IMPACT OF CREDIT ON THE PERFORMANCE OF BANKS AND OTHER FINANCIAL INSTITUTIONS, A CASE STUDY OF KILIMANJARO CO-OPERATIVE BANK LIMITED

BY

NASSIB MWEDADI

A RESEARCH PAPER SUBMITTED IN PARTIAL FULFILMENT OF REQUIREMENTS FOR THE MASTERS DEGREE IN BUSINESS ADMINISTRATION (AGRIBUSINESS) OF SOKOINE UNIVERSITY OF AGRICULTURE. MOROGORO, TANZANIA

2008

ABSTRACT

This study investigated the impact of credit on the performance of financial institutions focusing on the Kilimanjaro Cooperative Bank Limited (KCBL) in Moshi Municipality, Kilimanjaro Region, Tanzania. The researcher interviewed the Bank Manager, credit officer, and the Management board. He also obtained valuable information through reviewing relevant documents (reports and credit documents). The information was analyzed using a simple impact assessment approach. The study revealed that KCBL is poorly performing on account of unsatisfactory asset quality attributed to poor loan administration, unsatisfactory earnings and credit management as loans. On the other hand the study also revealed that the bank was performing well in terms of extending loans and overdrafts to many borrowers to cater for inputs acquisition and other expenses. The total gross loans amounted to TZS 3,351.06 million and were extended to various sectors including Agriculture (28.37%), Education (12.62), Transport & Communication (12.13%), Trade (10.75%), and manufacturing (8.22%) Hotels & Tourism (6.45%). Personal loans (6.36%), Real Estate and Construction (5.63%), Health (4.87), Fishing (3.05%) and the remaining (1.49%) were on insurance and finance. The Bank faced various risks ranging from financial and non-financial risks. KCBL has several systems in place which include various management and board committees to address credit risk. The study also found out that the KCBL did not have an approved credit policy manual for its day to day lending activities making it difficult to abide by the best practices of credit management. It is therefore suggested that the bank should prepare a credit policy to act as a blue print in credit management. The study also recommends s that there should be both English and Swahili versions of the contract documents so that indigenous borrowers can comprehend these documents easily.

DECLARATION

I, **NASSIB MWEDADI**, do declare to the Senate of Sokoine University of Agriculture that, this research paper is my own original work and has not been submitted for a higher degree award in any other University.

30th July 2008

Nassib Mwedadi
(MBA-Agribusiness Candidate)

Date

The above Declaration is confirmed by

26th Aug 2008

Dr. F.T. KILIMA
(Supervisor)

Date

COPYRIGHT

DEDICATION

I dedicate this work to my family and my supervisor for their love, support and encouragement.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF APPENDICES

LIST OF ABREVIATIONS AND ACRONYMS

BOT	-	Bank of Tanzania
CRDB	-	CRDB bank Limited
DFI	-	Development Financial Institution
KCBL	-	Kilimanjaro Cooperative Bank Limited
MFI	-	Microfinance Institution
MIS	-	Market information system
NBAA	-	National Board of Accountants and Audit
NBC	-	National Bank of Commerce
PAYE	-	Pay as you earn
RFI	-	Rural Financial Institutions
SACCOS	-	Savings and Cooperative Credit Societies
SWOT	-	Strength, Weaknesses, Opportunities and Threats
TRA	-	Tanzania Revenue Authority
USAID	-	United States Agency for International Development

CHAPTER ONE

1.0 INTRODUCTION

As Organizations have incurred more and more debts in recent decades, those institutions that market and underwrite public debt have assumed greater importance to promote sound debt management. The need for sound debt management is to prevent events such as the developing world's external debt crisis of the 1980's, and the Asian crisis of the 1990's (Wood, 1998).

The financial system has been suffering from what is known as credit crunch phenomenon (Stanley and Geofrey, 1997). This situation may occur when bad loans are issued to real estates, third world countries and high risk corporations. These bad loans have resulted into partial collapse of saving and loan industry, the decline of banks and insurance companies, and an inability or unwillingness by lenders to lend money to moderate or high risk borrowers. Thus, many lenders are becoming more risk averse allocating capital based on risk rather than interest rate that could be charged on borrowed money (Stanley and Geofrey, 1997).

