FACTORS CONTRIBUTING TO NONPERFORMING LOANS IN NON BANKING INSTITUTIONS IN TANZANIA: A CASE OF NATIONAL SOCIAL SECURITY FUND

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CERTIFICATION

I, the undersigned, certify that I have read and hereby recommend for acceptance by the Open University of Tanzania, a dissertation titled *"Factors Contributing to Nonperforming Loans in Non Banking Institutions in Tanzania: A Case of National Security Fund''* in partial fulfillment for the requirements of the Award of the Degree of Masters of Business Administration (MBA) of the Open University of Tanzania.

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Date

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DECLARATION

I, Wilfred Modest Barongo 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.

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Signature

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Date

DEDICATION

This research report is dedicated to the most important people in my life, my late parents whom I loved so much. My parents worked so hard to make sure that I completed my schooling. I thank them very much for their devotion, love, patience and support.

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ABSTRACT

Pension Funds' statutory contributions from members must be prudently invested to conserve money value and those members are availed with benefits when they fall due in the future. One of the frequently given reasons for inadequacy of benefits in Tanzania is inappropriate investment such as loan provision which mostly result into nonperforming loan. The case study was carried at NSSF head office, Kinondoni and Ilala Regions offices in Dar Es Salaam City to investigate the factors contributing to nonperforming loan in non-banking institutions in Tanzania. The specific objectives were, to assess efficiency and usefulness of loan appraisal techniques used for qualifying borrowers, examine investment officers' performance on assessing borrowers and examine loan policy efficiency as guiding tool for decision making. The study found out that the inadequate investment analysis, government intervention, few loan/investment officer compared to the workload, lack of knowledge on investment appraisal techniques for investment officers, inefficient loan policy as well as inefficiency of monitoring mechanism in assuring timely loan repayments are factors leading to increasing trend of nonperforming loans. Therefore recommended that the organization should limit investment in the loan portfolio by providing loans to the project with attractive returns but with low risks (minimal), to conduct constant monitoring and evaluation (investment auditing) for each investment as well as to equip loan/investment officer with different loan appraisal skills by ways of training. From the management point of view loan recovery should not be relaxed by a single moment. Relaxation mostly is observed in nationalized financial institutions therefore it is recommended to engage recovery agency.

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LIST OF ABBREVIATIONS

BoT	Bank of Tanzania
DCF	Discount Cash Flow
GDP	Gross Domestic Product
CEO	Chief Executive Office
IRR	Internal Rate of Return
LART	Loan and Advanced Realisation Trust
NPA	Nonperforming Asset
NSSF	National Social Security Fund
NPL	Nonperforming Loans
NIC	National Insurance Corporation
NPV	Net Present Value
PBP	Payback Period
PPF	Parastatal Pension Fund
ROI	Return on Investment
SSRA	Social Security Regulatory Authority
UDOM	University of Dodoma

CHAPTER ONE

1.0 INTRODUCTION

This chapter presents the backgrounds the National Social security Fund. It charts out investments categories focusing the performance trend of loan portfolio in the past six years, statement of the problem, research objectives, research questions and significance of the study. Finally, the chapter concludes by showing the research report outlay.

1.1 Background Information

Pension funds are social security Institution. Social Security means any kind of collective measures or activities designed to ensure that members of the society meet their basic needs and are more protected from contingence to enable them to maintain a relatively decent standard of living consistent with social norms (Dau, 2003).

International Labour organization (ILO) defined social Security as" The protection measures which society provides for members, through a series of public measures against economic and social distress that would otherwise be caused by the stoppages or substantial reduction of earnings resulting from sickness, maternity, employment injury, unemployment, disability, old age, death, the provision of medical care subsidies from families with children" (ILO, 1992, p.4)

The concept of social security has been changing with time from tradition ways to modern form of protection. As societies become more industrialized and dependent on wage employment it was no longer possible to rely upon the traditional system of

social security. The negative impact of industrialization and urbanization attracted the attention of policy makers to formalize a social security system that addressed the emerging social security issue (Dau, 2003).

Pension funds in Tanzania are investing among others in loan provision to registered companies. Relation between pension funds and investment is that, pension fund is a cost centre that is financed by members' premiums on one hand and returns from investment on the other hand. That is statutory contributions from members must be prudently invested to conserve money value and that members are availed with benefits when they fall due in the future. One of the frequently given reasons for inadequacy of benefits in Africa is inappropriate investment environment in the region. As a result, low returns are realized from investment avenues of not only pension funds (PFs) but also other corporate investors. Pension funds find themselves not having enough resources to plough back into members' benefit accounts leaving social security beneficiaries poor for ages (Mwamoto, 2003).

As far as Pension Funds investments are concerned, there is need for them to manage assets which have sound returns and keep away with assets which are non performing that includes nonperforming loans. "Non-performing loans" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or under guidelines relating to asset classification issued by the Reserve Bank (Reserved Bank, 2005).

In recently year, there have been trends of increasing number of non-performing loans in pension funds especially in the National Social Security Fund (NSSF).

NSSF as one of pension funds invests in provision of loans so as to build its long term assets base and generate revenue through interest income. This is done through issuance of commercial loans to projects which are technically, commercially and economically viable in priority sectors of the economy.

Loans as one of the classes of investments in the investment portfolio of the Fund do not perform well, as the outstanding loans have been ever increasing. Poor performance of loans investments, have a significant bearing implication on income from investment for the Funds whose obligation to the members have increased substantially in recent year. Therefore low returns in investments affect the sustainability of the Fund and may reduce the ability to repay pensioners. In Africa and elsewhere in the developing world, social security benefits have never met members' expectations, partly due to poor performing investment vehicles (Mwamoto, 2003). Therefore this study seeks to analyze the factors leading to the increasing trends in Nonperforming loans of the pension funds in Tanzania.

1.1.1 Overview of NSSF

The National Social Security Fund was established in 1997, by Act of Parliament number 27, (The National Social Security Fund Act, 1997), and became operational from 1st July, 1998, being a conversion of the then National Provident Fund, originally set by the Parliament through The National Provident Fund Act, 1964. The then National Provident Fund (NPF) was established in 1965 as a government department in the ministry of Labor. In 1975 it was reconstituted as a parastatal organization under the Board of Trustees of NPF. From 1st July 1998, the Fund was converted from NPF to National Social Security Fund (NSSF), an organization,

which is based on universally accepted social insurance principles. The functions of the Fund are to register liable employers and employees; collect contributions from both employers as well as employees; manage and administer the fund; invest the fund available; pay out of the fund benefits as well as claims to its members; and provide technical assistance including advisory services for the purpose of promoting social security programmes.

The change from NPF to NSSF was undertaken after a project known as URT/90/003 titled "Development of social security in Tanzania." The project was sponsored by the ILO, UNDP and the government of the United Republic of Tanzania (URT). The project was conducted between March 1991 and December 1995. Project findings indicated that existing provident funds had a narrow coverage in terms of membership size and range of benefits offered. For example, the agricultural and informal sectors, although commanding a large share of the economy are not covered by any formal social security scheme. It also indicated that Provident funds had serious and fundamental deficiencies, which, for a long time, have prevented fulfillment of providing long-term income support in old age, invalidity and survivorship. The purpose of the Fund is to provide social insurance protection to all employees falling under the private sector, international organizations, diplomats and embassies, and all employees in the government and parastatals not covered by any scheme due to certain limitations like title held, age and contract of employment.

The protection is offered in terms of short term and long-term benefits. The short-term benefits include the maternity benefits, employment injury, funeral grants, and

health insurance benefit (SHIB). Long-term benefits include old age pension, survivor's pension, and invalidity pension.

1.1.2 Perspectives of Investment Functions in Pension Fund

Investment function is an inseparable activity of any progressive social security funds. Social Security Funds do invest, inter alia, to maintain and enhance value of members contributions remitted to them; such objectives merit attention on their own right (OECD, 1999).

Investment functions of the pension funds are performed with the objectives of generating more income to the Funds and hence increase its ability among others, to pay improved and meaningful benefit to its members. The pension funds invest in Long term as well as in short term investments. The pension funds around the world has significantly grown, forming one of the important instruments of social security, guaranteeing income from old age and enabling consumption in event of shocks such as loss of job, disability and death (Mmari, 2004). It is estimated that the stock of Pension assets, including voluntary pensions, is now as much as fifty percent of the world GDP (Palacios and Pallares, 2000).

Social security fund managers make investment decision to capture real growth. Usually social security funds are subject to investment regulations and restrictions that, as one of the salient features of benchmarking investment process tend to shrink the universe of possible investments.

In Tanzania, almost all social security funds have investment policies that govern their respective investment decisions in the form of "asset restrictions" and prudent

person rule. These policies have guiding principles that have to be adhered to wherever decision makers execute decisions pertaining to investment undertakings; these principal include safety, liquidity, yield, diversification and social economic utilities. These policies also prescribe stage by stage procedures that have to be followed starting with expert analysis by the directorate of investments followed by management investment committee (MIC), then Boards' Investment Committee and lastly the full board for final approval.

1.2 Statement of the Problem

During the period between 2001/02 and 2006/7 the trend of increasing volume of nonperforming loans in pension funds especially for NSSF has been observed. This has significant bearing on income from investment for the pension funds whose obligations to the members have substantially increased in recent years.

The trend of increasing nonperforming loans seems to be huge in NSSF as compared to other pension funds. For example there was Tsh. 2,173.22 million of loans which were not performing in the year 2002/03, the volume increased to Tsh. 9,800.07 millions in the year 2006/07 (principal and interest).

The investment decision is very important in pension fund because its consequence transcends to the future and will have to be endured for a long period. As far as pension funds investments are concerned, there is a need for pension fund to manage assets which have sound returns and keep away with assets which are non-performing.

Emanating from the potential need of pension funds to have assets which are performing better in terms of producing enough returns on investment; this study seeks to investigate the factors leading to the increasing trends of Non Performing loans of the pension funds in Tanzania.

1.3 Objectives

1.3.1 General Objective

Generally, the objective of the study was to investigate the factors leading to increasing trend of Nonperforming loans in Non Banking Institutions in Tanzania.

1.3.2 Specific Objective

(i) To assess efficiency and usefulness of loan appraisal techniques used for qualifying borrowers

(ii) To examine investment officers' performance on assessing borrowers.

(iii) To examine loan policy efficiency as guiding tool for decision making.

1.4 Research Questions

(i) Are investment appraisal techniques effectively used and efficient to assess borrowers?

(ii) Does the performance of investment officers efficient?

(iii) Does the available loan policy efficient for reducing defaulters?

1.5 Significance of the Study

Tanzania social security scheme is undergoing reforms, which are aimed at improving the efficiency and effectiveness of the funds. Given the ideal importance

of pension funds as financial institution, subsequent findings from the research are expected to identify reasons for increasing nonperforming loans for pension funds, NSSF being one of such cases. This has a paramount importance to policy makers, management, staff and members of the Fund. The study is of significant assistance to the management in creating enabling environment for continuity and sustainability of the Fund. Also, research findings from the study will serve as secondary data for future researches in the Pension industry.

1.6 The Scope of the Study

This part describes the limitations that the researcher encountered during the research process as well as the delimitations which are the ways the researcher used to overcome these limitations.

1.7 Limitations

The limitations which the researcher encountered during the research process were difficult of respondents to accept to participate in answering of questionnaires. Furthermore being able to convince managers to answer the questionnaire as were very busy and often out of the office.

