Consumer Loan Processing and Monitoring in Tanzanian Banks: A Strategy for Growth and Empowerment of Micro and Small Enterprises

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This paper examines the link between the loan processing and monitoring in banks, and asset growth and empowerment of individual customers. The findings revealed that better allocation and utilization of financial institution's economic capital not only facilitates outreach to more under banked and unbanked productive poor people but also empowering them by stimulating investments and increase productivity in a cost-effective way for poverty reduction. On the other hand, unplanned implementation of credit risk management, frauds, misconduct, none commitment and dishonest among employees, accounts for the greater part of non-performing loans and portfolio performance problem among banks.

INTRODUCTION

Financial institutions mobilize savings for productive investments which facilitating capital flows to various sectors in the economy (Sufian, and Parman, 2009 and Shanmugan and Bourde, 1990). In most economies commercial banks are the dominant financial institutions and they grant more instalment loans to consumers than any other financial institutions (Greuning and Bratanovic, 2003). Despite their roles, there are evidences that well functioning commercial banks accelerate economic growth, while poorly functioning commercial banks impede economic progress and exacerbate poverty (Barth, Caprio and Levine, 2001). The performance of commercial banks is thus highly needed in order to achieve their objectives. Credit risk management, which is one among the problems facing banks is very crucial to not only sustainability and growth of the commercial banks, but also to the stability of currency and the economy as a whole (Greuning and Bratonovic, 2003). Poor credit risk management can cause liquidity risk and can make a commercial bank insolvent. The existing risk is also attached to their products. This includes on balance sheet products like short and long-term loans, and off balance sheet like letter of credits and other guarantees. Loans however, constitute a large proportion of credit risk as they normally, account for ten to fifteen times the equity of a bank (Kitua, 1996). Thus, banking business is likely to collapse in case of a slight deterioration in quality of loans.

Despite the existing risks, loans provided by banks are considered as important service that assist the owner of micro and small enterprises to acquire capital for investment in productive activities. This is based on the fact that most micro and small enterprises (MSEs) are constrained by internally generated finance (see Carpenter and Petersen, 2002; Binks and Ennew, 1996, Reid, 1996 and Chijoriga and Cassimon, 1999). Therefore micro credits are considered to be an appropriate solution because the amount of money needed to start a micro or small business is generally quite minimal (Sonfield and Barbato, 1999). Access to credit enables the MSEs owner to cover some or all of the cost of capital equipment, expansion, or renovation of buildings. It helps existing or would-be entrepreneurs acquire the means for establishing or expanding a business (e.g. building premises and working capital). Credit can also assist the business owner to cover cash flow shortage, to purchase inventories, to invest in new technology, expanding the market and being able to take advantages of the suppliers' discount. Without sufficient capital therefore, MSEs are unable to develop new products and services or grow to meet demand (Coleman, 2000 and Kuzilwa, 2005).

The importance of credit calls for help from banks to extend their financial facilities to the enterprises. However, credit management should be at the centre of banks operations in order to maintain financial sustainability and reaching more clients. Despite these facts, over the years there has been increased number of significant bank problems in both, matured as well as emerging economies (Basel, 2004). Among these problems, weakness in credit risk management has all along been cited as the main cause for the bank problems (Richard, et al, 2008 and Chijoriga, 1997). In Tanzania for example, Meridian BIAO Bank and the Tanzania Housing Bank (THB) were closed in 1990s, and almost in the same period, i.e. 1995/1996 the National Bank of Commerce (NBC) and the Cooperative and Rural Development Bank (CRDB) combined wrote off loans equivalent to Tshs 122 billion (US$ 112million) (IMF, 1999). These findings indicate that there is a lack of proper credit risk management system. One of the reasons may be the weaknesses in collecting enough relevant information on borrowers, which create inability in screening out bad from good borrowers. Also poor follow up and control over the borrowers, account for the poor performance. These unfavourable trends of loan non-performance in Tanzania, create a subject matter for this study. This paper therefore examined how loan processing, monitoring and management affect assets growth and empowerment of both the financial institutions and their customers. The following sections present importance of credit management on asset growth and empowerment; methodological considerations and findings of the study.

