



**Full Length Research Article**

**NON- PERFORMING ASSETS AND THEIR IMPACT ON GROWTH OF BANKING INDUSTRY IN TANZANIA: A CASE OF NMB BANK**

**\*Dr. Stephen Laurent Isaac Mwakajumilo**

Teofilo Kisanji University (TEKU) Directorate of Research, Publication, Consultancy and & Postgraduate Studies,  
Teofilo Kisanji University (TEKU), P.O. Box 1014 Mbeya-Tanzania

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**ABSTRACT**

The aim of the study is to assess the impact of non-performing assets on the growth of banking industry in Tanzania specifically NMB Bank. The objectives of the study accessed the impact of non-performing assets on growth of banking industry, analyzed the causes for non-performing assets in banks. Furthermore it explored and identified specific steps that bank officers have to deal with the problems. The findings revealed that the impact of non-performing assets facilitated by non-recovery of loans, hence caused great harm to the economic framework and structure, loss of trust of dishonest, reduced customer ability in buying, legal issues, lack of aggressive credit collection policy, poor credit assessment. Moreover specific steps taken by bank managers to avoid drastic downfall and the recovery of crisis with meaningful suggestions for financial stability. The study recommended that the bank management have to provide enough education on loan management to their clients as well as their workers. The banks also have to ensure that sufficient and quality staffs are trained. The management of the bank has to review its credit management policy in order to improve the quality of assets. The creation of manageable lending behavior should be managed properly with the regular check of the value and other legal status.

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**INTRODUCTION**

Banking industry in the world is the major sector of the economy that has achieved renewed focus after financial sector reforms and the entry of public and private sector banks. This sector is the foundation of modern economy development. Through mobilization of resources and their better allocation, banking industry plays important roles in the development process of Tanzanian economy. Banks improve the allocation of resources by lending money to priority sectors of the economy (Saunders 1994). These banks provide a meeting ground for the savers and investors among various indicators of financial stability, non-performing loans assumes critical importance since it reflects the asset quality, credit risk and efficiency in the allocation of resources to productive sectors. Following the events of the US banking industry in 2011 turned around to improve the Bank holding companies where the performance was weak by historical standards. (Brown Bridge 1998). The Banking industry recovery faced challenges due to ongoing of Non-performing asset levels.

By 1980s, Tanzania was in the midst of severe economy crisis, characterized by 30 percent inflation, unsustainable fiscal and external deficits, and shortage of basic consumer goods, collapse of agricultural exports and shrinking GDP and increasing dependence of formal financial Institutions on Government subsidies. During the late 1980s and 1990s a large number of African Countries underwent episodes of systematic and borderline banking and financial crisis across the developing world. Sing (2007) insisted that, these crises, varying in scope across countries were largely characterized by poor performance of banking and financial institution. They were largely associated with a rapid accumulation of Non-performing loans in the banking industry. The level of non-performing assets in East Africa countries in the mid of 1990s up to 2000s were 50percent and above. For example, the Bank of Uganda annual supervision Report for 2010 indicates that the level of Non-performing loans in Uganda banks stood 2.2percent, in Kenya the ratio of Non-performing in Kenyan banks was 6.2percent, in Tanzania 6.7 percent while Rwanda 11.3percent (International Monetary Fund Report 2002).

**Background to the Problem**

Regardless the efforts made by the country to liberalize the formal financial sector(banking industry) in Tanzania in 1991

**\*Corresponding author: Dr. Stephen Laurent Isaac Mwakajumilo**  
Teofilo Kisanji University (TEKU) Directorate of Research,  
Publication, Consultancy and & Postgraduate Studies, Teofilo  
Kisanji University (TEKU), P.O. Box 1014 Mbeya-Tanzania

and strengthening of the roles of the Directorate of Banking Supervisions of Bank of Tanzania aimed to ensure a safe and sound banking sector in Tanzania and promote stability and public confidence in banking and financial system in the country, bank failures and accumulation of large number of non-performing assets in 1990s periods have been a common phenomenon in Tanzania due to the absence of credit information bureau, poor lending strategies, poor management, corruption, lack of adequate capital, low level of technology, reckless lending, dishonest, poor credit documentation, poor supervision capacity (William 1995, Chijoriga 1977, Kimei, 1998), concentration in few customers/groups, poor risk management, political and government interventions. Despite the fact that a lot of studies have been carried out to look at the factors influencing performance, study has to be done to identify Management factors behind the relatively poor banking industry performance in achieving the targeted growth of banking industry. The study intends to study the contribution of Banking Management towards the performance of these established commercial Banks mainly after liberation action and restructuring of financial banking sector in Tanzania.