1.8 Delimitation

In consequence of the above limitations, the study was conducted at NSSF head office, Kinondoni and Illala offices with the expectations of obtaining relevant respondents. Furthermore the researcher developed a closer relationship with the respondents by explaining and clarifying the objective of the research.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

Literature review is divided into two traditionally recognized parts i.e. the theoretical and empirical literature. A review of the available relevant literature reveals that there are no direct empirical researches on this subject area. The available theoretical literature does not significantly relate directly to the nonperforming loans in non-banking institutions. In the a foregoing, the theoretical literature review focuses on the various aspects revolving around this research area namely, understanding the meaning of social security schemes as non baking institutions, loan and its classifications, nonperforming loan, a review of nonperforming loan related theories and a review of factors that influence nonperforming loans.

2.2 Definition of Terms

2.2.1 Social Security Scheme

Matto (1995) defines social security (in ILO context) as “the protection” which society provide for its members through a series of public measures against economic and social distress. Otherwise such distress would have been caused by stoppages or substantial reductions of earnings resulting from sickness, unemployment, invalidity, old age, death and so on (Matto, 1995).

2.2.2 Loan

A loan is a sum of money advanced to a business that must be repaid, with interest at some point in the future. The lender must bear the risk that the borrower may not

repay the loan. The interest rate charged is the price for that risk. A loan is money, classified as follows:

(i) Passed: Solvent;

(ii) Special Mention: Loans to enterprises which may pose some collection difficulties, for instance, because of continuing business losses;

(iii) Substandard: Loans whose interest or principal payments are longer than three months in arrears of lending conditions are eased. The banks make 10% provision for the unsecured portion of the loans classified as substandard.

(iv) Doubtful: Full liquidation of outstanding debts appears doubtful and the accounts suggest that there will be a loss, the exact amount of which cannot be determined as yet. Banks make 50% provision for doubtful loans;

(v) Virtual Loss and Loss (Unrecoverable): Outstanding debts are regarded as not collectable, usually loans to firms which applied for legal resolution and protection under bankruptcy laws. Banks make 100% provision for loss loans. Non-performing loans comprise the loans in the latter three categories and are further differentiate according to the degree of collection difficulties.

2.2.3 Non-performing Loans

A simple definition of non-performing is a loan that is not earning full payment of principal and interest is no longer anticipated or a loan that is not earning income and principal or interest is 90 days or more delinquent or a loan that is not earning income and the maturity date has passed and payment in full has not been made.

There is no global standard to define non-performing loans at the practical level. Variations exist in terms of the classification system, the scope and contents. Such problem potentially adds to disorder and uncertainty in the NPL issues. For example, as described by Se-Hark Park (2003), during 1990s, there were three different methods of defining non-performing loans in Japan: the 1993 method based on banking laws; the "Bank's Self-Valuation" in March 1996; and the "Financial Revival Laws-Based Debt Disclosure" in 1999. These measurements have gradually broadened the scope and scales of the risk-management method. Similar to the trend in Japan, more countries, regulators and banks are moving towards adopting and adapting better and more consensus practices. For example, in the U.S, federal regulated banks are required to use the five-tier non-performing loan classification system according to BIS: Pass, Special Mention, Substandard, Doubtful, and Loss. Presently, the five-tier system is the most popular risk classification method, or, in some cases, a dual system of reporting according to their domestic policy guidelines as well as the five-tier system.

2.3 Theoretical Review

There are a variety of theories that relate to nonperforming loans. These theories have implications to the way in which some critical aspects in nonperforming loans are evaluated, hence it is imperative to discuss some of these theories. A discussion of some of these theories is as follows:

2.3.1 Theory of Asymmetric Information

The theory of asymmetric information tells us that it may be difficult to distinguish well bad borrowers (Auronen, 2003) in Richard (2011), which may result into

adverse selection and moral hazards problems. The theory explains that in the market, the party that possesses more information on a specific item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender) (Auronen, 2003) in Richard (2011).

The party that knows less about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction. The theory also elaborates that adverse selection and moral hazards have led to significant accumulation of non-performing loans in financial institutions (Bester, 1994; Bofondi and Gobbi, 2003).

2.3.2 Deflation Theory

The deflation theory (Fisher, 1933), suggests that when the debt bubble bursts the following sequence of events occurs; debt liquidation leading to distress selling and contraction of deposit currency, as financial institution loans are paid off. This contraction of deposits cause a fall in the level of prices, which leads to greater fall in the net worth of business, hence precipitating bankruptcies which leads the concerns running at a loss to make a reduction in output, in trade and in employment of labor.

These cycles cause complicated disturbances in the rates of interest and a fall in the money value. The complicated disturbances described above can be summed as both external and internal forces (macro and micro factors) influencing state of over-indebtedness existing between, debtors or creditors or both which can compound to loan defaults.

2.3.3 Financial Theory

Financial theory pioneered by Minsky (1974), also known as financial instability hypothesis, attempted to provide an understanding and explanation of the characteristics of financial crisis. The theory suggests that, in prosperous times, when corporate cash flow rises beyond what is needed to pay off debt, a speculative euphoria develops, and soon thereafter debts exceed what borrowers can pay off from their incoming revenues, which in turn produces a financial crisis. As a result of such speculative borrowing bubbles, banks and lenders tighten credit availability, even to companies that can afford loans and the economy subsequently contracts. The theory identifies three types of borrowers that contribute to the accumulation of insolvent debt: The "hedge borrower" can make debt payments (covering interest and principal) from current cash flows from investments. For the "speculative borrower", the cash flow from investments can service the debt, i.e., cover the interest due, but the borrower must regularly roll over, or re-borrow, the principal. The "borrower" borrows based on the belief that the appreciation of the value of the asset will be sufficient to refinance the debt but cannot make sufficient payments on interest or principal with the cash flow from investments; only the appreciating asset value can keep the borrower afloat. Financial theory underpins this study in that, a hedge borrower would have a normal loan and is paying back both the principal and interest.

2.3.4 Ownership Structure Theory

Ownership structure theory pioneered by Jensen (1976) integrated the elements of theory of property rights (Ronald, 1937), the theory of agency (Ross, 1973) and

Mitnick, 1974) and the theory of finance (Minsky, 1974). The theory explains why highly regulated industries such as public utilities or banks have higher debt-equity ratios for equivalent levels of risk than the average non-regulated firm. Jensen (1976) argues that, "ownership structure" rather than "capital structure" is the crucial variables to be determined, not just the relative amounts of debt and equity but also the fraction of the equity held by the manager. Ownership structure theory is appropriate for this study in that NPLs levels are investigated on basis of financial institution ownership structure dependence.

2.3.5 Factors that Influence Nonperforming Loans

2.3.5.1 Loan Amount

Lager loans have greater risk exposure, so the variable cost per currency is higher (Schreiner, 2001). If lenders do not take extra care, there could be more loan defaults. Greater loan size means less depth of outreach for borrower, but usually means more profitability for the lender (Schreiner, 2001). Schriner (2001), points out that average balance, a proxy for depth of outreach is directly proportional to revenue and default risk. The amount of loans could be a factor causing NPLs as it directly relates to risk.

Many lenders have problems with the repayments of clients whose loans issued exceed their capacity to repay (Wright, 2001). Higher loan size on the average may imply overestimation of borrowers' repayment capacity. On the other hand, higher loan size could mean that borrowers have higher capacity to earn and to repay the loans.

The loans that is too large for business needs may result in the use of loans for personal needs and results in the inability to pay from income (Norell, 2002). Friends of credit officers or privileged figures are usually the ones who receive large size loans based on favoritism, overlooking the capacity to pay back.

Khandker (1998) claims that loan recovery rate for larger loans may be lower than small loans. One of the reasons for the possible relationship between high repayment rate and small loans could be higher risk distribution. The small size of loans reduces credit risk for new borrowers (Holt and Ribe, 1991). A sound credit record should be built before bigger loans are granted to customers. It may be an important incentive for the customers to receive more loans in the future if they have good payment records and lender tend to award higher loans to those with good credit history.

(i) Management Information Systems

Management information systems are essential for accurate data and monitoring of borrowers' progress (Sacay and Randhawa, 1995). There should be effective management information systems in tracking payments, due loans, and overdue loans in order to systematically monitor loan performance (Yaron, *et.al.*, 1997). Loan collection may be affected by the quality of loan officers. Poor screening and insufficient monitoring of loans affect the quality of loans (Holt and Ribe, 1991).

(ii) Policy and Objectives

Clear policy has to be communicated well among the staff and clients with proper signals. Without clear policy, communicated objectives may not be set clearly or not taken seriously. Unclear objectives on a loan collection, for example, may result in

low quality of loan portfolios. Without clear objectives of outreach, loan officers may not concentrate on serving the target group (Holt and Ribe, 1991).

(iii) Government Interventions

Interventions may be based on political motives. Unprofitable special programs are often imposed on lenders owned by the government. Interest payments are often remitted or loans are written off for political reasons and may create a culture of default (Khandker, 1998). Direct interventions should be implemented either to address specific market failures or to reduce poverty, furthermore the effectiveness of the intervention should always be measured against the objective (Yaron, *et al.,* 1997).

The demand for loans may not be significantly affected by the level of interest rates (Rhyne, 1998), but the interest rate setting is related to client selection (Meyer, 2000). Borrowers with more promising projects might be selected at reasonable market rate. Loan collection performance might be better if borrowers with poor projects are not selected. Subsidized rates lead to rationing, which tends to favor the wealthy and politically connected and borrowers might not take loans seriously enough (Muraki, *et al.*, 1997).

Borrowers may take loans less seriously since the rate is lower than the market rate and money may not be used for the best investment available in the market. However, lower interest rates may be helpful for small borrowers who may not know many high return investment opportunities lenders to expand credit to its priority

sectors without paying sufficient attention to loan recovery (Khandker, 1998). Government interventions could reduce the autonomy of lending institutions since they have to comply with the government requirements.

(iv) Interest Rates

The demand for loans may not be significantly affected by the level of interest rates (Rhyne, 1998), but the interest rate setting is related to client selection (Meyer, 2000). Borrowers with more promising projects might be selected at reasonable market rate. Loan collection performance might be better if borrowers with poor projects are not selected. Subsidized rates lead to rationing, which tends to favor the wealthy and politically connected and borrowers might not take loans seriously enough (Muraki, *et al.,* 1997). Borrowers may take loans less seriously since the rate is lower than the market rate and money may not be used for the best investment available in the market. However, lower interest rates may be helpful for small borrowers who may not know many high return investment opportunities.

2.4 Empirical Studies

There have been various findings from the different studies that have explained the possible factors that contribute to nonperforming loans. Therefore it's imperative to discuss the findings and strategies used in these different studies to enhance the way in which this study can be conducted effectively and furthermore establish the gap that has been left by the previous studies.

In scholar studies, problem loans are often used as an exogenous variable to explain other banking outcomes such as bank performance, failures, and bank crises

(Boudriga et al., 2009). However, some studies investigate problem loans as an endogenous variable (Sinkey and Greenwalt, 1991; Kwan and Eisenbeis, 1997; Salas and Saurina, 2002) in (Boudriga et al., 2009). GDP growth, inflation and interest rates are common macro-economic factors, while size and lending policy are micro-economic variables (Greenidge and Grosvenor, 2010). These variables are by no means exhaustive, but they provide a useful framework for monitoring the development of non- performing loans (Guy, 2011).