To address this problem, the Banking sectors of many industrialized countries have been subjected to various forms of deregulation. Apparently, policy makers believe that improving efficiency and performance of financial systems could be achieved through policies aiming at increasing banks' competition on price, product services, and territorial rivalry (Smith, 1984). Bank deregulation has created greater competition among financial institutions such as commercial banks, savings and loans, credit unions, brokerage houses and new companies offering financial services (Stanley and Geofrey, 1997).

While recognizing the need to improve debt management it is important to realize that public debt is not, and cannot be isolated from the rest of the financial management systems. The collapse of other financial management sub-systems especially budgetary control have provided the motor for the phenomenal increase in public sector debt over the past three decades in almost every country (Lewellen, 1976).

Planning indebtedness is just as essential as planning cash flow, and many analysts feel that these two objectives should be considered as one owing to their close relationship. Public indebtedness is often the result of a political decision of either not to raise taxes or to reduce expenditures to affordable levels. Public indebtedness can also result from periodic response to seasonal fluctuations in revenue and disbursement.

At the national level, any financing operation that demands committing the credit of the state should be channeled through the agency responsible for public credit. This will minimize oversights and assure proper recording of the transaction as a liability to new debt and planning of the corresponding inflow of cash (James van Horne 1968). However, according to the World Bank Development Report (1994) governments will continue to be major users of funds as well as conduits for resources from multilateral Development banks. This is because governments are responsible for large and growing urban infrastructure which represents the major source of demand for financial resources. To meet these demands, new initiatives including revitalizing of existing financial institutions are being tried.

Stiglitz (1998) argues that the financial sector constitutes the 'brain' of the economy and banks are the major constituents of the financial sector. This is especially true in bankdominated economies where the banking system plays a crucial role in the intermediation process and also constitutes the mainstay of the payments system. However, the banking sector, in isolation, cannot be efficient unless there exist a conducive framework in other sectors of the economy as well. According to Binhammer (1975) financial intermediaries have some roles to play. Firstly, they provide financial assets that will satisfy the tastes and preferences of the potential savers and thereby inducing them to increase their propensity to save. Secondly, they facilitate the transfer of funds from surplus spending units to units that demands more funds. As it can be noted, the direct flow of money between savers and borrowers is hindered by risks and inconvenience, and the cost of transfer as well as the desire of savers (lenders) to avoid liquidity problems. Thus a financial infrastructure should provide a country with an efficient payment mechanism. Also, it should encourage and mobilize savings and provide an efficient mechanism for allocating savings according to country's priorities for economic and social development. This is an ideal situation which can be applied with the knowledge of structure of the economy and its population.

According to Tanzania's population census of 2003, 85 percent of the country's poor people live in the rural areas and rely on agriculture as their main source of income and livelihood. In Tanzania agriculture provides over 61% of both GDP and merchandise exports. The Word Bank country study on Agriculture (World Bank 1994) indicated that Agriculture is the foundation of the Tanzanian economy, providing employment, food and exports. This information implies that the Tanzanian economy depends on the rural community, thus this community should be provided with the necessary facilities to foster economic growth. Financial institutions seem not to have fulfilled their roles. The foregoing arguments suggest that although all financial institutions have roles to play, commercial banks are better placed to facilitate changes in the rural community in terms of savings mobilization and credit allocation to foster economic growth and improve welfare of its people.

Experiences show that the socialist-oriented economy of Tanzania has not been fully planned. The banking system is publicly owned while the economy is to a large extent privately owned and is generally unplanned. It is difficult for example to asses the credit requirements of parastatals since centrally approved physical plans are normally not accessible. The functions of the banks in this context therefore are to ensure that all qualified borrowers receive credit to enable them to undertake their productive activities, and to use the credit wisely. Credits worthy customers in this case are those firms and projects with sound financial conditions, performance and viability and consequently low probability of default (Rwegasira, 1991).

In general banks and other financial institutions play a pivotal role in improving the well being of the people in a country through advancing credits and other necessary financial services. The performance of these financial institutions should be assured and sustained. This research aimed at investigating the impact of credit on the performance of financial institutions. The research will contribute new ideas related to credit delivery and sustainability of institutions involved.

1.1 Problem statement and justification

Some clients of Kilimanjaro Cooperative Bank Limited (KCBL) whose loan repayment period has already passed have not yet paid their arrears which amounts to 514 000 000 TZS. As a result the BOT (2007) examination report recommended for the KCBL to stop its credit services until the bank collects all the arrears.