Importance of Credit Management on Asset Growth and Empowerment

Banks as part of financial institutions face various risks. These risks can be categorized into three major groups, financial, operation and strategic risks (Koch and MacDonald, 2005). Financial risk includes capital adequacy, liquidity and credit risk. Operation risks involve risk associated with people and process, mismanagement and fraud, internal system failures, technology, legal, marketing and regulatory as well as external events. While the strategic risks include reputation risk, system risk and risk associated with changes in variables of businesses and strategy. The credit risk is a most expensive risk in financial institutions and its effect is more significant as compared to other risk as it directly threaten the solvency of financial institutions (Chijoriga, 2011 and 1997). The magnitude and level of loss caused by the credit risk as compared to other kind of risks is severe to cause high level of loan losses and even bank failure (Chijoriga 2011 and Richard, et al, 2008). Also loan portfolio not only believed to be the largest asset and pre-dominate source of revenue but also is one of the greatest sources of risk to financial institution's safety and soundness (Richard, et al, 2008). An effective credit loan management is therefore one of the road maps toward safety and the soundness of financial institution through performance, monitoring and prudent actions. This facilitates sustainability which empowers the financial institution through cost- effective provision of financial services. Furthermore sustainability assures access to services over time, raises the probability of expanding both the range of products suited to needs of poor clients and outreach to bankable men and women to urban and pre- urban or rural clients (Kuzilwa, 2005, Richard, et al, 2008 and Fatemi and Fooladi, 2006).

Additionally, the existence and survival of these financial institutions enable the current and potential customers to have an access of loans over time. These loans enable entrepreneurs or small group of people to start, develop, diversify or expand their businesses (Kessy, 2007). Loans can change peoples' lives for the better especially the lives of those who need it most. A small loan can make all the difference to a poor or low-income family. With access to loans, they can earn more; build-up assets, and better protect themselves against unexpected setbacks and losses (Kuzilwa, 2005). They can move beyond day-to-day survival toward planning for the future, they can invest in better nutrition, housing, health and education for their children. Loans also support the poor households to manage critical financial transactions, stimulate local markets and extend employment opportunities as businesses grow.

Different studies have also found that loans offer more than just material benefits; they can also address issues associated with "non-material" poverty, which includes social and psychological effects that prevent people from realizing their potential (Kessy and Urio, 2006 and Hulme, Moore and Shepherd, 2001). The process of taking a credit, investing and repaying of loans, seems to empower the poor through a personal transformation from a feeling of "I cannot" to one of 'I can". I can do something about my poverty. In theory at least, this self-financing feature (financial sustainability) allows for massive-expansion of financial institution to reach tens if not hundreds of millions of underserved people. Getting cash into the hands of poor people for example helps increase self-esteem among the poor. It translates them into control over a financial resource which, in turn, builds their economic empowerment, voice and status within the family and ultimately within the community. This again improves family welfare because they can channel more of their incomes to meeting the needs of their households.

METHODOLOGICAL CONSIDERATIONS

In order to achieve the objectives of this study one bank was selected as a case study whereby the units of inquiry include head of consumer credit division, senior manager responsible for follow up, monitoring and recovery, head office consumer credit supervisor, two credit officers and data entry officer – placed at credit department head office, four (4) credit officers at one branch in Dar es Salaam and five (5) beneficiaries of the scheme. The choice of the above units of inquiry was purposively and has been influenced by their knowledge on the subject matter and types of data required. Interviews were conducted among the respondents to explore crucial issues like procedure and terms of giving consumer credit, time taken from loan application to the disbursement, time for repayment of loan and actions taken when they fail to pay. Also information on impact to the users was collected from the beneficiaries of loans.

In data management and analysis, the researcher thoroughly read all the relevant documents and wrote notes. Also the information collected through interviews was summarised in the form of reports. Then the relevant information was organized in similar topics and those that were in line with study objectives were put together into major topics.

FINDINGS

Credit Processing and Monitoring

The findings of this study rely on different stages of consumer credit scheme (i.e. loan processing and approval, disbursement procedures, loan recovery) and remarks made by the interviewed beneficiaries of consumer credit scheme. The consumer credit scheme focuses on employees of different organisations. In this regard, the employer had to execute the consumer credit loan scheme agreement with the bank, in order to guarantee their employees. After executing the agreement, the employer has to nominate two to three authorized signatories who are responsible to verify and guarantee the employees application forms. The signatories have to sign two specimen signature cards of which one is placed at the branch and another at head office, credit department. Furthermore only confirmed and pensionable employees from the organizations or institutions that are eligible for this service. The applicants must properly fill application forms which will then be authenticated and endorsed by the head of department and guarantor's authorized officer together with endorsement of advocate or magistrate of district level or above. The form is supported by the following attachments; an application letter, which has to pass through his/her employer to the bank, most recent original salary slips of two months, photocopy of identity card and most recent taken passport size. In addition, the applicant has to have or open a quick account with the bank.