More recent researches started studying this problem but with particular reference to both developing countries and emergent economies (Haunerand and Peiris, 2005; Matthewes et al., 2007), as cited by (Maggi and Guida, 2009) Bercoff et al (2002) examine the fragility of the Argentinean Banking system over the 1993-1996 period; they argue that non performing loans are affected by both bank specific factors and macroeconomic factors. To separate the impact of bank specific and macroeconomic factors, the authors employ survival analysis. Using a dynamic model and a panel dataset covering the period 1985-1997 to investigate the determinants of problem loans of Spanish commercial and saving banks, Salas and Saurina (2002) reveal that real growth in GDP, rapid credit expansion, bank size, capital ratio and market power explain variation in non- performing loans. Furthermore, Jimenez and Saurina (2005) examine the Spanish banking sector from 1984 to 2003; they provide evidence that non performing loans are determined by GDP growth, high real interest rates and lenient credit terms. This study attributes the latter to disaster myopia, herd behaviour and agency problems that may entice bank managers to lend excessively during boom periods. Meanwhile, Rajan and Dhal (2003) utilise panel regression

analysis to report that favourable macroeconomic conditions and financial factors such as maturity, cost and terms of credit, banks size, and credit orientation impact significantly on the non performing loans of commercial banks in India.

Babihuga (2007), in an IMF working paper, explores the relationship between several macroeconomic variables and financial soundness indicators (capital adequacy, profitability, and asset quality) based on country aggregate data. She explained the cross-country heterogeneity by differences in interest rates, inflation, and other macroeconomic factors. However, the study does not consider the impact of industry specific drivers of problem loans. Most empirical studies examine the influence of the macroeconomic environment on non performing loans (Louzis et al, 2011). Rinaldi and Sanchis-Arellano (2006) analyze household non performing loans for a panel of European countries and provide empirical evidence that disposable income, unemployment and monetary conditions have a strong impact on non performing loans.

Berge and Boye (2007) find that problem loans are highly sensitive to the real interest rates and unemployment for the Nordic banking system over the period 1993–2005. Lawrence (1995) examines the theoretical literature of life-cycle consumption model and introduces explicitly the probability of default. This model implies that borrowers with low incomes have higher rates of default due to increased risk of facing unemployment and being unable to settle their obligation. Additionally, in equilibrium, banks charge higher interest rates to riskier clients. Rinaldi and Sanchis-Arellano (2006) extend Lawrence‟s model by assuming that

agents borrow in order to invest in real or financial assets. They argue that the probability of default depends on current income and the unemployment rate, which is linked to the uncertainty regarding future income and the lending rates.

Breuer (2006), using Bankscope data, analyses the impact of legal, political, sociological, economic, and banking institutions on problem bank loans. Nevertheless, her study suffers from a representativeness bias due to the fact that Bankscope data on non performing loans are only available for a very limited number of countries and for a few numbers of banks. Other studies focusing on the macroeconomic determinants of non-performing loans include Cifter et al. (2009), Nkusu (2011) and Segoviano *et al.*, (2006). Carey (1998) argues that the state of the economy is the single most important systematic factor influencing diversified debt portfolio loss rates"" (Carey, 1998, p. 1382). Quagliarello (2007) finds that the business cycle affects non performing loans for a large panel of Italian banks over the period 1985–2002. Furthermore, Cifter et al. (2009) provides empirical evidence for a lagged impact of industrial production on the number of non performing loans in the Turkish financial system over the period 2001–2007.

Salas and Saurina (2002) estimate a significant negative contemporaneous effect of GDP growth on non performing loans and infer the quick transmission of macroeconomic developments to the ability of economic agents to service their loans (Bangia *et al.,* 2002; Carey, 2002). Nkusu (2011) investigating the macroeconomic determinants of loan defaults through panel regressions and panel vector autoregressive models. The author suggests that hike in interest rates result in

deterioration of borrower‟s repayment capacity and hence, cause of increase in non-performing loans. There is significant empirical evidence to suggest that local economic conditions explain to some extent, the variation in non-performing loans experienced by banks (Keeton and Morris, 1987; Sinkey and Greenwalt, 1991; Salas and Saurina, 2002; Rajan and Dhal, 2003) as cited in (Greenidge and Grosvenor, 2010) Research conducted in the Caribbean includes that of Khemraj and Pasha (2009), who examined the determinants of non-performing loans in Guyana. The empirical results revealed that with the exception of the inflation rate and bank size, all other factors have a significant relationship with the non performing loan ratio (Greenidge and Grosvenor, 2010).

Causes and treatment of non-performing loans were studied in detail by Bloem and Gorter (2001). They agreed that “bad loans” may considerably rise due to abrupt changes in interest rates. They discussed various international standards and practices on recognizing, valuing and subsequent treatment of non-performing loans to address the issue from view point of controlling, management and reduction measures. A study conducted by Espinoza and Prasad (2010) focused on macroeconomic and bank specific factors influencing non-performing loans and their effects in GCC Banking System. After a comprehensive analysis, they found that higher interest rates increase non performing loans but the relationship was not statistically significant.

Salas and Saurina (2002) find a negative relation between bank size and non performing loans and argue that bigger size allows for more diversification

opportunities. Hu et al. (2004) and Rajan and Dhal (2003) report similar empirical evidence. Another strand of literature has focused on the degree of loan concentration in various sectors, and proposes that vulnerabilities within sectors of high loan concentration tend to exacerbate the non performing ratio (Herring and Wachter, 1999) as cited in (Guy, 2011). However, Stiroh (2004) does not find evidence of benefits from diversification in the form of reduced risk, for the US banking system, since non-interest income growth was highly correlated with net interest income during the 1990s.

The moral hazard of too-big-to-fail banks represents another channel relating bank-specific features with non performing loans (Louzis et al, 2011). A policy concern is that too-big-to-fail banks may resort to excessive risk taking since market discipline is not imposed by its creditors who expect government protection in case of a bank‟s failure (Stern and Feldman, 2004). Consequently, large banks may increase their leverage too much and extend loans to lower quality borrowers (Louzis et al, 2011). Boyd and Gertler (1994) argue that in the 1980s the tendency of US large banks towards riskier portfolios was encouraged by the US government‟s too-big-to-fail policy. On the other hand, Ennis and Malek (2005) examine US banks‟ performance across size classes over the period 1983–2003 and conclude that the evidence for the too-big-to-fail distortions is in no way definite. Hu et al (2006) also show that bank size is negatively related to non performing loans.

In a seminal study, Berle and Means (1933) in Louzis et al. (2011) argue that dispersed ownership of corporate equity may lead to a poorer performance of the

firm as the incentive of shareholders to monitor the management weakens. An opposing view is that an efficient capital market imposes discipline on firm‟s management and therefore dispersed ownership should not have an effect on firm‟s performance (Fama, 1980) as cited in (Louzis et al., 2011). A strand in the empirical literature tests these contrasting views using loan quality as an indicator of riskiness but evidence is inconclusive (Louzis et al, 2011).

Iannotta et al. (2007) find a link between higher ownership concentrations and loan quality using a sample of 181 large banks over the period 1999–2004, thus lending support to the Berle and Means view. On the other hand, Laeven and Levine (2009) employ data on 279 banks and find a positive association between greater cash flow rights of a large owner and risk taking. Furthermore, Shehzad et al. (2010) present empirical evidence, from a data set comprising 500 banks from 2005 to 2007, that ownership proxied by three levels of shareholding (10%, 20% and 50%) has a positive impact on the non performing loans ratio when the level of ownership concentration is defined at 10% but a negative impact when the level of level of ownership concentration is defined at 50%. Therefore they suggest that sharing of control may have adverse effects on the quality of loans extended up to a level, but in cases of a strong controlling owner, bank‟s management becomes more efficient leading to lower non performing loans. Azofra and Santamaria (2011) find that high levels of ownership concentration benefit both the bank‟s profitability and efficiency for a sample of Spanish commercial banks.

Empirically, Novaes and Werlang (1995) report lower performance for state controlled banks in Brazil and Argentina due to high proportion of problem loans

given to government. Micco et al. (2004), analyze 50,000 financial institutions with different ownership types covering 119 countries. They conclude that non performing loans tend to be higher for banks with state ownership than for other groups. Hu et al. (2004) use a panel of Taiwanese banks and find a positive correlation between capital share owned by the state and the level of non- performing loans. Garcia-Marco and Robles-Fernandez (2007) investigate the relationship between risk taking and ownership structure. They document that commercial banks (mainly private owned) are more exposed to risk than deposit banks (mainly state owned). More recently Hu et al (2006) analysed the relationship between non performing loans and ownership structure of commercial banks in Taiwan with a panel dataset covering the period 1996-1999. The study shows that banks with higher government ownership recorded lower non-performing loans. Using a pseudo panel-based model for several Sub-Saharan African countries, Fofack (2005) finds evidence that economic growth, real exchange rate appreciation, the real interest rate, net interest margins, and inter-bank loans are significant determinants of non-performing loans in these countries. The author attributes the strong association between the macroeconomic factors and non-performing loans to the undiversified nature of some African economies.

2.4.1 Empirical Studies from Tanzania

Various studies have been conducted in the field of social security in Tanzania. Bossert (1987) conducted a study on traditional and modern forms of social security in Tanzania. He (Bossert, 1987) pointed out that modern social security system in many developing countries cover a small minority of the population, namely,

workers and employees in regular (urban and industrial) employment. A large part of the population, namely farmers, casual labourers and those self-employed outside agriculture depend on traditional forms of social security. Morever, the study by Matto (1995) on the existence of traditional social security institutions, namely, families, kinship and neighborhood in modern times established that the effectiveness of these traditional institutions have weakened due to government policies.

Another study by Tungaraza (1994) focused on how changes in social security institutions are bound to increase insecurity of their members. He (Tungaraza, 1994) was particularly interested in changes in traditional social security systems and their impact on women. Omari (1994) also focused on the plight of women in the society. He (Omari, 1994) highlights that formal security systems benefit only a relatively small number of women while the majorities have no access to them. In areas where women are dominant, there are no developed formal social security programmes or systems.

A study by Kaare (1994) focused on the comprehensive social security in Tanzania in response to inadequacy of the then existing system (NPF). The inadequacy was analyzed in two aspects. First, the narrow coverage, which left a larger section of the population uncovered (peasants, casual labourers, self-employed outside agriculture).

Komba (1996) focused on legal aspect as conducted a study on the contractual aspects relating to the NPF (now NSSF) operations in which he found that NSSF was

not a banker and thus its activities lacked legal banking. Also he found that there was gradual decline in NSSF membership for example, from 17.4% in 1988/89 to 2.53% in 1992/93 and attributed the decrease to structural adjustment programme measures under which many NSSF members were retrenched.

Hauli (1994) studied the impact of crisis and adjustment policies on modern forms of social security in which he noted negative effects that led to demoralization of social security members. Another study was conducted by Masinda (1997) discovered that investment portfolios of NSSF, PPF and NIC were not managed well that might had lead to loss of income. Kidula (1995) found loss of income resulted from poor performance of real estate and loan portfolios in a group of parastatals. These three studies were concerned with the future earnings of NPF/NSSF members given the time value of money.