Many countries have introduced programs to develop Credit Institutions aided by bilateral and multilateral donor agencies such as World Bank and United States Agency for International Development (USAID) without fully understanding the environment of the Rural Credit Market. These interventions were undertaken because Credit Programs were not only easier to implement than other policies but also because they would benefit agriculture (de Aghion & Murdoch, 2005:263). Evaluation of many credit programs sponsored by the World Bank and other agencies revealed that most financing institutions are unable to break even and that most of the credits supplied did not reach the intended beneficiaries (Johnson, 2004).

However, many Critics have argued that these credit programs failed because of the limited role of the interest rate and saving mobilizations (Adams, Graham and Von Pischke 1995). Borrowing money often entails certain obligations for the borrower over and above repaying the interest and principal. Non- and late- payment of loan is the most damaging threat to any provider of financial services. Often, late or non payment results from poor attitude and not inability to pay (Kaijage and Tarimo, 1999).

Nearly 90% of Tanzania population depends on agriculture and small scale production. However the present formal Banking institutions have not been able to meet financial needs of small scale enterprises. There is an urgent need to design an appropriate financial structure to cater for the needs of the people in these enterprises (BOT 1997).

In a nutshell, 80% of the Bank's income is derived from the interests, especially credit services. This income is used by the Bank to pay salaries for its workers and other recurrent and overhead costs. However, failure to return the loaned money and interests may have adverse impact on the performance of the Bank. Therefore, there is a need to asses the impact(s) of credit service on the performance of the Banks and other Financial Institutions.

1.2 Objectives

This study aimed at providing insights on the impact(s) of the credit services on the performance of the banks and other financial institutions. Specifically, the study aimed at first assessing banks' debt management; secondly identify credit risks to both borrowers and the lending institutions and finally to suggest the best practice.

1.3 Research questions

The study was guided by the following research questions

2. Is there any credit management policy?
3. How has the credit management policy contributed to improving banking performance of KCBL?
4. What approaches, procedures and action are adopted by the firm to make sure that there is an effective Credit management?

1.4 Significance of the study

The study is expected to have the following contribution:-

1. The study will generate new knowledge in the area of credit management.
2. Findings are also expected to provide best credit management practices for financial institutions.

There is abundant literature on credit and credit management (Lewellen, 1976; Mwisho 1999; Tulchin, 2003; Beaver, William and Ellen 1996; Edward, Andrea and Andrea, 2001). However most of this literature is based on global experience. To my best knowledge there is little or empirical evidence on the subject that is purely on local financial institutions.

1.5 Scope of the study

The impact of credit can be discussed in international, national and organizational level. However, the research was specifically confined to the impact(s) of the credit services on the performance of the KCBL. This impact assessment was based on information collected from General Manager and other staff of KCBL during the internship.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Theoretical and empirical studies on banks and other financial institutions

Financial Markets operates in every country and each country has its own financial system. However, a general approach in analyzing and understanding financial market is provided by Rodriguez and Carter (1976) who argued that the same set of actors appears in every financial system. On one extreme there are group of individuals and institutions that consume less income than they generate. At the other extreme is a set of individuals and institutions that have sufficient earnings to meet their expenditures. The role of financial markets is to channel the excess funds from savers into the hands of those who have needs for funds beyond their capacity to generate. There are two groups of institutions that facilitate this flow of funds from savers to investors:-

(i) Financial institutions that accept deposits from savers and lend funds to investors, usually enterprises. Financial institutions may be Commercial Banks, Savings Banks, Insurance Companies and Pension Funds. All these aim at channeling funds from savers to investors.

(ii) Security markets where savers and investors meet directly. This occurs in the equity and debt market where the business enterprises obtain funds directly from savers.

Several studies on banking have been conducted. A few studies have addressed specific issues on rural banking. Two important issues have emerged from these studies. Firstly, saving mobilization is necessary otherwise money for lending would not be available (Stanley and Geofrey, 1997). Secondly, banks and other credit institutions are viewed as one of the most important and powerful instrument for fostering economic development because any business activity depends very much on its liquidity. Therefore, researchers have emphasized that it is important to ensure that savings are mobilized and sound credit policies are instituted.

2.2 Credit mechanisms and investment projects

There are several aspects in which the commercial banks would consider to improve financial intermediation and encourage economic growth. Binhammer (1975) classifies rural credit and finance into five major categories.