## LITERATURE REVIEW

This chapter attempts to review the relevant literature on non-factors that performance assets, also to discuss the influence performance of banks in mitigating non-performance assets which leads to reduce the knowledge gap. Several efforts have been taken for the enhancement of boosting banking industry in Tanzania. The country of Tanzania in the mid of 1990s decided to undergo a major banks financial reforms by eliminating government propensity for innovertains in the financial system particularly through setting financial prices and allocation of credit and foreign exchange, eliminating restrictions on competition and free entry into the financial sector which formerly was controlled by government particularly after Arusha Declaration in 1967 where the ownership of all the means of production taken into the hands of the government.

The Government of Tanzania through Bank of Tanzania established the Banking Financial Institutions Act (1991), and the privatization of banking industry which allowed to operate private banks in Tanzania. The split of the National Bank of Commerce into two Banks NBC(1997)Ltd and National Microfinance Bank (NMB), the privatization of government parastatals through joint venture, direct sale, receivership, or total liquidation or recategorization as a result some of the parastatals which had Non-performing assets ceased to exist following the financial sector reforms 1990 in which aim was to put in place a conducive environment for the efficient provision of financial services in Tanzania based on free market principles. The Banking and Financial Institution Act (BFIA) 1991, facilitated the licensing of new banks and financial institutions resulted into greater competition in the financial sector thus enhanced efficient mobilization of financial resources. The banking sector that comprised of three (3) commercial banks before reforms currently has more than 50 Commercial Banks and Non-bank financial institution whose customer care has improved markedly with many new products introduced including automatic tellers machine (ATMs) and debit cards.

The establishment of the Loans and Advances Realization Trust Act of 1991 which enabled government to assume and subsequently realizing non-performing of assets publicly owned banks, thereby facilitating the restructuring and privatization of CRDB and NBC and the liquidation of THB. Moreover, observes that Tanzanian Banks which dominate the country's financial system are liquid, well capitalized and resilient to most shocks. Selwyn and Thambi (2001) analyzed the magnitude of NPAs in Indian commercial Banks. They observed that NPAs of some banks were higher than their capital and reserves. They further observed that even the percentage on NPAs to own funds of some of the top banking public sectors were quite high. Sharma (2004) highlighted the most significant factor contributing to the problem of NPA from point of view of top bankers from public sector banks. The study found out that measures required for management of NPAs which include formulation of banker's credit appraisal techniques tabling of monitoring department among the most important areas. Waweru and Kalani (2009) in their Kenya based study investigated the causes of NPAs, actions that bank managers had taken to mitigate that problem and level success of such actions. It was discovered that lack of an aggressive debt collection policy was perceived as the main bank specific factor contributing to the non-performing debt problem in Kenya.

According to Brown Bridge (1998), most of the bank's failure were caused by non-performing assets. Areas affecting more than half the loans portfolios were typical of failed banks. Many of the bad debts were attributable to moral hazard; the adverse incentives on bank owners to adopt imprudent lending strategies in particular inside lending and lending at high interest rates to borrowers in the most risky segments of the credit market. Kihunwa (1995) in his study "Experience of Bank Restructuring" The case of Cooperative and Rural Development Bank (CRDB), noted that before 1993, performance of Cooperative and Rural Development Bank (CRDB) in Tanzania was not good due to bad lending programs, financial mismanagement, and political pressure causing the Bank to accumulate large sums of non-performing assets. After its structure in mid 1990s, the bank is now one of those banks that are performing well in Tanzania, both in terms of lending and saving mobilization.