Baruti (1997) wrote comprehensively on the role of pension fund in the transition towards a free market economy. He (Baruti) examined the role of the Fund as a non-bank financial institution and the Tanzania transition period from planned to market economy. The study discovered the potential of the Fund to diversify into banking business with an aim of improving members' benefits. A study by Metta (1998), Nchulla (1998), Ngatuni (1999), Yahaya (2000) discovered that NSSF should operate on the market aspects of social security products.

In his study on investment decision and risk assessment at the National Insurance Company (NIC) Kessy (2001) found that the Discounting Cash Flows (DCF) methods acquire superiority over the conversion methods, because DCF incorporated

the time value of money and risk aspects in investment. He further observed that NIC the resource allocation decision of NIC was mostly affected by external factors such as the government interventions. Hence it failed to identify critical variables and suitable strategies to achieve the project objectives. Research findings by Leonard (2004) relating to investment decision on Information and Communication technology (ICT) project show that the payback and NPV are the most preferred methods in appraising ICT project.

Other studies are 'Efficiency of Public managed pension funds in Tanzania', a comparison of the NSSF and PPF by Selemani (2004); Rugemalila (2005) in the factors attracting the needs of regulatory and supervisory in Tanzania pension fund. He discovered that lack of regulatory and supervisory framework for social security funds is significant problem which has to be addressed properly before it has caused stringent and intricate implications on provision of social security protection to Tanzania by the government and other players in the social security sectors.

2.6 Policy Review

Various Government Policies have been established for the guidance of investment for non-banking institution such as social security schemes. According to SSRA policy the institution should prescribe limits for investments in various asset categories to foster risk diversification and limit excessive concentration of risk. Also state that it should safeguard and protect the interest of the members of the schemes by directing investments in safe and high yielding investment opportunities without compromising diversification and social economic utility criteria.

The policy requires ensuring that there is sufficient liquidity to meet maturing obligations and to ensure high level of integrity and professionalism in the governance and administration of the investments of social security schemes. NSSF Investment Policy is vested upon its role as a guiding document in the investment decision-making process with the Fund. It provides guidance on reasons for investing, investment principles underlying the Fund's investment decisions, level of funds to be set aside to cater for investment, types of investment avenues where available funds are to be invested, how much should be invested in each investment category, the expected minimum return from each type of investment avenue and mechanism of making investment decisions.

2.7 Research Gap

Going through the literature it is obvious that there is a need for this study as most of the aspects that have been dealt focused on banking institutions. Furthermore the literature available in the markets of highly sophisticated and controlled nature which is utterly different from that of Tanzania and some factors deem irrelevant in application to the Tanzanian environment. Through literature review it's clear that a gap of massive magnitude is needed to be filled and this research provides the first step to do so.

2.7.1 Loan Appraisal Techniques

It is clear that banking institutions have got standard loan appraisal techniques for assessing borrowers, but there has not been clear if loan appraisal techniques used by non-banking institutions are efficient and effectively used to provide quality borrowers.

Loan appraisal or analysis ensures that loans are made on appropriate terms to clients who can and will pay them back. Loan analysis examines the business and the person (and the group if applicable); Loan analysis examines the progress as well a point in time. Loan analysis is both qualitative and quantitative. In measuring this objective the following will be point of focus;

2.7.1.1 Risk Analysis

Loan appraisal techniques normally should focus on identifying risks resulted from loan offered to borrower. The major risk expected is non-compliance of borrowers that is failure to repay principal and interest in time or failure completely. The main question to ask is what the risks of the business and the person are. Components to be considered during the analysis are as follow:

(i) Debt Equity – Ratio

One means of determining the appropriateness of a loan and/or appropriate loan size is the debt-equity ratio, which compares the current debts of the business and the proposed loan amount to the existing net equity of the business. The net equity is the client's own investment or the enterprise's worth. Care should be taken to minimize this ratio in order to avoid exposing both the client and the organizations to too much risk.

(ii) Loan Collateral

Risk analysis involves both the risk to the lender as well as to the borrower. Whereas debt-equity analysis focuses toward the risk to the business (and indirectly on the

risk to the lender), collateral analysis directly measures risk of loan recovery for the lender (and indirectly the risk of being put out of business for the borrower).

(iii) Working Capital Increase

A large increase in the size of a business increases risk. Working capital is the "liquid" assets of a business -- cash, inventory, etc. When these are increased in too large of increments, it is easy to overstock invest in materials that do not have a high return, thus making it harder to repay a loan from the returns generated. The intent of a working capital guideline is to minimize the risk of client losing the business's working capital due to lack of experience managing a much large quantity of money.

2.7.1.2 Return or Profitability Analysis

In conduct this analysis two questions should be asked. The first question is business profitable? And the second is are the returns sufficient to cover the loan, the interest and costs and return a profit? The analysis should point out the following:

(i) Working Capital Turnover

Working capital must work- it must rotate and be used frequently. The intent of this guideline is to determine if the business needs the additional working capital.

(ii) Profit Margin

Profit margin is used to show the margin of net income or profit generated on sales over a specific period of time. In case of production activities, it is the net income in relation to the net sales income from the production. For retail or wholesale

activities, the profit margin can also be seen as the “mark-up” charge above actual costs.

The value of the profit margin analysis is two-fold: (1) it forces the borrower, group and/or the credit officer to calculate the income and expenses of a business activity. This should be done both for the current period (normally week or month) without a loan and for a similar period with the projected loan. An acceptable or adequate profit margin varies according to the business activity and the sales “turnover of that business. The risk involved with the activity is also a consideration. While there is no set indicator, the adequacy of the profit margin is best measured by comparing with other similar businesses.

2.7.1.3 Repayment Capacity Analysis

When conduct analysis the analyst should ask him/herself that can the client repay and What repayment commitment can the client afford. The purpose of a micro-business loan is to capitalize the business. Hence, repayment ought to come from the profit generated by the loan and not from “dipping” into the working capital. Repayment capacity is often overlooked on small, first-time loans but later becomes a very important indicator when loan size increases. The analysis should focus on cash flow analysis.

(i) Cash Flow Analysis

Cash is necessary to make a business secure and able to withstand adverse economic and market conditions and take advantage of business opportunities. Cash is needed

at all times, but the incomes generated and the expenses incurred in a business may not be evenly distributed. Analysis of these inflows and outflows of cash allows the borrower and the lender to understand when credit is needed and when it can be paid. Whereas repayment capacity is a quick and simple indicative tool for analyzing repayment capacity for loans with relatively even cash flows such as retail operations, a simple but more time consuming repayment analysis is needed for loans such as agriculture that can have seasonal or uneven flows of income and expenses.

2.7.2 Loan Policy

Policy being a crucial guiding tool for loan process and decision making should be efficient to reduce defaulters. The quality loan policy should observe internal loan review, loan administration process, loan process sequences and its related components of lending maturities, loan pricing, financial information, loan authority and collections mechanisms. Also should consist of appropriate approval process, underwriting standards, assigned internal risk rating, provision for bad loans and collection guide. Loan policy has to consider loan portfolio review by undertaking systematic analysis, independence characteristics, state qualification of personel to be involved in loan portifolio management, depth review and follow up.

2.7.3 Loan/Investment Officers

Officers are key people who process loan and who are abiding to the policy. There is a possibility that investment officers in the non banking institutions lacking skills compared to the banking institution because of nature of organizations. In order loan

officer to perform efficiently and effectively should be assigned reasonable tasks, should be having relevant skills and qualification. Skills and qualifications should basically be on financial skills, auditing, and loan evaluation techniques.

2.7.8 Conceptual Framework

Being a set of coherent ideas or concepts organized in a manner that makes them easy to communicate to others help to explain why we are doing a project in a particular way. It also helps to understand and use the ideas of others who have done similar things.

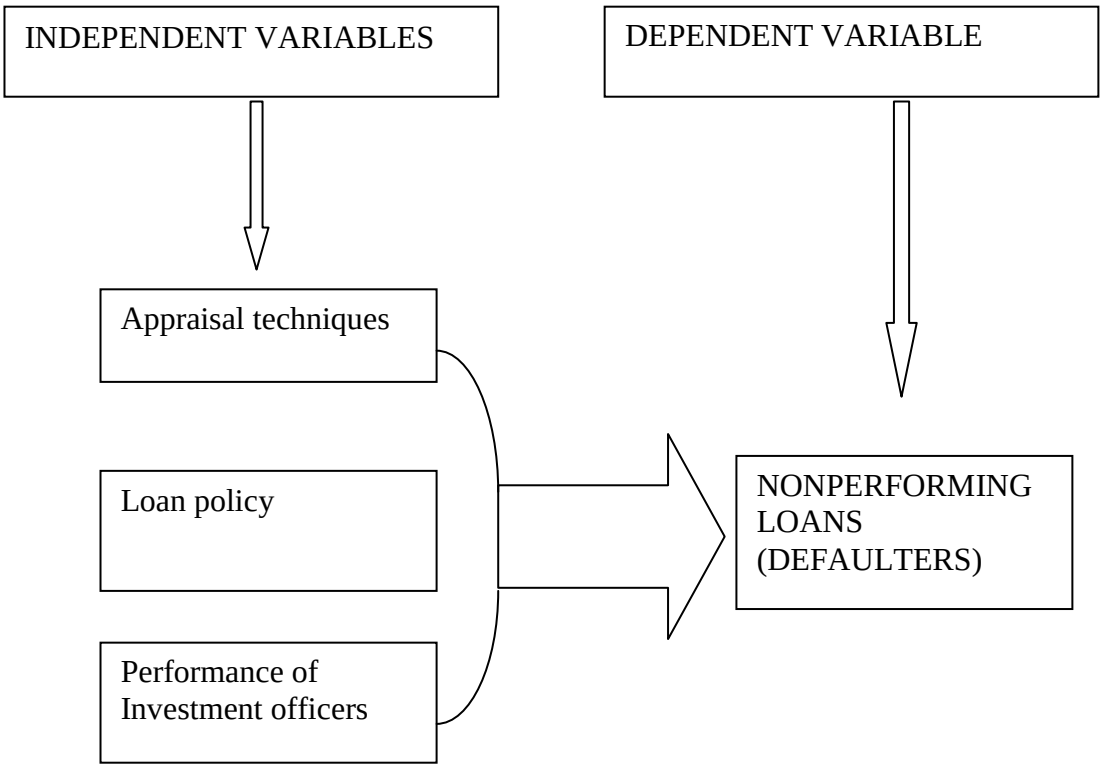

Figure 2.1: Conceptual Framework Model

Source: Researcher, (2013)

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

In this chapter, the research of research tools that were used in collecting and analyzing data are explained. These tools include research strategy, which is the general plan of how the researcher answered the research questions, sampling techniques that define the sample size drawn from the population, data collection and analysis techniques. The issues of validity and reliability are addressed in this study as well as the research approach.

3.2 Research Strategy

This is a case study that was conducted at NSSF head office, Kinondoni and Ilala regional offices in Dar es Salaam, According to Krishnaswami (2005), a case study is an in-depth comprehensive study of a person, a social group, an episode, a process, a situation, a program, a community, an institution or any other social unit. NSSF head offices and Dar es Salaam regions offices were selected as the case study because of the fact that they are the offices dealing with investment decisions.

3.3 Area of Study

The study was conducted in three (3) NSSF Offices dealing with investment, including NSSF Head Office, Kinondoni and Ilala regions Offices located in Dar es Salaam Region. The three areas are most appropriate as they are linked with the investment decisions, of the organization comprising staffs that are knowledgeable of

investment. Other regions offices were left out in this study because mostly deal with members contributions collections.

