencies, motivation, quality and strategy are the main internal factors for profitability in Tanzanian Banking industry. The researcher found that, individual bank characteristics are able to explain a substantial part of bank profitability. Banks with more equity capital are perceived to have more safety and such an advantage can be translated into higher profitability. On the other hand, results reveal that a higher loan and advances to total assets ratio may not necessarily lead to a higher level of profits. Due to the competitive credit market condition and the successive cuts in interest rate, the interest spread, i.e. the important determinant of profitability, becomes narrower. A lower spread together with higher loan loss provisions lead to lower profitability. Therefore, instead of loan size, it is the spread and the quality of the loan that matter. Lastly, my study shows that smaller banks, on average, achieve a higher return on assets than larger ones. Concerning the macroeconomic indicators, the inflation rate plays an important role in explaining the banks' return on assets. The positive relationship between inflation and bank performance suggests that a bank's income increase more with inflation than its costs.

CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATION

5.0 Introduction

This chapter presents the summary, conclusions and recommendations based on the results. The importance of the role of banks in the economic development and growth of a country cannot be underestimated. A healthy financial system is a prerequisite for proper financial mediation leading to sustainable private investment and the promotion of entrepreneurship. The banking industry has witnessed many reforms and policies over the past decade. The competitive landscape and operational environment have become dynamic. There is heightened pressure on banks to compete as banks have become more integrated into the global financial system. In order to withstand economic shocks and to maintain financial stability, it is imperative to identify the determinants that influence bank profitability for Both Local and Foreign Commercial Banks in Tanzania and the extent of their impacts.

This study examined the determinants of commercial banks profitability in Tanzania. These determinants were categorized into internal factors and external factors. The external factors were sub-divided into macroeconomic factors and financial structure factors. This categorization was in line with earlier studies (Short, 1979; Bourke, 1989; Molyneux *et al.*, 1992; Demirguc-Kunt *et al.*, 1998) on bank profitability where profitability was viewed a function of both internal and external determinants. Two key measures of profitability (dependent variables) were used in this study. These comprised of ROA and ROE. The variables were specially chosen to measure the impact of capital adequacy, operating expense, liquidity, asset quality, Bank size, inflation, GDP, money supply and bank concentration on profitability respectively.

5.1 Findings of the Study

It is generally agreed that a strong and healthy banking system is a prerequisite for sustainable economic growth. Commercial Banks in Tanzania have been undergoing major challenges in the dynamic operating environment over the past decade. In order to withstand negative shocks and maintain financial stability, it is important to identify the determinants that mostly influence the overall performance of banks in

Tanzania. During the study period, the researcher came out with the following findings.

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5.2 Conclusion

The study examined the factors or determinants that influence and impact on bank profitability. Two main determinants of bank profitability were identified; the internal determinants and the external determinants. The internal determinants are bank-specific and can be controlled by the bank manager. The external determinants are outside the control of banks although banks can strategically be positioned to exploit the opportunities in these environments or mitigate threats from this environment.

Using ROA as the main measure of bank profitability, internal determinants comprising of capital adequacy, operating efficiency, liquidity, and asset quality and bank size and with external determinants comprising macroeconomic factors and financial structure like inflation and GDP were significant to bank profitability.

Also the study took a look on things like roles, risk faced by commercial Banks in Tanzania and the management/procedures or steps of mitigating/eliminating those risks. These risks were put into consideration as are among other factors which can affect the profit generation of commercial banks. The researcher tried to check out the roles played by these commercial bank where the followings were discussed, Capital Accumulation, Mobilization of Savings, Availability of Funds, Attaining Self Sufficiency, Implementation of Modern Technology, Development of Agriculture Sector, Development of Industrial Sector, Expansion of Market, Essential for Foreign Trade, Remove Budget Deficits, Creators and Distributors of Money, and Research and Development. Also risks which commercial bank face in its effort toward profit generation were discussed to be but not limited to Liquidity Risk, Credit Risk, Market Risk, Operational Risk, Strategic Risk and Compliance Risk**.** Finally, the ways of managing risk were also put into discussions which were Risk Identification, Risk Measurement, Risk Control and Risk Monitoring

5.3 Suggestions

As indicated in the introduction chapter, the main objective of this research was to investigate the determinants of local and foreign commercial bank profitability in Tanzania. The researcher would like to give some suggestions basing on the study conducted;

Firstly, the researcher would like to suggest to the governments of Tanzania and financial management institutions to take into account the main fabrics and other policy repercussions towards commercial bank profitability that have gained considerable importance in Tanzanian financial sector. This would probably be achieved through undertaking comprehensive and rigorous stress testing to avoid risks associated with market failures in the sector.

Secondly, Cross-country studies should be conducted to give a comprehensive assessment between the economic performance and policy prescription (including fiscal policy instruments) with commercial banks' overall performance. Supervisory and related services should be geared towards optimum utilization of resources, prudent risk management, sound competitive environment and excellence in service.

Thirdly, for commercial banks in Tanzania, there are a need to be more risk vigilant related to changing macroeconomic factors in liberalized regimes across countries.

Fourthly, there is a need of Policies to be directed to improve risk management and technology, strengthen supportive information and bank supervision, and develop inter-bank, securities and equity markets to maintain macroeconomic stability for better future performance of commercial banks.

Lastly, it would also be important to look into long term effects of inflation on the overall bank performance to expect asymmetric effect of such uncertainties on bank's profitability.