According to the World Bank report (1994) in Uganda, the country's banking industry was described as extremely weak with huge non-performing assets and some banks teetering on the verge of collapse. Kaur (2004) focused on the problem of NPAs in public sector banks and concluded that, the total elimination of NPAs is not possible but can be minimized. It is always wise to follow proper policy for appraisal, supervision and follow up advances to avoid NPAs. Rajesham and Rajender (2008) found that NPAs have negative impact on the productivity, funds deployment and credibility of the banking system and overall system economy and concluded that, strong political will only find satisfactory solution to the problem mounting level of NPAs and will become financially strong under the competition and global turbulent business environment.

## FINDINGS

The findings of the study, reviewed some crucial factors that lead to poor performance of banking industry, hence leads to increase in a Non-performance assets as discussed below:

1. Homogenous of banking business, lack of information among depositors concentrate in few customers/ groups and connection among banks may trigger a collapse of the banking industry. Types of products offered by the banking business is a homogenous type of business where products offered are almost similar except for the interest rates and quality of service. The failure of one bank can trigger failure in the other due to the relationship which exist between them.

2. Lack of information among depositors may lead bank customers to think that their bank also has a problem like one in trouble, may force customers to withdraw their funds (bank run), hence creating liquidity to the failing bank (Sounders, 1994; Chijoriga, 1997). For example when NBC had a huge amount of Non-performing assets problems, some of NBCs big customers closed their accounts and moved to the newly established banks.

3. Concentration on a few borrowers or groups of borrowers, may also create a possibility for a bank to collapse. For example: The British Barings Bank was forced out of the business due to being dependent from a single customer, when a single customer suffered with a problem/shortage of liquidity (the economist, 1996). Likewise NBC had offered a large part of its loans portfolio to parastatals firms and cooperatives which turned out to be NPAs. Thus, when the public firms failed to pay its debts, the NBC found itself in liquidity problems.

4. Connection between banks create problems for the bank especially if the failing bank is a big player in a particular market e.g.: lender to other banks. So when a bank is not connected with other banks or is not too big to fail bank (TBTB), the government may fail; for example; Meridian Biao Bank in Tanzania which was not bailed out by respective government, NBC in Tanzania, Bank of Credit and Commerce in USA.

5. Poor transmission of monetary policies from the Central Bank to the rest of economy. Sluggish and poor monetary policies control and increase interest rates can create problems to the banks since customers may not afford to pay the interest in Tanzania, the unclear and un-directional monetary policies had contributed to the Bank failure (BOT, 1995).

6. Failure to cope with technological changes also can cause bank failure. Ineffective and inefficient banking payment and settlement system is a result of using out date technology. NBC before split into two banks namely: NBC(1997) Ltd and NMB Bank was using manual work hence created or lead to a lot of complaints from its customers due to inefficient, queuing and delays in some cases, poor data storage and record keeping system as result the banks were exposed to fraud, money embezzlement and theft.

7. Poor risk management, it occurs when bank does not properly analyze the customers' credit worthiness, it leads to possibility of awarding loans to defaulters with both principal and interest.

8. Political and government interventions as being a cause of bank failure (Chijoriga: 1997, Kimei, 1998). In the controlled planned economies where majority and where most of lending

policies and other regulations are controlled and regulated by the government. Before the financial and banking sector reforms the majority of the former socialist countries had centrally planned economics. It was the duty of the government to choose projects which have lending interest rather than financial viability or profitability of the sector or project. From the literature review, it's true that, if Government and political intervention applied in the lending decisions there is a possibility of banks to fail. In Tanzania this is proved by NBC case which was suffered NPAs due to the linkage between Government policies, directives and its operations.

9. Lack of trained manpower.

During those past days where the banks led into inefficiency and effectiveness to the use of outdated technology, also manpower was the problem due to lack of skills and knowledge acquired in schools or colleges rather than were basing on experience from monotonous repeated work).

10. Absence of credit references bureau, Mwakajumilo, Stephen Laurent Isaac (2003) made the investigation on performance of formal commercial banks in Tanzania after the liberalization of financial sector in 1991. He found that despite the strengthening of the roles of Directorate of Bank Supervisions. Bank of the Tanzania, Banks failures of accumulation of large number of non-performing assets in the past 1991 due to the absence of rating or references bureau for tracing the customers or borrowers information which actually used to promote increasingly level of trust and stimulating economic development by addressing the impediments that contribute to the increasing number of non-performing assets.