3.4 Sample Size and Sampling Technique

The study employed purposeful sampling. Purposive sampling is a type of sampling where the researcher chooses the desired sample to be included in the study (Chambua and Kester, 1993). Purposive or judgmental sampling enables the researcher to use his/her judgment to select cases that best enable him/her to answer his/her research questions and to meet the research objectives. Kothari (2000) argued that purposive sampling is considered as representatives of the population for the case study of the research. Purposive sampling was used in picking the key investment officers and other members of the staff by virtue of their experience. The sample comprised 60 respondents.

3.5 Data Types and Data Source

Both primary and secondary data were collected for the study. The aspects of primary and secondary data are;

3.5.1 Primary and Secondary Data

Primary data refers to the data a researcher obtains from the field that is a subject in the sample (Mugenda, 1999). Guest (1990) argues that a primary source of data provides the word of witness or first record of an event. They include a broad range of materials such as diaries, letters and other documents produced by the participants in an event. In this study, primary data was collected through the use of self

administered questionnaires and in depth-interview. The primary data was obtained from investment officers and other related staffs as they answered the given questionnaire. Secondary data refers to the kind of data used by a researcher but has been collected by other people for some other purpose (Saunders, 2000). The secondary data for this study includes different reports such as annual reports, financial reports and other related manuals which were used.

3.6 Data Collection Techniques

These refer to the different methods that researchers use to obtain the relevant information for answering the research questions. Data collection techniques included; document review and questionnaires. Below is an account of the data collection techniques used in this study;

3.6.1 Documentary Review

The researcher reviewed several annual reports, financial reports, investment manuals and different guidelines which had rich information on the performance trend and the criteria used in investment decisions.

3.6.2 Questionnaires

The questionnaire method is the method that permits the use of a set of questions to collect data and carry out a social research. Kothari (2003) argues that a questionnaire consists of a number of questions printed or typed in a definite order on a form or set of forms. This method of data collection is quite popular, particularly in a case of large inquires. There are two broad categories of questions that are used in questionnaires, namely; structured/closed ended and

unstructured/open ended questions. Closed-ended question refers to questions which have specific and objective answers, while open-ended questions are the type of questions which are subjective hence give respondent a complete freedom of response. Structured and unstructured questions were distributed to respondents.

Questionnaires were administered to Managers, Investment Officers and other staffs at NSSF head office, Kinondoni and Ilala offices. The questionnaire was structured in a way that it provided data that are both quantitative as well as qualitative. The questionnaire therefore included both closed ended questions which provided quantitative data as well as the open-ended questions which provided qualitative data.

3.6.2.1 Validity

Before data was collected through questionnaire, the researcher piloted /tested the questionnaire in order to ensure that the instrument of data collection collected /gathered the right kind of data for the study in accordance to the research objectives. Most important, questionnaires were refined to ensure that respondents had no problems in answering them.

Piloting of the questionnaire at NSSF Head office to provide face validity .i.e. the extent to which the questionnaire makes sense. This was achieved as the researcher examined the piloted questionnaires to ensure that respondents had no problems in understanding the questions. Ten members of the staff at NSSF head office were involved. These people were chosen to test the questionnaire because they fitted the expected profiles of the respondents of the study.

3.6.2.2 Reliability

Reliability of the questionnaire is concerned with consistency of respondents in providing data/answers that may be replicable in explaining the phenomena. In assessing the degree of consistency in the responses given by respondents when the study is to be replicated, the researcher adopted the following approaches to reliability verification: Comparing data collected via questionnaires with data gathered using a Test-re test method (Saunders, 2000). Under the Test re-test approach to reliability testing, the researcher correlated two data sets collected from the same questionnaire at two points in time from the same respondents. This simply giving the same group of respondents the same set of questions twice. The main aim was to determine if these respondents could yield the same results. The researcher chose five out of ten respondents that were used in the pilot study to answer the questionnaires for the second time.

3.7 Data Analysis Techniques

Microsoft excels and SPSS were used in aiding the analysis of the research data obtained from the case study. The SPSS was used in constructing pie charts and other illustrations which were necessary in summarizing information (Saunders 2000). The Microsoft excel was used in the presentation of the data in the graphical form to facilitate easier understanding of the research findings (Saunders 2000).

CHAPTER FOUR

4.0 DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter presents analysis and discusses the study findings. The study aimed at investigating the factors for nonperforming loans in non-banking institutions. The findings are presented in line with the specific objectives of the study which are articulated in chapter one. The data has been analyzed using Statistical Package for Social Science (SPSS) which made cross tabulation of variables very easy. Also views observed are presented as opinions.

4.2 Respondents Characteristics

In this part, the sample characteristics were fully analyzed. For this study, the sample characteristics are the characteristics members of staff at NSSF head office, Kinondoni and Ilala Regions offices of Dar es Salaam Region. The characteristics observed included work experience, sex distribution and knowledge on investment analysis. The reviews of these characteristics provide insight to why the answers of the respondents may vary. A sample size of 60 respondents was observed.

4.2.1 Work Experience

Respondents were asked to mention the number of years they had worked. The aim was to know their knowledge of nonperforming loans acquired from their work experience. It was sought that knowledge of nonperforming loans is highly correlated with awareness resulted from working experience for both members of staff. Table 4.1 provides the findings:

Table 4.1: Work Experience

Status	Respondents	Percent	Valid Percent
11-14 years	18	26.7	26.7
7-10 years	17	28.3	28.3
3-6 years	16	30.0	30.0
Above 14	9	15.0	15.0
Total	**60**	**100.0**	**100.0**

Source: Field data, (2013)

Table 4.1 above shows that the respondents with eleven to fourteen years of working experience were 18 which represents 30.0% of the respondents while respondents with seven to ten years working experience were 17 which is 28.3% of the respondents. Further 16 respondents had working experience of three to six years presenting 26.7% of respondents. The above 14 years were only 9 respondents presenting 15.0%. Less response of the highly experienced respondents was due to their old age. It is evident that the majority of respondents had long working experience because only 16 (26.7%) respondents had the work experience below 7 years.

Table 4.2: Sex Distribution

Status	Respondents	Percent	Valid Percent
Male	34	56.7	56.7
Female	26	43.3	43.3
Total	**60**	**100.0**	**100.0**

Source: Field data, 2013

4.2.2 Sex Distribution

Determination of respondent's sex was important to understand how gender distribution of employment opportunities is reflected at NSSF. Also the focus was to

discover if sex distribution might have impact on investment decision. It has been thought that female are trustful than male hence adherence to the procedures unlike female who are courageous to violate procedures.

The results from Table 4.2 indicate that the males who participated in the study were many than females. Male who responded to the study were 34 which is 56.7% of the respondents while female were 26 presenting 43.3% of the population. Low response of female might have influenced by the few in number at the working place or negligence of women. But this does not conclude that gender has impact on inefficiency to investment decision.

4.2.3 Knowledge on Investment Analysis

Respondents were asked whether they had knowledge on investment analysis. The aim was to know the understanding level of respondents on the issues of investment. The measurement was by saying “yes” or “no” from among respondents. The result was that those who had knowledge were 42 respondents which presents 70.0% of the total respondents while 18 respondents had no knowledge on investment analysis equal to 30.0% of the total respondents as shown in Table 4.3

Table 4.3: Knowledge on Investment Analysis

Status	Respondents	Percent	Valid Percent
yes	42	70.0	70.0
no	18	30.0	30.0
Total	**60**	**100.0**	**100.0**

Source: Field data, (2013)

The implication from Table 4.3 justifies that since 42 (70%) of the respondents had knowledge on investment analysis, therefore they were conversant with what the study. But also the study might has provided awareness to those who had no knowledge in one way or another.

4.3 Findings and Discussion

4.3.1 Loan Appraisal Techniques for Assessing the Borrower

The investigation was conducted by asking if there were loan appraisal techniques used to assess the borrower. The aim was to determine if non-banking institution has loan appraisal techniques for assessing the borrowers but also knowing if the techniques used are efficient. Three issues were examined and tested to this attribute, the issues were: if loan appraisal technique used to assess the borrower, if borrowers influence the loan appraisal procedures and type of borrowers offered loans.

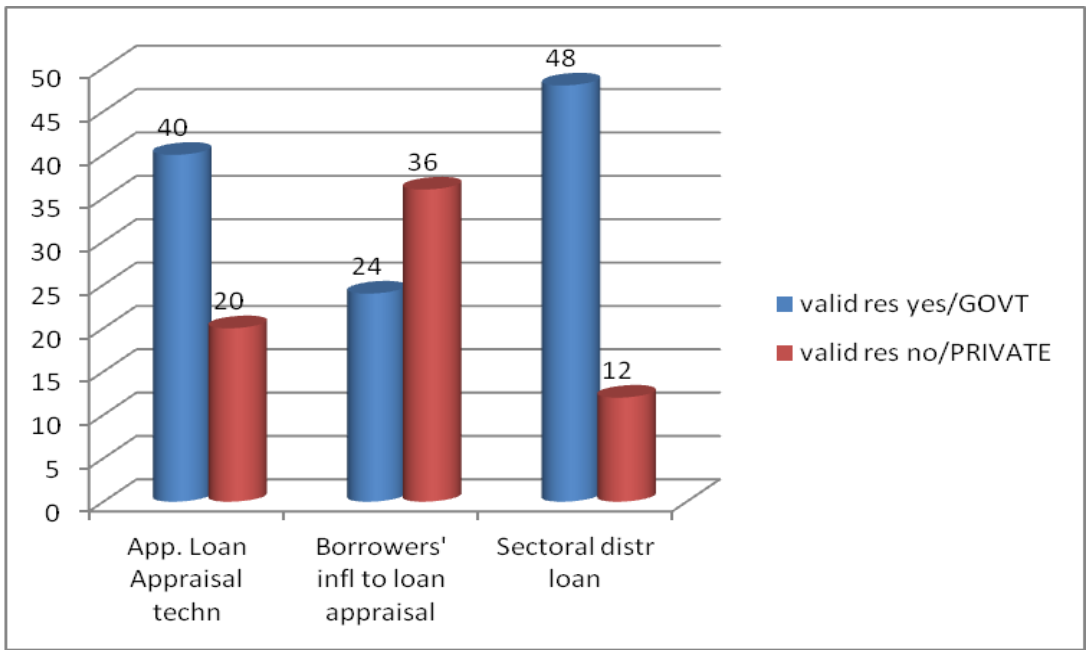

Figure 4.1: Loan Appraisal Techniques

Source: Field data, (2013)

The measurement was “yes” or “no” among the respondents for the purpose of understanding the presence of the techniques and how useful are. Figure 4.1 provides the findings in figures for the assessed aspects:

A question concerning application of loan appraisal techniques invented to explore whether NSSF has standardized loan appraisal techniques and if were applied. Findings in figure 4.2 show that 40 respondents agreed that NSSF use different appraisal techniques to assess the borrowers in order to minimize or to eliminate defaulters. The agreed respondent presents 66.7% of the total respondents. 20 respondents equal to 33.3% of the respondents disagreed that NSSF does not use loan appraisal techniques. Since majority agreed that the loan appraisal techniques were used to assess borrowers’ concludes that respondents appreciate the way loan appraisal techniques were used to asses borrowers.