Upon returning of dully filled in application form by the employee, the branch credit officer verifies, if the employee come from the organization or institution which have a contract with the bank, if the form is properly filled in all space provided, endorsed by authorized signatory, and whether the form is stamped and endorsed by an advocate/magistrate. The credit officer also checks if the form is inserted with customer's quick account number and payroll particulars. After fulfilling the conditions, the credit officer computes the eligible amount of loan, so as to make sure that the monthly loan repayment (deduction) will not result to an individual's take home pay fall below one third of the client's gross salary. Then, the credit officer passes the application form to branch manager for review. The repayment period ranges from one year to two years, and the interest rate charged is 1.6% per month (or 19.2% per annum) in diminishing amount. After review, the branch manager, may ask for corrections or make a decision of rejection in case the customer does not qualify and inform him/her accordingly. Otherwise, approve, if the loan amount is within his/her approving power and if not, forwards the application form with recommendation to the head of credit for decision.

After review at this stage, the credit officer forwards the application forms to the divisional manager of consumer loans for verification, review and approval, if fall within his/her approving powers. If the application is above his/her approving powers, he/she recommends the loan by signing in the application forms and forwards to head of credit for approval/rejection. If the recommended amount exceeds the approval limit of head of credit then it is recommended to chief executive officer for decision. Once the loan application is approved by the relevant approving authority, the credit officer at division of consumer loans enters the necessary information in the date base, and prepare the offer letter which are to be signed by the head of division for issuance to the respective applicant's branch. The division manager sends the details of the approved loans of that month to the respectively employers. Remittances of instalment deductions details are done not later than 12th of the following month. Upon the acceptance of the terms and condition, the manager disburses the loan to applicant's account, after a fully repayment of administration fee of 1% of the loan amount approved.

The loan follow-up and monitoring is the primary responsibility of the respective branch manager. The mechanisms used in follow up and monitoring start with spooling and printing the personal loan report from the system in order to reveal the list of borrowers with missed loan instalments and their respective institutions. Then, follow -up with the employer to establish the reasons for non-payment or demand cheque from the employer if it is established that the employee's salaries were deducted. If the employee has been terminated, died or absconded, the follow-up is made on the terminal benefits from his/her employer or from pension fund. If the branch manager fails to recover the instalment arrears after making a follow-up with the employer, he/she informs the division manager consumer loan immediately. The division manager of consumer loans carries out vigorous recovery measures until when all loans in arrears are regularizes. Otherwise, recommends to secretary to the bank to take legal measures against all hard-core defaulters after fruitless negotiations with them, like issuing three months termination notice to the employer who is uncooperative. Once the agreement is terminated the bank, stop to issue repeat loans. However the employer is supposed to continue to remit to the bank deductions in respect of outstanding loans of its employees until when all their loans are fully repaid.

Credit Review

The findings of the study also revealed that both quantitative and qualitative reviews of consumer loans are carried out at both branch and head office credit department. This involves assessment of employer's attitude toward remittance of instalments. This is done at the head office by the division of personal loans and at the branch by the branch manager/credit officer in case of local upcountry employers. In case of non-submission of instalments for three consecutive months, the head of credit informs the employer on the bank's intention to terminate the contract. Critical credit review is conducted by using different methods; however age analysis for classifying loans is commonly used. Different categories are defined by the bank by considering the length of outstanding loan. Table 1 summarises the categories.

TABLE 1
LOANS CLASSIFICATION AND EXISTING RISK

S/N	Class	No. of days outstanding
1	Unclassified	1-90
2	Especially Mentioned	91-120
3	Substandard	121-150
4	Doubtful	151-180
5	Loss	181 and above

When classifying loans and advances using the provision matrix, the branch manager ages them according to maturity. Those which are not yet due are considered as "current" and those which are not paid at maturity are considered "past due". From table 1, there are five classes of outstanding loans; these are unclassified, especially mentioned, substandard, doubtful and loss. The bank considers any outstanding loan for more than 181 days to be a loss.

Problems Facing Banks in Provision of Consumer Loans

The findings of this study revealed that there are number of problems that are facing banks especially in offering loans. The first and most pressing problem is a risk associated to non-repayment of loans. In line with this there is also a reputation risk, which is caused by delay in loan processing. The delays are caused by credit officer in forwarding the applications to the appropriate stage. Fraud which is done by some dishonest credit officers and or branch managers by granting loan resulting in deductions to above two-third of gross salary contrary to the policy is another problem. Sometime they disburse the loan without the approval of the manager for credit officer or head of consumer division or head of credit for the case of collusion between the credit officer and the branch manager. The same staff, can change the loan terms, can make unauthorized rescheduling or automatic transfer of consumer loan deductions as well as open ghost loans for the purpose of taking the money.

