

KAMPALA INTERNATIONAL UNIVERSITY

THE IMPACT OF LENDING POLICY UPON RECOVERY RATE

THE CASE STUDY OF CRDB BANK – DAR ES SALAAM

A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE AWARD OF BACHELORS DEGREE
IN MICRO-FINANCE MANAGEMENT (BMF)
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BY:

ALBERT MUSHUMBA

BACHELOR OF MICRO-FINANCE MANAGEMENT

SUPERVISOR

DR. SUNDAY

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ABSTRACT

This study was done in order to analyze the impact of lending policy of CRDB Bank upon recovery rate and consequently to give recommendations wherever possible for the sake of making loan recovery rate performance more competitive and profitable in the future and current market.

The main problem in this study is the impact of loan recovery process and procedures as guided by the lending policy of the bank which to large extent hinder the process.

In carrying out this study, data collection techniques such as; observation, personal interview, structured questionnaire and documentary review have been employed. Security pledged such as landed property was found to be not realistic to recover the loan issue to considered were;

- Higher lending interest rates hinder rate of recovery
- New Land Act 1999 lengthen recovery process as not supportive to the bank
- Poor securities pledged depreciate in value such as chattel mortgage.

From the research findings, a recommendation has been made that the policy should be reviewed thus makes the following changes to improve recovery rate and motivate customers towards loan repayment:-

- Encourage other forms of securities apart from landed properties
- Discourage acceptance of residential houses as securities
- Lending rates to be at concessionary rate. Lowering lending rates to match with saving rates so as to encourage borrowing and loan recovery process.
- The bureaucracy in the legal system which slows down the settlement of commercial disputes especially foreclosure of mortgages should be improved to accelerate rate of recovery.

CHAPTER ONE

1.1 Background information of CRDB Bank Limited

o Incorporation

CRDB BANK LIMITED is a private commercial bank. The Bank was established on July 1st 1996 to succeed the former Cooperative and Rural Development Bank (CRDB), which was public institution with majority of shares held by the Government of the United Republic of Tanzania. The succession was as a result of the liberalization of banking industry in Tanzania.

The liberalization which followed the enactment of the Banking and Financial Institutions Act (BFIA) of 1991 and Government's policy to divest its interest in the sector, prompted a recapitalization of the Bank to levels stipulated by the BFIA (1991)

Restructuring

CRDB has been blessed with an invaluable partnership from the Danish International Development Agency (DANIDA). DANIDA's commitment and support in technical, managerial and financial areas of the Bank's operations has been instrumental for the success of CRDB BANK LIMITED.

DANIDA therefore is fundamentally involved in CRDB's restructuring as demanded by the BFIA (1991). The restructuring which started in 1992 aimed at a more efficient organizational system, better returns to shareholders and overall improvement in the financial performance of the Bank. The exercise involved:

o Organizational restructuring

Where the organizational structure is comprehensively decentralized and designed to make the Bank more customer oriented, more accountable and with ability to compete in the free market economy.

o Operational restructuring

Where operational policies and procedures are streamlined to make the Bank more efficient and customer oriented in its operations.

o **Financial Restructuring**

Where the Bank is to start operating on sound financial basis and fulfilled conditions and measures of financial soundness mainly as outlined by BFIA (1996)

o **Human resource management**

Where requirements for human resources are established and manpower downsizing is affected. To have optimum number of employees with respect to customers and bank profitability, 600 employees had to be retrenched. Measures are taken to ensure that jobs restructuring would stimulate employees work productive and aim higher.

o **Cultural change**

Where new corporate culture with attributes stressing on customer service and ability to compete are to Bank staff.

Ownership

Shareholding diversification is one of the aspects of the CRDB financial restructuring. In an unprecedented exercise CRDB became the first successful major Tanzanian privatization that involved the sale of shares to the public.

CRDB BANK LIMITED is owned by over 11,000 shareholders under the following major groups (by value of shares);

Private Individuals	37.5%
Cooperatives	14.1%
Companies	19%
DANIDA Investment Fund	29.4%

Source CRDB Annual report 2000

The authorized share capital of CRDB Bank Limited is Tshs 10.0 billion and presently the paid up capital is Tshs 8.4 billion

CRDB Bank Limited is a bank that cares for its customers and has the capacity to advise its clients. It is a bank committed to respond to development of Tanzania's economy and society by financing only environmentally friendly projects.