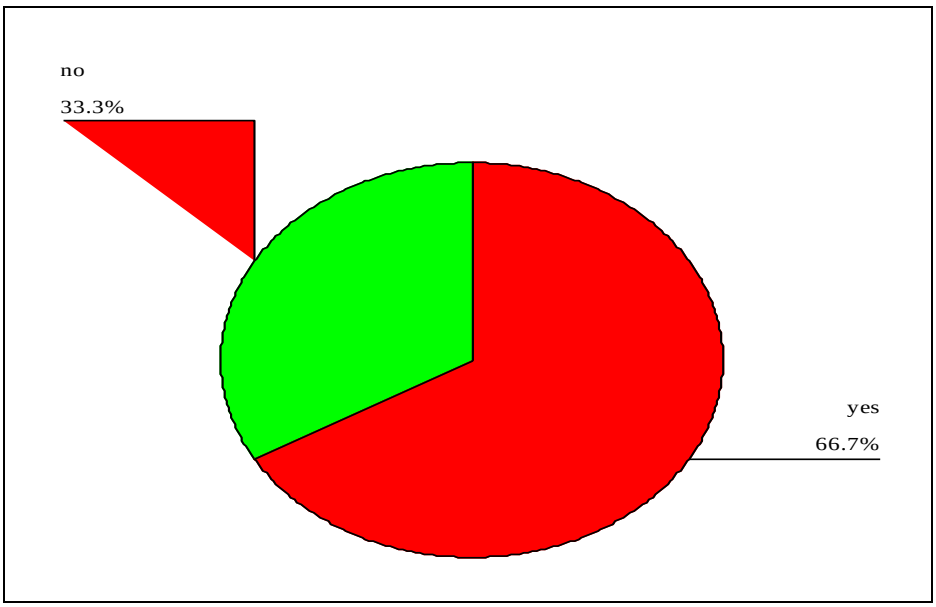

Figure 4.2: Application of Loan Appraisal Techniques

Source: Field data, (2013)

Further respondents were asked whether borrowers influence loan appraisal procedures. The purpose was to discover elements that might have influenced non-adherence to the procedures such as malpractices in terms of grand corruption and grafting. Figure 4.3 shows that 36 respondents equal to 60.0% of total respondents said *"no"* which implies that borrowers do not influence the loan appraisal procedures. The remaining 24 respondents equal to 40.0% said *"yes"* this means agreed that applicants influence loan appraisal procedures.

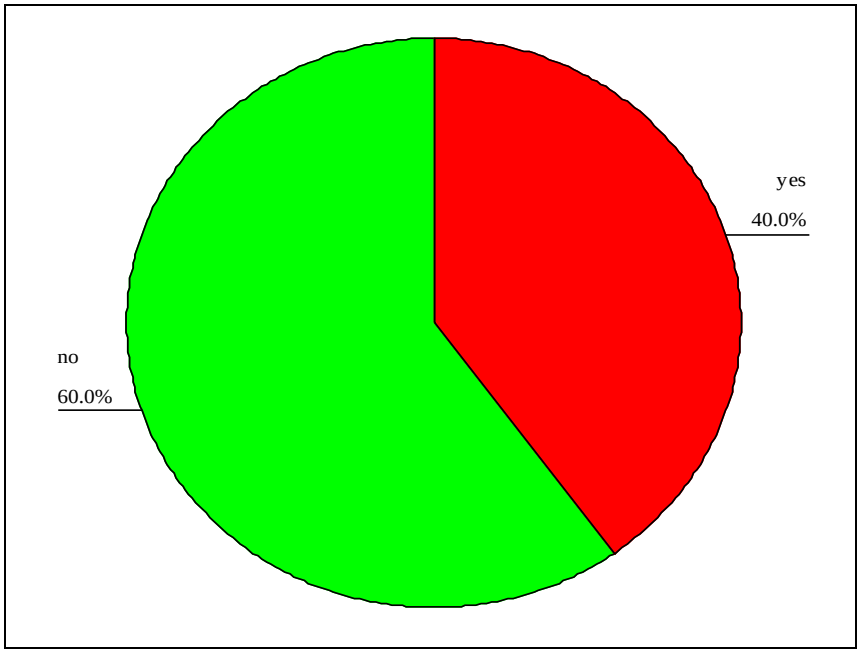

Figure 4.3: Loan Applicants' Influence on the Loan Appraisal Procedure

Source: Field data, 2013

The question concerning sectoral loan distribution aimed at discovering the sector which is more influential to NSSF. The intention was to determine between private and government borrowers who have poor records on loan repayment. This is due to the fact that these borrowers have different operating environment. Figure 4.4 provides specific the findings:

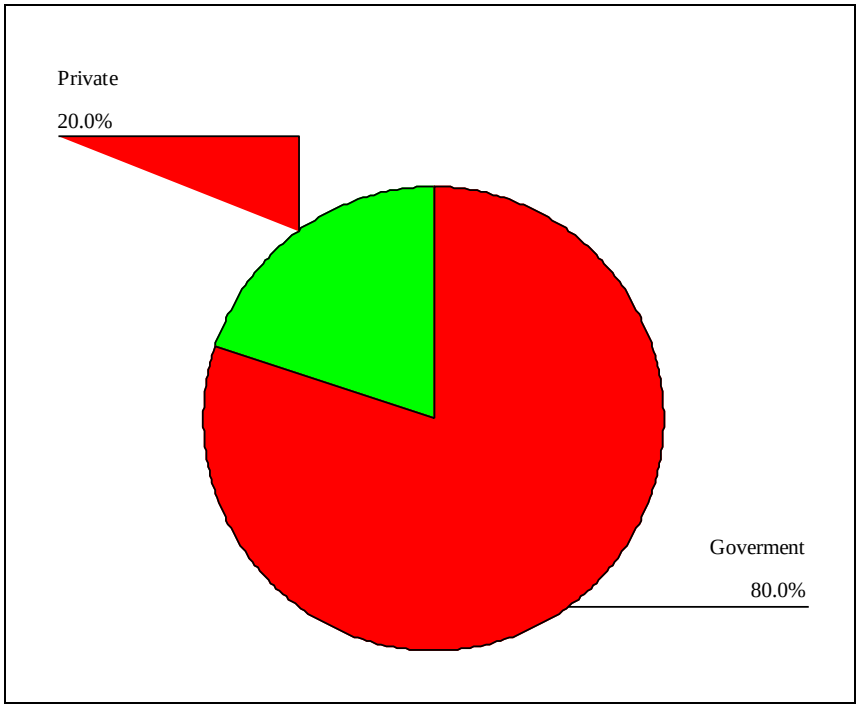

Figure 4.4: Response on Types of Borrowers Offered Loan

Source: Field data, (2013)

The findings from Figure 4.4 shows that 48 respondents which is 80.0% of total respondents answered that NSSF mostly provides loans to the Government sector 12 (20.0%) replied private sector. This implies that NSSF mostly provide loan to the Government. In general, from the above three issues explored all resulted into satisfaction with regards to efficient of loan appraisal techniques used to assess borrowers and so had positive effects. This implies that performance is assured.

Furthermore respondents explained that the government intervention had been a contributing factor of nonperforming loan for NSSF. He said that NSSF had been investing with the government due to the fact that the organization was sure of recovering its funds plus interest charged. Added that political clouts and government intervention influences pension funds' investment decisions. The

decisions are being influenced in different ways, first is implementing into unplanned investment for the purpose of fulfilling they are intended political motives. Also government influences on ensuring that the government projects are financed regardless of viability. Whichever influence of the government inside of it there found hidden negative impact to NSSF. The hidden negative impact could has resulted from wrong analysis done for the aim of favouring the government but because NSSF is big organization it does not realize the impact easily.

4.3.2 Investment Officers' Performance on Assessing the Borrowers

Issues examined in assessing the investment officers' performance on assessing the borrowers includes; number of investment officers compared to the workload and if available investment officers had enough knowledge on investment appraisal techniques. Findings of the objective are depicted in Figure 4.5 below whereby respondents responded "yes" and "No".

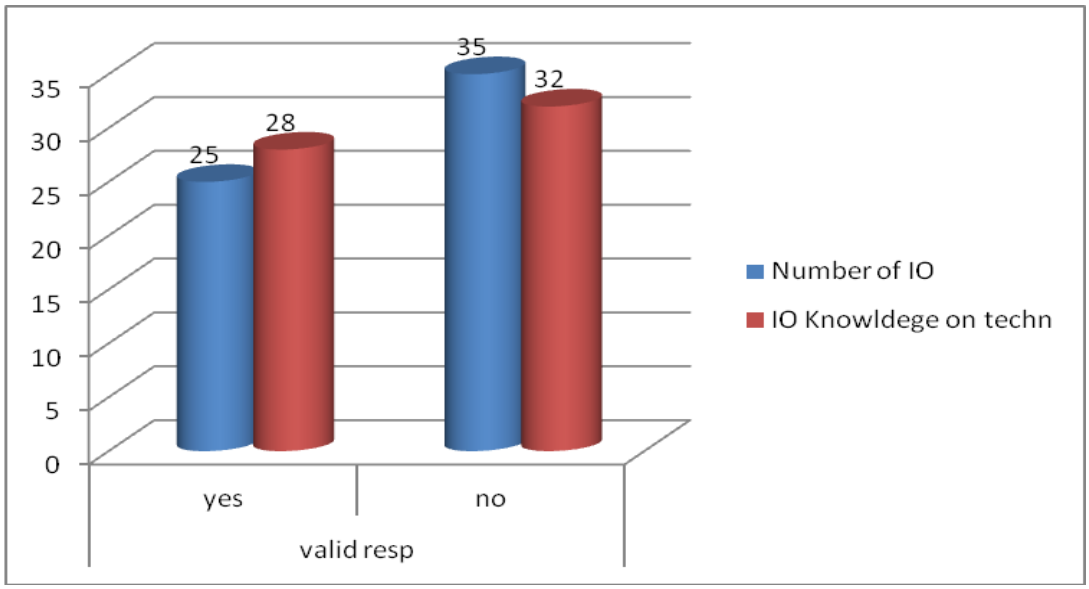

Figure 4.5: Investment Officers' Performance

Source: Field data

The researcher looked into the status of NSSF Investment officers to determine whether their number was proportional to the workload. It was thought that due to the fact that investment officers are only the staff with knowledge of investment analysis unlike other members of staff with other responsibilities. Figure 4.6 shows that 25 respondents presenting 41.7% total respondents answered that the number of investment officers was enough to manage the workload. The remaining 35 respondents equal to 58.3% of total respondents disagreed. This implies that the officers were unable to perform well due to the workload

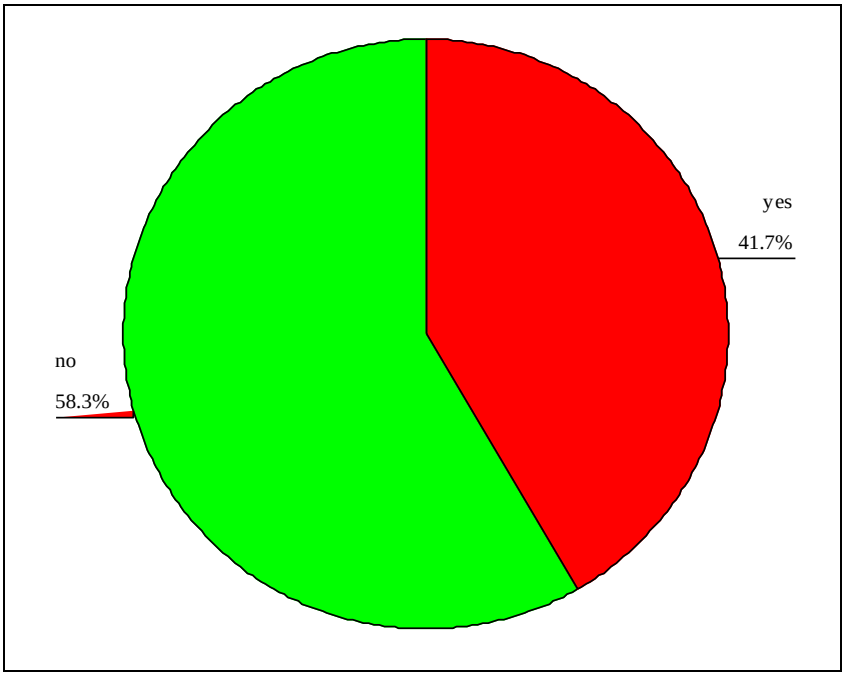

Figure 4.6: Availability of Loan/Investment Officers

Source: Field data, 2013

Respondents were asked whether investment officers had knowledge of investment appraisal techniques. The aim was to understand the level of the officers' knowledge with regard to investment issues. Figure 4.7 shows that 32 (70.0%) of respondents

answered that available investment officers had no enough knowledge of investment appraisal techniques while 28(30.0%) of respondents agreed that investment officers had enough knowledge of investment appraisal techniques. Therefore, implies that the officers were not well informed of the loan appraisal techniques which could lead to nonperforming loans.