(i) Consumer credit to enable a farmer to purchase for himself and his family other goods and services which are not provided by his current subsistence activity and past savings;

(ii) Cultivation finance to assist with the purchase of seed, fertilizers, insecticides, and other recurrent farm inputs needed to produce agricultural products;

(iii) Crop or marketing finance to provide funds when crops are harvested and before they are processed for sale;

(iv) Development finance for the introduction and extension of farming and processing operations; and

(v) Commercial finance to promote and sustain commercial activities such as processing and transport services and trade.

The financial services discussed in section 2.2 above can be achieved where small-scale farmers or enterprises may be considered for credit facilities. According to Rwegasira

(1992) the rural area is the main stay of agriculture which employs and supports many Tanzanians. The rural area is also the appropriate location for small scale business enterprises. Therefore, the banks and development financial institutions (DFI) should be positioned to tackle lending problem in this sector of the economy. However, lending to small-scale business and the rural peasants tend to be more costly and carries higher risk. Consequently, the banks and DFI's tend to avoid operating in rural areas. In the 1970's, it was only 40% of the CRDB loans which trickled down to the rural villages. In the 1980's, about 70% of the CRDB loan issued to finance seasonal inputs was concentrated in the two regions of Tanga and Iringa where the probability of crop failure was unlikely. There is evidence that other financial institutions such as NBC were traditionally urban and commercially oriented. Thus, in the early 1980's, more than 85% of NBC lending was to commercial enterprises and the public sector (Rwegasira, 1992).

It is argued further that providing affordable credit to the rural population has been a prime component of development strategy (Yaron, 1994). Government and donors have sponsored and supported supply-led rural finance institutions to improve growth and equity and to neutralize or mitigate urban-based macroeconomic policies. However, high risks heavy transaction costs and mounting loan losses have undermined the potential of rural lenders to drain their financial resources and support only a small part of the rural population with little impacts on self-sustainability.

Yaron (1994) concluded that, state or donor support to Rural Financial Institutions (RFI) should concentrate on building the capacity of the institutions involved. Careful institution-building often constitutes the difference between RFI that could eventually become self sustaining after a few years of support during startup period and RFI that would need permanent subsidies and bail-out.

However too few resources are committed to guarantee adequate training, efficient managerial information systems, incentive systems and promotion of savings mobilization and the like, all of which are crucial to making RFI independent, well balanced and increasingly self-sustainable. These strategies also make commercial banks more relevant in terms of savings mobilization and granting credit to borrowers in both the urban and rural areas.

Also, Umebali's (1989) research on rural banking in Nigeria observed a tremendous improvement in their services which was attributed to a deliberate program to enhance their performance. The study concluded that rural banking helps in development of banking habit, stimulates agricultural production, promotes commercial and industrial activities and consequently reduces rural-urban migration.

2.3 Financial institutions' performance indicators

Yaron (1992) defines financial performance as the extent to which the full cost of providing services is directly paid for by service users. Social performance can be measured in several ways; Zeller *et al.* (2003) emphasizes on a compliance with minimum operational standards, including external standards of consumer protection as one of the ways. There are three other indicators that are widely used to measure the performance: the number of people using services in a given period (breadth of outreach); their social status including poverty status at the beginning of the period (depth of outreach); and the net benefit to each, including indirect benefits to other household and even non-household members during the period (quality of outreach or impact).

Innovation, such as a reduction in the costs of providing services, can result in simultaneous improvement in both financial and social performance, but many decisions entail a trade-off. For example, raising interest rates on loans is likely to improve financial performance (assuming inelastic demand), but at the expense of current social performance (due to reduced net benefit per client, as well as a possible short-term reduction in breadth and depth of outreach). Other trade-offs can only be assessed over time, since future social performance will depend upon both current social performance (e.g. via its effect on users' future demand for services) and financial performance (as a critical determinant of future capacity to supply services). Many MFIs have emphasized the prime importance of serving more clients through growth. The cost of investing in new capacity has an adverse effect in the short-term, but this can be offset through the realization of economies of scale (Hulme & Mosley, 1996). Improved financial performance is also necessary for growth in order to mobilize resources; hence there may be a case for lowering current social performance to enhance future social performance.

CHAPTER FOUR

4.0 RESULTS AND DISCUSSION

After spending six months in the credit department of the Kilimanjaro Cooperative Bank Limited the researcher came out with findings regarding the credit services and the bank's performance which are presented in this part. This section also provides information about the KCBL risk and risk management. It also gives suggestion to improve the bank's performance.