1.3.1 The Banking and Financial Institutions Act 1991

1.3.2 The Bank of Tanzania (BOT) Act 1995

1.3.3 Regulations and directives issued by the Bank of Tanzania

1.3.4 Written laws of the country

1.3.5 The Memorandum and Articles of Association of the CRDB

1.3.6 The CRDB Business Plan and budgets

1.3.7 The Authority Manual

1.3.8 Policies, regulations and guidelines issued by the Board

CRDB Bank started to give loans essentially in 1997. The loan portfolio at the end of 1996 was insignificant at Tshs 1.5 billion only. By the end of 1997, total loans and overdrafts had reached Tshs 13.4 billion, marking an annual increase of Tshs 31.2 billion. In 1999 there was a slight growth of 24% bringing up the loan portfolio to Tshs 38.7 billion. In year 2000 the loan portfolio was projected to grow at 9% to Tshs 42.2 billion. By any standard it should be concluded that there was dramatic rise in lending during 1997-1998.

The following main features characterize the Bank's loan portfolio

- i. Geographical diversification: loans are spread in all regions of the country
- ii. Sector-wise diversification: virtually all sectors of the economy are enjoying loans from CRDB
- iii. Gender diversification: men and women have had equal access to loans
- iv. Large proportion of loans is in small and medium size: the average size of loans is Tshs 20 million while the smallest loan is Tshs 2 million and virtually most loans are secured by landed property

1.4 Source of funds

Source of funds available for lending are as follows:

1.4.1 Customers deposits both local and foreign

1.4.2 Borrowings from local or external sources;

1.4.3 Shareholders funds;

1.4.4 Funds received under special arrangement for a specified lending purpose

1.4.5 Types of credit

1.4.6 Types of credit facilities offered by CRDB Bank

Credits available to customers are as follows:

i. Short term credit facilities

They have a contract period of the following

Short term credits include the following;

- a) Overdraft
- b) Documentary letters of Credit
- c) Bills discounted
- d) Guarantees
- e) Packing credit
- f) Local Acceptance facilities
- g) Personal loan facility
- h) Short term loans payable by installment or once
- i) Crop / commodity financing

ii. Medium / long Term Loans

These are for financing capital assets. They have a contract period of more than one year but not exceeding ten years.

The loan repayment period shall be set depending on loan required, the borrower financial position, the projects capability to generate income and the pay-back-period according to the cash flow.

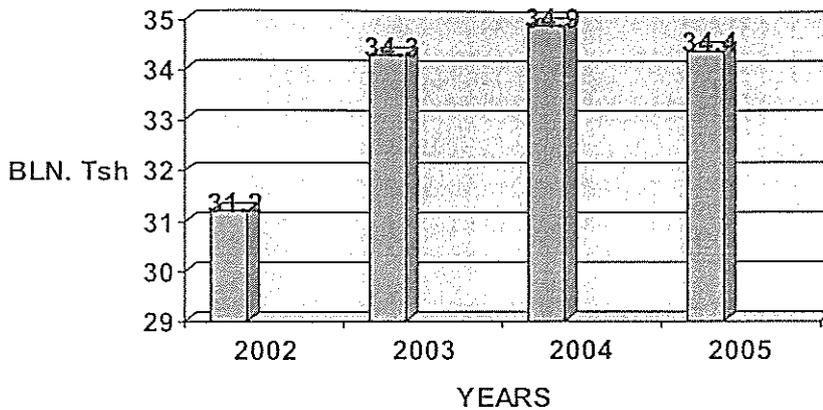
The 4c's of credit

A number of factors are emphasized in lending decisions. These are usually referred to as 4c's of credit. The number of C's varies from lender to lender but they are commonly used.

Character

This refers to the personal traits of the borrowers (completely apart from financial standing), which may be significant in the credit decision. Terms such as ethical, honest and integrity are important in this regard character is said to be the most important C's of credit because the dishonest borrower can always find the way to avoid the restrictions imposed by the lender on the on the agreement.

LOAN PORTFOLIO



Source: CRDB Annual Report 2004/2005

1.5 Problem Statement

In Tanzania's economy, financial institutions have their core business which is lending as a major source of income.