5.4 Recommendations.

From the Presentation and discussions of the results presented the researcher came up with the following recommendations basing on Research objectives and questions.

- The commercial banks should give more attention in reduction of expenses and other duplication of capital costs, to improve the profitability of the Bank by reducing operating, administrative and personnel expense.

- Government policies on employment and investments should be intensified to increase the profitability of banks. In an economy where government stimulates the creation of jobs and creates the right investment climate for both local and foreign investors, banks are likely to boom well.

- Efficient and effective liquidity management should be adopted by bank managers to ensure that banks do not become insolvent. Since banks are less profitable when less liquid, bank managers should be encouraged to invest in more liquid assets. This will not only improve bank profitability but it will also enable banks meet their short term obligations as they fall due.

- The profitability of commercial banks is shaped by bank-specific factors (that are affected by bank-level management) and macroeconomic variables as well as financial factors that are not the direct result of a bank's managerial decisions. Yet, industry structure does not seem to significantly affect. So, the banks' managers and policy makers should give high concern and set direction to manage properly bank-specific determinants of profitability.

- Economy of scale derived from bank size play a crucial role in commercial bank profitability. The benefit of size would reflect in the ability to reach wider markets. Banks should therefore be encouraged to look beyond local market (For Local Commercial Banks) and strategically expand their operations to other geographical markets and sectors of the economy. Location of bank branches is strategically paramount if banks must maximize return on investment.

5.5 Future Research

Future research could investigate determinants of commercial banks' profitability for the third world countries compared to the developed countries in the word. Also a future study can be on determinants of profitability for the commercial banks not listed in DSE

5.6 Lesson Learnt

First and foremost, this whole research exercise has been a great learning adventure where the skills for conducting research, report writing, and presentation of academic paper have been acquired. Research is a very serious work which involves a lot of thinking, planning, dedication and high concentration during data collection, analysis and report writing in presenting analytical views from the study findings.

Another lesson learnt is that majority of unemployed youths can be employed in self employment to them if well empowered, this will reduce the number of unemployment. If there is assurance of finance for financing small business activities from commercial banks; school leavers can use that great opportunity to employ themselves while waiting for further employment opportunity (white color job).

Finally, financial performance performed by banks plays a significant role in assuring and maintaining stability of the countries' economic systems. Especially, in the developing countries like Tanzania, since banks serve as fundamental financial intermediations, performance of the sector directly affects the economic development of the country.

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APPENDIX

Interview questions and questionnaires

This questionnaire is designed to gather information on "Determinants of profitability of commercial banks in Tanzania". The study is being carried out for a dissertation paper in partial fulfillment of requirements for the degree of the Master of Science in accounting and finance (Msc A & F) of Mzumbe University.The information in the questionnaire will be treated with confidentiality and will not be used for any other purpose other than for this research.

Section A: General Information

1. Name of the commercial Bank ………………………
2. Type of ownership
   (a) Private
   (b) Joint owned
   (c) Other…………………..
3. How long have you been in operation?

(a) 1-3 years	(c) 4 -5 years
(b) 6-10 years	(d) over 10 years

4. What is the relative size of your bank in terms of annual volume turn over?
   a) Less than 200 million
   b) 200-300 million
   c) 300-500 million
   d) 500-1Billion
   e) Over 1 Billion
5. Banks capital structure
   a) Debts
   b) Equity
   c) Debt &equity
   Other ……………………..

SECTION B: DETERMINANTS OF PROFITABILITY

6. How long have you being in operation after register in DSE?

(a) 1-3 years (c) 4 -5 years

(b) 6-10 years (d) over 10 years

7. What motivates you to be listed in DSE?

…………………………………………………………………………………….

…………………………………………………………………………………….

…………………………………………………………………………………….

8. What are the major factors leads to profitability of your bank

…………………………………………………………………………………….

…………………………………………………………………………………….

…………………………………………………………………………………….

9. What are the major challenges that you face in generating profit of your bank.

…………………………………………………………………………………….

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…………………………………………………………………………………….

10. What is the assistance you receive from the regulatory authority/Government?

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

11. Please indicate the extent to which each of the following factors is determinants of Profitability of the Bank. (1-Not applicable, 2=to a less extent, 3 to a moderate extent, 4= to a great extent, 5 to a very great extent)

Factor	**5**	**4**	**3**	**2**	**1**
ROA (Return on assets)					
Portfolio yield (The portfolio yield at the end of the period)					
Operational costs					
Debt/equity Total debt, including voluntary savings, divided by equity Outreach					
outstanding loan					
The number of credit clients					
Portfolio at risk					
Board size (The number of directors)					

Internal board auditor					
Product differentiation					
Labour productivity (The total number of loan clients divided by the total number of employees)					
Firm size (The natural logarithm of assets)					

12. The following are indicators of financial sustainability and poverty outreach, by type Of the Bank please indicate the extent to which each of the following indicators contribute to rise in profit of the Bank.

(1-Not applicable, 2=to a less extent, 3 to a moderate extent, 4= to a great extent, 5 to a very great extent)

Indicators	5	4	3	2	1
Repayment rate of loans					
Average loan size					
Loan size					
Average size of savings deposit					
Savings deposit					
Bank Size					
Credit clients					
Number of Branch					
Operational costs					

13. Which is the most important determinant for profitability generation in your bank?

a) Internal determinants

b) External determinants

c) Both internal and external determinants