4.1 Credit services

Financial condition and position of the Kilimanjaro Cooperative Bank is not good on account of unsatisfactory asset quality due to poor loan administration, unsatisfactory earnings and credit management. An overview of the selected current performance indicators is shown in Appendix 1

Appendix 1 shows that there is a very weak internal control as the loan officer is giving out loans above the deposits. The loan to deposit ratio is required not exceed 80% as per BOT regulations. The ratio was observed to be increasing and reached 83.3%. The increase is mainly attributed to bad debt since many clients have failed to repay their debts in time. The bank was not charging off facilities classified as loss during previous quarters contrary to regulation of the management of risk assets regulation of 2001 which requires the Bank to write off all loans at the end of every quarterly review.

The regulation requires that "Every bank and financial institution shall charge off or write off all loans at the end of every quarterly review. Recoveries out of the charged off accounts shall be recognized as per requirement of the National Board of Accountants and Auditors (NBAA) accounting standards and guidelines.

Loan documentation and administration is poor. Weaknesses observed includes: - laxity in making follow up of past due loans and overdrafts, granting credit accommodation in excess of borrower's limit, approving loans and overdrafts in excess of allowable limits and operating some accounts above the sanctioned limits. Other weaknesses include lack of up to date land rent receipts and nön execution of chattel mortgage for all motor vehicle pledged as securities.

Other faults include the missing of security documents like legal mortgage, chattels mortgage, title deeds and spouse consents, incomplete loan agreements, incomplete loan appraisal, improper suspension of interest, inadequate information on loan repayment schedules and improper classification of loans and overdrafts.

Review of credit files and security documents revealed the following weaknesses:

(i) The bank had a loan committee of the management board comprising of three members. It was noted that the committee had not met in the past one year. The last meeting was held on 8th July 2006.

(ii) It was observed that the bank was lax in making a follow up on non performing loans[1] and past dues. It was observed that 166 credit facilities amounting to TZS 146 253 million (43.64% of total proportions) had expired meaning that the customers are not repaying the arrears in time. Further, the salaried loans to employees of reputable institutions like TRA and traders in Kilimanjaro Region were found to be non performing.

(iii) The bank granted credit accommodation to some borrowers in excess of their limit contrary to the requirements of the regulation of the credit concentrations and other exposure limit regulation of 2001. The facilities granted were TZS 260 million and 170 million and were 42.32% and 27.67% of the bank's adjusted core capital respectively.

The rules on the concentration of credits under banks and financial institution Act says that "A total amount of credit accommodation which a Bank or Financial institution may grant directly or indirectly to any person or group of related borrower shall not exceed the limit prescribed in the Table 1 below.

Table 1: Collateral position and credit limits

Collateral position	Limit(as a % of core capital
Loan secured[2] by collateral the value of which is at least 125% of the credit accommodation secured by it (fully secured)	25
Loan secured by collateral the value of which is less than 125% of the credit accommodation secured by (partially secured)	10
Unsecured	5

[1] **Non performing Loans**-Any loan that is not generating income and is in arrears for 90 days
[2] **Loan security** – As uses in this context means security held solely for the purpose of money lending agreement

4.2 Contribution of KCBL to the economic development

Information obtained from the study shows that, KCBL plays an important role in promoting agriculture and other sectors of the economy. As for agriculture, the Bank plays a pivotal role to the growth and development of coffee farming in the Kilimanjaro region by extending loans and overdrafts to primary co-operative societies for the purchase of coffee and agricultural inputs. The bank also provides credit facilities to various other sectors. When this study was conducted, the gross loans amounted to TZS 3,351.06 million and were meant to finance Agriculture (28.37%), Education (12.62), Transport & Communication (12.13%), Trade (10.75%), Manufacturing (8.22%) Hotels & Tourism (6.45%), Personal loans (6.36%), Real Estate and Construction (5.63%), Health (4.87). Fishing (3.05%) and insurance & finance (1.49%). The bank had mobilized deposits amounting to TZS 3,977.50 million. Similarly, the bank had provided employment opportunities to 27 Tanzanians and facilitated tax collection for the government in the form of withholding taxes and pay as you earn (PAYE).