11. Poor management.

Hawkins(1995) in his study " Bank failures" Preventive measures and Appropriate Response" Pointed out that Bank failures, are usually caused by Management factors such as: The bank run by one domineering individual; Senior Managers have insufficient experience and banks have no formal Management structure or reporting lines, the failure of banks were reported to have poor strategy-going into business areas which cannot generate operating profit and weak control environment or adequate control environment.

12. Corruption and Nepotism, Some of the decision makers have been employed through corruption and bribery, hence leaving the work done for their interest and not for the majority but for the individuals. Corruption had also led to these banks to fail to extend loans to unworthy borrowers or too risky investment without making fully the required analysis.

13. Difficult in provision of consumer loans. The findings of this study revealed that there are number of problems that are facing banks especially offering loans such as risk associated to non-repayment of loans, reputation risk which is caused by delay in loans processing.

We learnt several factors that lead into increasing non-performing assets in banking industry in Tanzania. Researchers need to be conducted much in NMB Bank which

is found almost every part of the country and basically for low households' income. The Bank of Tanzania through Banking Supervision Directorate focusing on the priority areas as its pillar for sustaining financial stability and strengthening the roles of existing Deposit Insurance Bank (DIB) in safeguarding financial stability and preserving public confidence in the banking industry and development contingency plans for provision of systematic emergence of liquidity in times of need and for systematic resolutions. The Tanzania Association of Banks (TAB) should conduct important research to find out the perception of factors contributing to increase the non-performing assets. Bankers, Managers, Customers and experienced staff who in one way or another are out of job, are important informants regarding factors leading to banking industry to the failure, and equally can provide the same solutions.

**Table 1. Ranking on factors leading to Non-Performing Assets for Banks**

S/No	Factor	Frequency	%
1.	Homogenous of the banking business	11	55
2.	Lack of information among depositors	8	40
3.	Concentrations in few customers/groups	4	20
4.	Connection between banks especially for failing banks	6	30
5.	Poor transmission of Monetary Policies	10	50
6.	Failure to cope with technology changes	20	100
7.	Poor risk management	20	100
8.	Political and government intervention	20	100
9.	Lack of trained manpower	20	100
10.	Absence of credit references bureau	20	100
11.	Poor management	20	100
12.	Corruption and nepotism	15	75
13.	Difficult in provision of consumer loans	12	60
14.	Lack of adequate capital	13	65

**Source:** Field data. The findings indicate that there are several factors that influence failures of banks performances, hence increase non-performing assets in banking industry in Tanzania. The leading factors include absence credit of reference bureau, failure to cope with technological changes. Poor risk management, Poor management, Political and government intervention and lack of trained manpower.

## Conclusion

The factors leading to failure of banks hence increasing of non-performing assets to mention a few, they range from those which are due to lack of Management, Absence of credit reference Bureau, Poor risk management, Failure to cope with technological changes, Difficult in provision of consumer loans, Lack of information among depositors and among others. The factors that suggest more researchers on banking industry performance, which should in cooperate Government, Bank of Tanzania, Tanzania Institute of Bankers and Association for Banks to find out more causes for increase Non-performing assets even after financial banking sector reforms for example in 1991, The Tanzania government forced to save the National Bank of Commerce(NBC) which was too big to fail bank by advancing it a sum of Tsh 18,886,550,000/= about US dollar 37millions by then inform of government Banks to cover for its Non-performing asset since most of banks in Africa countries facing problems have

either bailed out, closed or restructured (Kime:1998). This suggest researchers in dealing with the quality of management staff, modern technology, capacity of banking supervision in monitoring and evaluating trends of banking industry sector, establishment of the Credit Reference Bureau. By conclusion, the banking industry is vital for economic development for any country, so efforts have to be made to ensure that each bank operates in a competence basis to reduce of not eliminating the Non-performing assets although eliminating in total a non performing assets is big deal in normal circumstances. Strong reasons to expect Tanzania banking sector to pay more significant role in the economy if supported by appropriate policy which consolidate the gain made during banks reforms which actually removed obstacles to lending deepening financial international and helping the development of financial sector in Tanzania as result a Non-performing assets might be reduced if not eliminated.

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