Another problem is associated with poor arrears reporting, which is caused by weak communication and follow up between the disbursing branch and the assigned branch to collect cheque from employers. Also inability to recover the loans from terminal benefits is among the problems. This is caused by either terminal benefit been already pledged elsewhere or insufficient to liquidate the outstanding loan amount and length legal process to get rights of administration of assets. The study also found that inaccurate provisioning which is caused by poor equinox reporting to determine the amount of portfolio in the various risk bands as per regulatory requirement, inadequate bank capacity to compute and pass the provisions in the system and limitation in report writing and data extraction by IT and credit staff. There are also some problems on part of employers in term of not only delay in guaranteed the employees application forms and remitting repayments (especially private companies), but also financial/liquidity problem on their part resulting in salary arrears.

Consumer Credit Client's Success Stories

Despite the above shortfalls, consumer credit services provided by the bank have to a greater extent helped the beneficiaries to gain not only access to operating capital to their businesses, but also boosting their living standards and then gradually building their assets up to the level of becoming micro-entrepreneurs. This goes in hand with literature review, which explains the importance of credit in empowering the enterprising active people, so that they can sustainably engage in business that will liberate them from the bondage of poverty and contribute to community development (Richard, et al, 2008, Kessy, 2007, Kuzilwa, 2005, Kessy and Urio, 2006 and Hulme, Moore and Shepherd, 2001). The following are remarks made by the five interviewed beneficiaries of consumer credit.

"I appreciate the consumer loan scheme very much, with a little savings possessed, I was granted a loan of Tsh 3,500,000/= on March 2005, for the purpose of buying a pick up for person use and hiring

business. After one year of operation, I succeeded to buy a salon car; the business assured me of school fees for my children and better life" (Interview with one employees of National Printing Company). The second remark came from a secondary teacher at Lindi district in Lindi Region. Who appreciated the consumer loan of the bank, which enabled him to start a dairy cattle faming in 2005. He started with two dairy cattle and currently, he owns five of them, he goes further by saying that *"the project improved my family living standard tremendously".* Another secondary school teacher in Mwanza, admitted that *"I was empowered by consumer loan to finish my study at Agency for Development of Education Management (ADEM) at Bagamoyo in Coast Region by paying the college fees and thanks God for promotion to headmistress".* Another respondent said that the purpose of taking the loan was to start a small business of selling the second hand cloths for the motive of growing her income. She lamented that contrary to her expectations *"the business is not growing but remain constant".*

It was noted that one of the main reasons that contributed much for many businesses not to grow is lack of business skills that is entrepreneur's knowledge and experience. It is therefore argued that all stakeholders (the government, financial institutions, and learning institutions) should come with strategies on how to impart the entrepreneurship knowledge to the potential customers. Also one of the respondents took the loan for the purpose of buying a plot for house building, but end-up by diversifying the fund to college fee for his young brother and house rent. From this observation, which is also supported by different writers (Gaile and Foster, 1996; Hulme, 2000 and Mosley, 2001); it is suggested that the most prerequisite for success is proper use of available fund. This is true because there is no substitute for good planning, effective organization and execution with accountability for effective performance. Therefore, for beneficiaries whose purpose of taking loans are for injecting in their businesses, they must be developed and equipped with good managerial skills on how to run their economic activities. This will assure sufficient cash flow to finance other human initiatives.

CONCLUSION AND IMPLICATIONS

From the results, it has been found that the credit scheme helps in increasing income of the beneficiaries. Increase in income helps in improving standard of living like food and nutrition, better housing, education opportunities as well as empowerment particularly in decision-making and provides individual self-esteemed. Hence, there is a relationship between credit management objectives and attainment of an institution and current customers' assets growth and empowerment. In other words, effective loan credit management means survival, efficiency and cost effective provisioning of financial services. Banks can help unbanked and under banked enterprises and households to break poverty vicious cycle. This is done through accessing the credit funds over time, which creates jobs and income.

The study has also revealed that dishonest, frauds and misconduct among employees are looming. As incidences impair the functions of banks, there should be a question on functionality and effectiveness of internal control procedure of loan approval. In this regard, the banks should improve the remunerations to its employees, in order to motivate them for effective and efficient performance. The management of banks should revisit their internal procedures in a bid to seal off loopholes that facilitates frauds and misconduct among employees. Policies which do not address the delinquent loan problems aggressively attract arrears within the financial institutions. Strict policies that make both credit officers and customers responsible should be encouraged. It is also argued that one of the most important factors for repayment is the "mentality of the entity that generates the portfolio". Some of the best payment records among the financial Institutions have been attained by programs that begin under the premise that no level of late payment will be accepted even though the borrowers are from the poorest segments of the population. The management of the banks through policies and their action should create an institutional culture in which late payments are unacceptable. That culture should fully ingrained in the entire staff and consequently in each borrower.

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