The bank has planned to improve its performance in the next five years as per Appendix 2. The ratios presented in Appendix 2 demonstrate reasonable improvement with respect to liquidity ratio, loan deposit ratio and return on equity. These achievements demand hard work, commitment and improved professionalism. The bank's management must take stern action to control staff turn over by paying greater attention to staff. The general Manager need to take direct charge over staff matters. Both internal and external training must be employed to improve skills and mould attitudes.

avoiding or placing limits, mitigating risks and off –setting risks. However different techniques will be needed for different risks depending on their transparency, timeframe for emergence, amount at shake, and the probability of the risk event occurrence.

iv. Risk monitoring

The key thing for the Bank to consider is an adequate Market Information System (MIS). Monitoring therefore means developing reporting systems that identify adverse changes in risk profiles of major products, services, and activities. This is important for KCBL to monitor loan repayment pattern, the state of accounts, and interest rate margins. Monitoring reports should be regular, timely, accurate, informative and directed to appropriate persons.

Effective risk management should be understandable, measurable, and controllable and are within the bank capacity to withstand adverse results. KCBL should strive to improve its ability to identify measure, monitor and control all the potential risks.

4.4 Risk management in the context of KCB limited

The Bank faces various risks, both financial and non-financial risks. KCBL has several systems in place to address the problem. These include various management and board committees. Improving the lending books remains a critical aspect of credit risk management at KCBL. For this reason it is proposed that upgrading skills of the officer handling credit must be taken seriously. This shall bring an improvement in monitoring of loans and advances and early identification of those loans, which may be facing problems.

Sources of credit risks at KCB Limited

Some of the identified sources of credit problems at KCBL include laxity in performing loan appraisal, failure to visit loan projects for monitoring, inadequate MIS, low values of some property offered as security against the loan, lack of updated credit manual, and bad customers (customer who default in repaying of the loan).

Role of the Management Board in credit risk management

As far as credit risk management is concerned the Management Board of KCBL has an important role in credit risk management and credit granting. It has the function of approving Bank's credit risk strategy as well as developing appropriate policies. Other roles includes, determining the Bank's overall risk tolerances, maintaining credit risk exposure at prudent levels, setting up lending authority structure, ensuring that the persons dealing with credit risk management have the right exposure and knowledge, ensuring that internal audit reviews of credit operations are performed, ratifying exposure exceeding the level of management authority, and outlining the frequency of management reports.

If KCBL need to control risks, it has to have a frequent checking of the loan applicant's public and other information including off -balance sheet positions, checking the strategic objectives of the applicants and investigating their overall risk profile, overseeing the capacity of the borrower with respect to quality management of his product or services, observing the profitability of borrower and seeing if they are able to repay the loan and checking their credit standing to identify their repayment behavior (history). The Bank should also put in place an independent internal system for the assessment of credit, risk and management process. These should include the management committee as well as the internal Auditor, as an independent reviewer.

Supervision, monitoring and follow up

To minimize the risk associated with lending, the bank normally supervises and monitors their customers who obtain the loan facility.

(i) To ensure timely repayment of the loan;

(ii) To ensure that all terms and conditions of the credit agreement are being strictly adhered;

(iii) To be satisfied that the business is being conducted as stated in the appraisal report; and

(iv) To assist the borrowers in terms of advice on solutions for problems pertaining to business, as well as the right course of action.

Credit administration

At KCBL, the administration of credit entails the processes of controlling, monitoring, tracking and follow-up of borrowing accounts. In all cases it requires the manager to always be on the move as the "know well your customer and his affairs" rule demands the lending banker to avoid armchair management. KCBL should do the following in order to have a smooth credit administer services to its customers.

(i) The bank should adherence to the terms/ conditions of credit/ loan agreement form and make sure that all stipulations that require fulfillment are perfected before funds are disbursed.

(ii) It should start charging a non- commitment fee in case of late utilization when the amount is already sanctioned. For example, 1% per month as a non commitment fee on the full amount may be charged for the period the customer delays to repay the loan.

(iii) Stock statement should be submitted to the bank regularly as agreed. Where stocks are financed, the bank should charge an interest as hypothecated. The bank officer should make regular stock inspection to verify whether or not the stocks are in the godowns and for how long.

(iv) For the case of overdrafts, fluctuations on the accounts are insisted upon by the bank because they tell how the business is progressing. Normally healthy fluctuations with a swing to credit balances are worthy considering. Very little or no fluctuations in an account is an unhealthy sign indicating that either stocks are slow moving or that the customer is holding dead stocks which are becoming difficult to sell, or he is diverting funds to some unrelated uses.