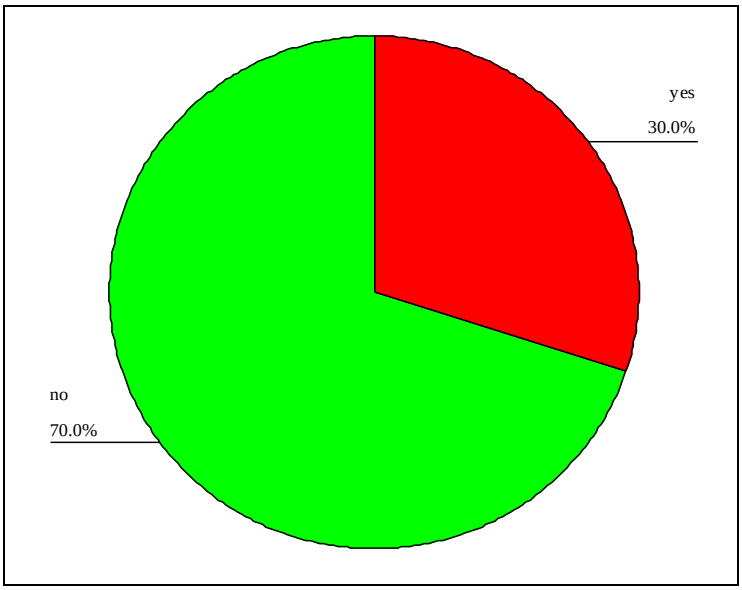

Figure 4.7: Knowledge of Investment Appraisal Techniques Knowledge

Source: Field data, (2013)

4.3.3 Efficiency of Loan Policy

The policies are the guidelines which outlines the set up in which an organization will work by creating the environment which will allow its development. To explore this, tree issues were examined. The issues were: role of loan policy in reducing defaulters, interest charged as guided in the policy and efficiency of monitoring mechanism. The general findings are depicted in Figure 4.8.

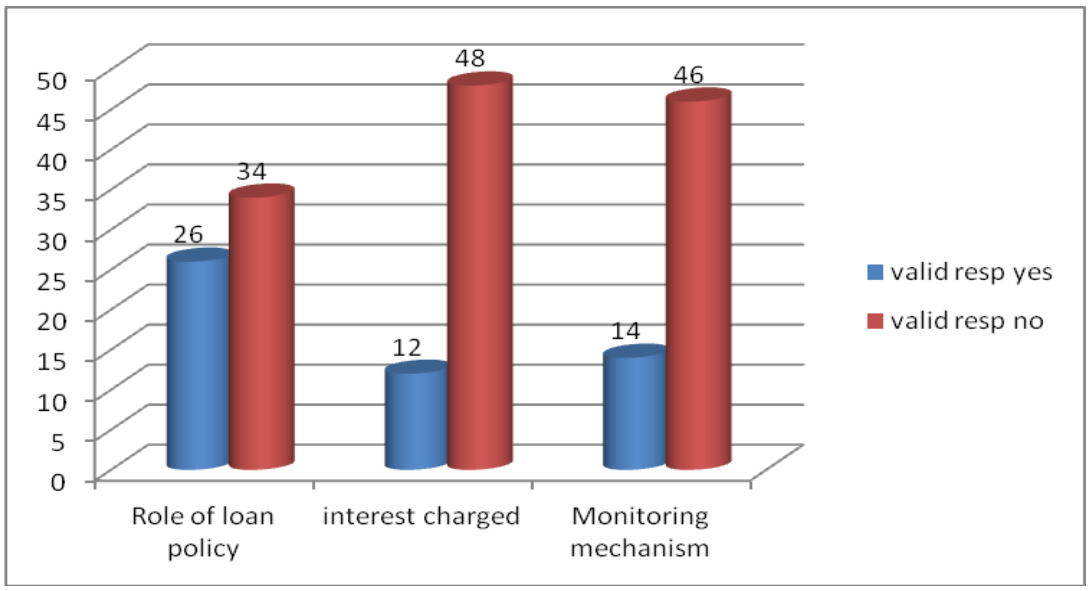

Figure 4.8: Efficiency of the Loan Policy

Source: Field data, (2013)

Respondents were asked if the loan policy helped to reduce defaulters. The finding from the study was that 34 (56.7%) respondents replied that the loan policy did not help to reduce defaulters, while 26 (43.3%) said it does. This implies that the policy is not implemented. Figure 4.9 indicates the score:

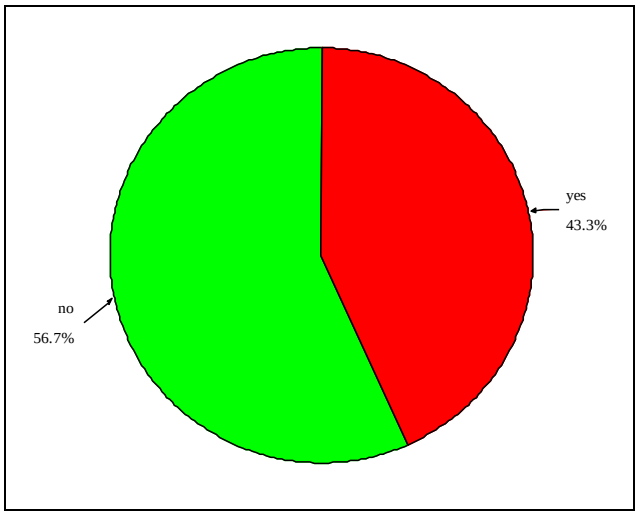

Figure 4.9: Role of Loan Policy in Reducing Defaulters

Source: Filed data, (2013)

Respondents pointed out that the policy and objectives of the organization are clear on investment processes where by the loan is among of those investments. The policy requires the organization to prepare an investment manual which will clarify the guiding procedures of investment. What is done current is investing basing on experience but for new employee become difficult where it can provide room of distortion during the investment by skipping the procedures.

Additionally Respondents were asked if NSSF charge high interest rates compared to banking sector. The focus was to discover interest charging mechanism if might had impact on high interest rate to the borrowers. The study found that 48 (80%) of respondents who were the majority said that NSSF do not charge high interest rate compared to banking institutions. Only 12(20.0%) of the respondents said that NSSF charge high interest rate compared to the banking institutions.

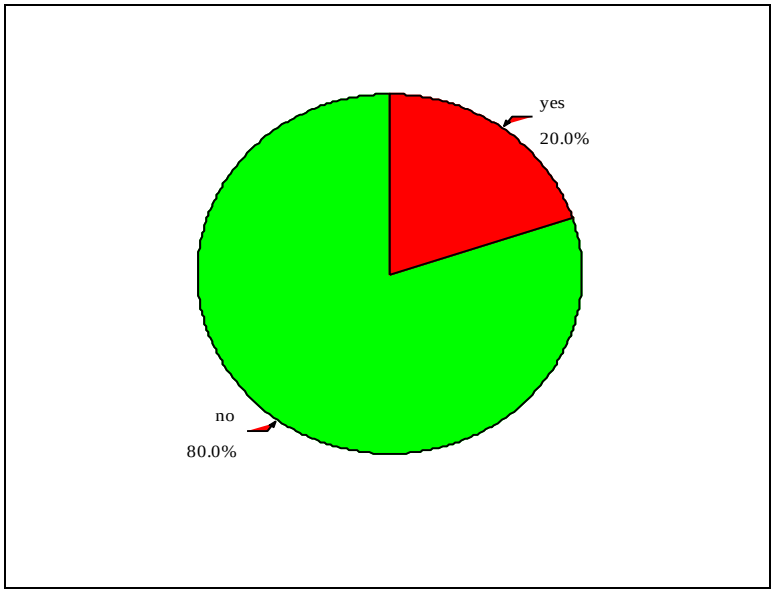

Figure 4.10: Interest Rates Charged by NSSF Compared to the Banking Sector

Source: Field data, 2013

On their explanations respondents said that NSSF being a non banking organization is offering affordable rate to its borrowers so that to attract other stakeholders to borrow. Added that currently there is a need of reviewing the policy and one of the amendments will be charging the loan interest rate on market basis. In so doing will help to have quality borrowers unlike now. But the challenge remains to the government which is the major borrower hence major defaulter. It is expected that establishment of SSRA will combat such problems to social security funds by providing independent guidelines and limits of loan to be disbursed to the government.

Furthermore, a question was asked if the monitoring mechanism was efficient to assure timely loan repayment. The response as shown in Figure 4.11 below in which 46 (76.7%) respondents replied that monitoring mechanism was not efficient. 14(23.3%) of the respondents answered that monitoring mechanism is efficient.

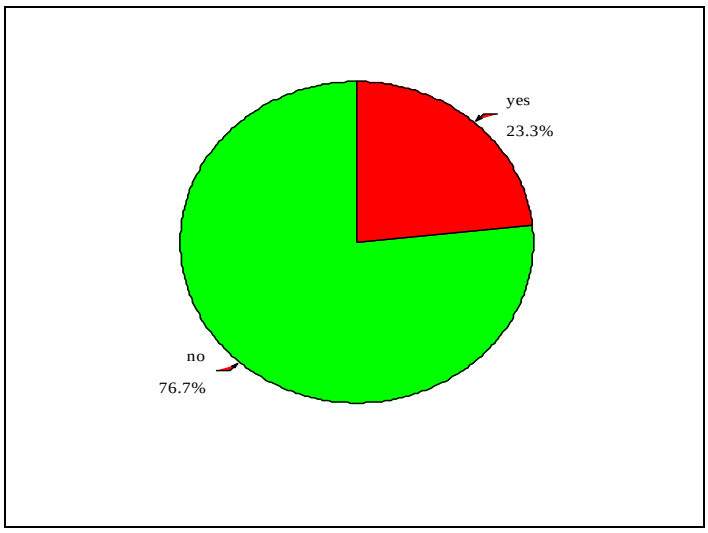

Figure 4.11: Efficiency of NSSF Loan Monitoring Mechanisms

Source: Field data, (2013)

Further respondents explained that there is poor management of loan portfolio in our organization. The management lack serious control and monitoring on loans granted to the borrowers. This lack of control and monitoring has provided chance to the borrowers to use funds not to the intended business. Cited examples of Gomba Estates, Kagera Sugar, Kiwira, Katan in Tanga, UDOM and Genera Tyre but surprisingly only Kagera Sugar is repaying the loan. The remaining companies including UDOM project are among the major defaulters. The only problem here is poor monitoring caused by management of the organization.