(v) Periodic review of customer's cash flow (projected) is important since this is a customer's cash budget. Periodic review will indicate whether or not the business is performing in accordance with the budget. Deviations of great magnitude should be explained by the borrower.

(vi) The manager has to review the credit facilities to be aware of the expiry and remind the customer to repay or renew the facility in advance before the expiry date. Credit Officer should analyze on monthly basis the positions of overdrafts and loan accounts against the proposed repayment arrangements and serve the borrowers formal repayment demand letters signed by the General Manager. If response to such letters is not forthcoming a warning letters should be sent to borrowers indicating the legal action or security realization to be taken. If the legal steps are necessary the Bank's Legal Officer should take particulars of the defaulter and inform him/her of the Bank's intention to realize the security and/or take legal action. In case of no positive response being received arrangements for auctioning the property mortgaged to the Bank should be done immediately and the General Manager should attend the auctioning.

(vii) Loan provisioning should be done in accordance with the BOT's guidelines on provisioning for outperforming advances. The credit officer should consolidate the Branch report and submit them to BOT

The General Manager should verify the accuracy of the reports and have them signed by him/herself and Chief Accountant and before submitting them to the BOT.

CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

Kilimanjaro Cooperative Bank Limited is performing poorly due to poor credit management practices attributed to lack of a working credit policy and lending procedures. This is a critical challenge to the management board as it has to make sure that the policies are in place and are put in practices. It is therefore suggested that the bank should use its credit policy as a blue print in smoothing credit management operation. To be simple in both the parties (offerer and offeree), the contracts documents should be in a simple English and Swahili languages. This is because most of the clients are indigenous Tanzanians who understand their national language better.

The current study shows that KCBL is effective in supporting the societies within the Kilimanjaro as well as the whole northern zone. From 1995 to 2006, many people have received financial support from the bank. Most business projects mainly in agriculture, hardware shops, transportation, SACCOS and modern house construction received support from the bank.

The study shows that many customers of KCBL have defaulted as the loan repayment period has elapsed and yet their arrears were not cleared. Failure to repay is caused by both internal (within the bank) and external (outside the bank) factors. The internal factors include lack of a working credit policy, poor monitoring, lack of frequent visits to the client's business operations and lack of training to the customers about the loan disbursement while the external factors include non performing business projects, death of borrowers, change in both country economy as well as political situation and natural calamities such as such as accident, fire and theft.

5.2 Recommendations

In the nearest future, KCBL have to consolidate and improve its performance with respect to:

(i) Deposits. The deposits have to be increased through improving customer service, new products and aggressive marketing of the Bank product. Since the market is almost the same, KCBL shall have to differentiate its product through other aspects such as improved quality services- attracting new clients and building a credit history with them. In addition, KCBL shall have to retain good clients as a cost effective way to attract new clients.

(ii) KCBL shall have to provide its clients with conducive atmosphere, quick service and good language in order to attract and retain clients. This will include doing major renovations at the bank's site and improving the bank compounds in general.

(iii) Promoting product diversification could be potential avenues for diversification.

(iv) With increasing competition in the financial market in Kilimanjaro, KCBL has to be dynamic with respect to changes in the business environment. The first step in building good competitive advantage is in developing an internal capacity capable of changing the organization as the industry changes. The management should continuously carryout rigorous SWOT analysis both of the institution and the competition.

(v) Comprehensive Market Research has to be undertaken to establish the nature and size of the market including details on the competitors. The Market research should consider customers' reactions to KCBL services, improving competitiveness and market share

It is very easy for the bank to control these risks by just abiding to the best practice in credit management. Also, the bank through its credit department should plan to train the borrowers about the loan arrangement so as to reduce bad debts. The bank should try to give certificates to the customers who repay the loan in time so as to build customer loyalty and maintain good will.

REFFERENCES

Beaver, W. H. and Ellen E. E (1996). Discretionary behavior with respect to allowances for loan losses and the behavior of security prices, Journal of Accounting and Economics 22, 177-206.

Binhammer, H.H (1975). The development of financial Infrastructure in Tanzania; Kampala East African Literature Bureau, Kampala.

BOT (1997). Report on the 10th conference of financial institutions. April 7th -9th 1997.

BOT (2007). Full Scope Bank Examination Report, Cooperative Audit and Supervision Corporation (COASCO), KCBL.

de Aghion, A.B., & J. Murdoch (2005) The economics of microfinance. Cambridge: MIT Press.

Edward I, Andrea R and Andrea S (2001). Analyzing and Explaining Default Recovery Rates, Report submitted to ISDA,London.

Hulme, D., & P. Mosley (1996). Finance Against Poverty, London: Routledge.

James van Horne (1968). Financial Management and Policy, 5th ed Prentice Hall. International Inc, United States of America.

Johnson, S. (2004). The impact of microfinance institutions in local financial markets: a case study from Kenya. *Journal of International Development*, 16(3), 501-518.

Kaijage, S.E & Tarimo, N.E, (1999). Financial Management, NBAA-1999, Tanzania Printing services Ltd. Dar es Salaam.

Lewellen, Wilbur G. (1976). Management and ownership in the large firm "Journal of Finance."

Mwisho A.M (1999). Basic Lending Conditions and Procedures in Commercial banking. The journal of NBAA, Tanzania.

National Bureau of Statistics (2003). 2002 Population and Housing Census. Dar es Salaam, Tanzania: National Bureau of Statistics.

Rodriguez , R.M and Carter, E.E (1976). International Financial Management. Prentice-Hall, Inc, Englewood Cliffs.

Rwegasira ,K.S.P (1991). Financial Analysis and Institutional Lending operations Management in a Developing country. University of Dar es Salaam Press. Dar es Salaam.

Rwegasira K S P (1992). Problems of Financial Analysis in Institutional Lending operations. Some lessons from Tanzania Aldershot: Avebury.

Smith, D. (1984), "A Theoretic Framework for the Analysis of Credit Union Decision Making". *Journal of Finance*, Vol. 39, pp. 1155-1168.

Stanley,B.B and Geofrey, A.H (1997). Foundations of Financial Management, McGraw-Hill Company, USA.

Stiglitz, J.E. (1998): "Principles of Financial Regulation: A Dynamic Portfolio Approach", India.

Umebali , E.E (1989). Rural Banking in Nigeria. African review of money, finance and banking. Supplementary issue of savings and development, Milan, Italy.

Wood, Frank (1998). ACCA Study and Revision Pack of Accounting, Great Britain.

World Bank (1994). Assessing finance institutions: Tanzania and agriculture, a public interest analysis. Washington D.C.

Yaron J. (1994). What makes Rural Finance Institutions Successful? World Bank Research Observer, Vol 9. No. 1.

Zeller, M., C. Lapenu and M. Greeley (2003). Social performance indicators initiative, final report. Paris: Comite d'Echange, de Reflexion et d'Information sur les systemes d'Epargne-credit (CERISE), October. www.cerise-microfinance.org.

APPENDICES

Appendix 1: Overview of selected performance indicators of KCBL

Performance indicator	30th June 2006	30th June 2007
Capital adequacy ratio		
Core capital	642.53 million	556.98 million
Core capital to RWA&RWOBSE	27.43%	18.38%
Total capital to RWA&RWOBSE	27.43%	18.38%
Asset quality ratio		
Loss provision to total loss	21.70%	19.07%
Adversely classified loan (NPLs) to gross loan	32.92%	25.85
Loans to total assets	48.94%	57.52%
Earning ratios		
Return on assets (annualized)	-9.94%	-13.91%
Net interest margin	79.52%	84.87%
Non interest expenses to net income	87.86%	91.03%
Operating expenses to total assets (annualized)	6.05%	9.68%
Liquidity ratios		
Liquid assets to demand liabilities	55.49%	41.71%
Loan to deposits	75.45%	83.83%
Core deposits to total deposits	93.65%	94.26%

Appendix 2: Performance indicators of KCBL

	RATIO	2006	2007	2008	2009	2010
1.	Cost/income ratio					
	$\frac{\text{Cost}}{\text{Income}}$	65.5%	68.0%	66.6%	64.4%	62.0%
2.	Liquidity ratio					
	$\frac{\text{Current assets}}{\text{Current liability}}$	119%	122%	124%	136%	125%
3.	Loan deposit ratio					
	$\frac{\text{Loans}}{\text{Deposits}}$	81.4%	81.2%	80.9%	80.9%	80.6%
4	Return on equity					
	$\frac{\text{Net profit}}{\text{Equity}}$	20.6%	24.8%	24.8%	25.5%	26.5%