Secondary data observed through documentary review revealed to the researcher that much funds has been offered to borrowers as loan investment category. It also has been discovered that more funds were not paid timely (i.e principal +interest). Failure of borrowers to pay loans as required had resulted to bad debtors or defaulters. The situation of having defaulters had led to nonperforming loans as shown in Table 4.4.

Table 4.4: Loan Disbursed Vs Actual payment (Million TZS)

Year	Amount of Loan Issued	Target Loan Payment	Actual Loan Payment	Perf. %	Target Interest Payment	Actual Interest Payment	Perf. %
01/02	662.22	69.7	13.7	19.7%	192	26.9	14.0%
02/03	501.7	144.8	106.3	73.4%	44.4	74.7	168.2%
03/04	458.2	18	43.5	241.7%	-	-	-
04/05	14,989.7	587	358.7	61.1%	1446.6	1279.5	88.4%
05/06	42,102.5	-	-	-	2260.6	1612.1	71.3%
06/07	49,750.4	1669.1	2608.3	156.3%	3534.5	2672.5	75.6%

Source: Final Annual Audited Accounts of NSSF for the period of 2001-2007

Apart from finding the factors contributing to nonperforming loans researcher also asked respondents to give their remarks on what measure should be taken by the fund to reduce or eliminate the problem. In responding this question different opinions were provide that includes, investing prudently to preserve time value of money, to conduct in-depth analysis of all projects before investment decision, issuance of loans by phases according to implementation of project of the borrower, conduct investment audit for each investment, timely loan disbursement and issuance of loans to financial institutions only. Further responded that NSSF should set and maintain a percentage of holding investments especially in loan.

CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter gives the summary of the major findings of the study. It also discusses the findings to arrive to conclusions and recommendations on what could be done to rectify the observed situation. Finally, the chapter identifies and recommends areas for further research.

5.2 Summary

The study aimed at analyzing the factors contributing to in nonperforming loan of nonperforming loans in Tanzania, the case of NSSF. Specifically the research examined the loan investment showing increasing poor performance. The researcher gathered opinions through questionnaire of different respondents on the factors contributing to nonperforming loans and solutions to the factors.

The principal factors contributing to nonperforming loans as revealed in the study included; inadequate investment analysis and projects appraisals before making investment decisions; government intervention; borrower' influence to loan appraisal procedure; type of borrowers; number of loan/investment officer compared to the workload; investment officers' knowledge of investment appraisal techniques; role of loan policy in reducing defaulters; interest rates charged by NSSF compared to the banking sector and efficiency of monitoring mechanism in assuring timely loan repayment.

Findings indicated that six factors have a significant contribution to non-performing loans. These included; inadequate investment analysis and projects appraisal before

making investment decisions; government intervention; few loan/investment officers compared to the workload; lack of knowledge on investment appraisal techniques for investment officers; inefficient loan policy and efficiency of monitoring mechanism in assuring timely loan repayment.

According to the secondary data observed that there is an increasing trend of defaulters resulting to nonperforming loans. This will have an impact of slowdown of organization operations mainly on benefit payments to the members. Also the organization will not be able to meet administrative costs. The problem seems to grow since the organization still provide loan and less mechanisms of administering them.

5.3 Conclusion

It is important that the problem of nonperforming assets be addressed. It should be addressed to ensure adequate financing for social security so that members receive adequate benefits. Equally important, reducing non performing investments helps build a strong financial base which in the long run helps base for pension funds in building the economy of the country .

Implications for poor performing of some assets as revealed from the study includes failure for social security scheme or pension fund to achieve its objective of increasing the income from investment which will enhance to meet its highly obligation of paying benefits to its members, financial distress to social security scheme or pension fund and the social security scheme sometimes become financially unsustainable. Nonperforming loans has obvious implications for members and these are deprivation

of retirement benefits as provided by law, and low benefits. But it also has implications for the state, which may be required to supplement pension payments from general revenues of the government. Possible practical measures as revealed and discussed in the study fall into four categories. These are: The fund to conduct in depth analysis on all projects before investment decision are made; attitude change in political and government interference in investment decisions made by pension funds; changes in monitoring techniques and Regulated social security investments by an independent body.

The conclusion urges therefore that, non performing loans is a significant problem in the social security industry and if not properly addressed it would have stringent and intricate implications on provision of social security protection to the people of Tanzania by the Government. To overcome and curb this prevalent increasing trend of nonperforming loans, some recommendations have been provided.

5.4 Recommendations

This sub-section presents recommendations to various players in the investment decisions of pension fund that include board members, investment committee members, Management, managers and investment officers, and other participants.

Bearing in mind the powers, responsibilities, obligations and functions of those participating in investment decision, recommendations to reduce the problem of nonperforming loans are proposed. Firstly, investments should be done with care, skill, expertise, prudence and diligence and avoidance of government intervention

during analyzing loan applicant. Secondly, the organization should put in place investment manual which is an important document in verifying and detecting some deficiency in investment proposals submitted. The fund's investment policy requires the fund to formulate an investment manual that will operate in tandem with the policy. The fund investment manual shall provide specific details on the day to day investment activities of the fund. It will also provide the management with the strategic guidance, procedures, assets allocation, performance benchmarks, type of investments and ceilings. Thirdly, to conduct constant monitoring and evaluation (investment auditing) for each investment. This should be done by allocating enough resources to enable the exercise of investment auditing each year. This will help to detect poor performing investments including loans and take early steps to rescue the situation through observations and recommendations in that exercise.

Further the organization should limit investment in the loan portfolio by providing loans to the project with attractive returns but with low risks (minimal). The management should ensure that investment decisions in future will take into account the need to streamline proportions of all investment assets held by the Fund to conform to the strategic assets Allocation mix as guided in the Fund's Investment Policy. Additionally training on loan appraisal skills should be provided to loan/investment officers by ways of courses, field attachments and workshops.

Loan officers should avoid descriptive loan analysis instead use both including quantitative analysis that will help to establish wide range of loan assessment. Also will be in the position to identify associated risks. Risk assessment being a sensitive

and crucial factor may be bypassed most of the time. In order to avoid those satisfactory guidelines should be in place to be followed to assess risk.

The organization should develop situation specific models whereby different cases in terms of the types, sensitivity and complexity, require deferent treatment. Professional management can be used to develop situation specific tools that may help to deal with different situation differently. In present situation most of the loan officers still use traditional ways to deal with such situations that ultimately lead to an unsatisfactory conclusion.

From the management point of view, loan recovery should not be relaxed by a single moment. It may go to be a time barred deb. As the age of the loan lingers the possibility of getting the fund back becomes dimmer. So, relaxation is strictly prohibited. Most of the nationalized financial institutions loans become defaulted due to the lingering process. In this aspect the concept of engaging recovery agency is paramount.

In other financial institutions in Tanzania particularly the banking industry, measures to reduce the problem of nonperforming loans have taken, by imposing different models to detect possible defaulters. For example one of measure taken solve the problem of nonperforming loans in financial institution was formation of LART in 1991. LART was charged with the duties of holding for and on behalf of the government any non performing assets of banking and other financial institutions, and recover all amounts outstanding in respect of all transferred nonperforming assets.

5.5 Suggestion for Further Research

With reference to the study's limitations in terms of time and finance, which could facilitate an in-depth analysis of factors leading to the increasing trend in nonperforming loans in pension funds and its implications for NSSF, findings from the field noted various factors which contribute to nonperforming assets in pension funds. It is the researcher's opinions that further investigation be done to reveal other issues which contribute poor performance particularly in loan investment.

As the matter of facts, this study concentrated on the factors contributing to nonperforming loans in non-banking institutions and opinions of stakeholders on the ways of reduce or eliminate this problem of poor performance. It did not investigate specifically the regulation for investment, structure and composition of board member and investment committee; it is therefore recommended that further investigation be done from the rules, operational procedures, laws and structure of those dealing with investment of pension fund.

There is needed to make further investigations on the impact of the nonperforming of investment in pension fund in the economy of the country. And if there is a need of setting the limit of amount of holding fixed assets in Pension Funds in Tanzania is required.

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APPENDICES

Appendix I: Questionnaire

COVER LETTER FOR THE QUESTIONNAIRE

Dear Sir/ Madam,

My name is Wilfred Modest Barongo an MBA student at the Open University of Tanzania. I am currently writing my dissertation with the topic titled: investigating the factors leading to increasing trend of nonperforming loans in non banking institutions: The case NSSF

I kindly ask you to answer this questionnaire so as to enable me to finish this research work.

Your time and effort is highly appreciated, thank you very much.

Yours truly,

Wilfred M.Barongo

QUESTIONAIRE

1. **Where does your work experience range:**

A.	3-7 years	
B	8-11 years	
C	12-14 years	
D	Above 14 years	

2. **Gender:**

A.	Male	
B	Female	

3. **Do you have knowledge on investment analysis?**

A.	Yes	
B	No	

4. **What type of borrowers are mostly offered loans?**

A.	Private borrowers	
B	Government	

4(b) How do you relate the defaulting and type of borrower above?

……

……

……

……

5. Does the loan policy efficient to reduce or eliminate defaulters?

A.	Yes	
B	No	

5 (b) Explain your answer above

……

……

……

……

6. Does loan appraisal technique used to assess the borrower?

A.	Yes	
B	No	

If the answer is yes explain the common used techniques.....

……

……

……

7. Does NSSF has enough number of loan/investment officers compared to the workload?

A.	Yes	
B	No	

8. Do investment officers have enough knowledge on investment appraisal techniques?

A.	Yes	
B	No	

8 (b) Explain your answer above

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……

9. Do borrowers influence the loan appraisal procedures?

A.	Yes	
B	No	

9(b) Explain your answer above

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……

……

……

11. Does NSSF charge high interest rate on loan compared to the banking sector?

A.	Yes	
B	No	

11 (b) Explain your answer above

……

……

……

……

12. Does NSSF loan monitoring mechanism efficient to assure timely loan repayment?

A.	Yes	
B	No	

12 (b) Explain your answer above

……

……

……

……

13. What is your opinion on the measures that can be taken to reduce defaulters at NSSF?

(a) ……...

(b) ……..……

(c) ……..…..……

(d) ……

(e) ……..……..

Appendix II: Performance of Loan Portifolio Investment from 2001/02-2006/07

Figures in million TZS.

s/n	Year	Outstanding Principal	Outstanding Interest	Total Outstanding
1	2001/02	99.45	2,073.77	2,173.22
2	2002/03	99.45	2,842.78	2,942.23
3	2003/04	99.45	3,916.68	4,016.13
4	2004/05	99.45	5,349.29	5,448.74
5	2005/06	99.45	7,982.64	8,082.09
6	2006/07	421.25	9,378.82	9,800.07

Source: NSSF investment report (2008)