However lending as a core business, the guidelines that hold the lending process are set by the regulatory body of financial institutions in the country known as Bank of Tanzania.

Most of the commercial banks with an example of CRDB BANK have its lending policy which adhere to good banking practices and codes of ethics as per banks corporate values and culture.

The lending policy that is used to ensure that credits are granted approved and are being administered with highest degree of prudence and that timely and adequate actions are taken on problematic loans to prevent accumulation of portfolio losses.

The banks tend to use procedures in recovering loans which sometimes hinder customers to recover their loans timely or failed completely to repay it.

Some of the procedures in the lending policy which hinder rate of recovery are higher interest rates in repaying back loans.

Therefore there was a need to research the impact of lending policy procedures and strategies upon recovery rate.

1.5 Research objectives

The purpose of this research is studying the impact of lending policy and procedures upon recovery rate at CRDB Bank.

The following objectives were examined as follows;

- To assess whether existing lending policy have a positive or negative effects upon recovery rate in the bank.
- To suggest an alternative/better way of improving the lending policy so as to increase rate of recovery.
- To identify the factors contributing to low rate of recovery by the bank.

1.6 Research questions

- (i) What factors hinder/decrease the rate of recovery?
- (ii) What measures/action can be taken by the bank to improve the lending policy towards customer motivation in recovering their loans?
- (iii) What do the customers contribute to the improvement of the lending policy and accelerate the rate of recovery?
- (iv) How much loans have been recovered under the existing lending policy?

1.8 Significance of the study

The study will help to solve some of the problems caused by lending policy upon rate of recovery.

- (i) To stimulate further research on the problem concerned.
- (ii) The research findings will lead to a better understanding of the impact of lending policy upon rate of loan recovery in the banks.
- (iii) It will help the organization (CRDB BANK) to identify the source of the problem, whether it is within the organization or from the customers.

1.9 Scope of the study

The study concentrates at CRDB Bank Head office, Credit Department to investigate the impact of lending policy upon recovery rate.

The study also assessed the effectiveness of the lending policy of the Bank towards motivating its customers to recover their loans.

The selection was therefore dependent on the availability of clients and their willingness to cooperate and provides information they have.

1.10 Limitation of the study

- (i) One of the limitations of the study was the confidentiality of files and other documents that are not accessible.
- (ii) Some of the questionnaires were not returned by the respondents likewise some of the customers had a tendency of not responding to them.
- (iii) Time punctuality was another constraint as the researcher took few days to collect data. It was difficult to use other methods like customers surveying which require quite a lot of time.
- (iv) Cost of organizing the research paper was too high.

banks personnel to follow them. It stressed the need for banks to put their loan policies in writing and to ensure that the policies are being observed.

Adequacy of security (Filder 1983) says, "A great part of lending is unsecured, bank provide credit facilities on the strength of the borrowers personal integrity. Corporate customers are granted credit facilities by making thorough assessment of their financial statement by skilled assessors that is credit worth".

Perry (1975:300) says when a bank is approached for a loan a borrower is asked four questions and one of it is what is the source of repayment? We must consider the character of the borrower, the risk involved, the profitability of the transactions to the bank, the lending policy of the bank, which may be influenced by the best interest of the borrower and the community generally. Security is taken as a kind of insurance.

It is a golden rule of banking that if the banker can not see how the customer can repay an advance he must not lend even if adequate security is available. (Perry 1975:300)

Varshney (1984:60) says, a bank like any other business entity has to be managed in such a way that it leads to a growth and gives maximum profits. To achieve these goals, banks management should implement the following.

Loan and advances

Banks earn interest on loans and advances which is one of the major sources of income for banks. They pointed out that if the loan portfolio is properly managed, it would not only add to bad debts but also affect profitability adversely. Hence effective management of loans portfolio becomes all the more necessary for efficient functioning of the bank.

Improper follow up

"Money lent if not followed up, will go down the drain". Is a wise advice if can be seen that even very good borrowers wait for reminders for paying the installments.

P.V. Varshney (1984:6) added that lack of follow up results in poor repayments and finally turns to be bad debts. Moreover, if the follow up of an advance by the

bank is adequate and effective the chances of it going bad become very remote, namely action is very necessary in the case of overdue loans for a good recovery performance. Varshney added that the banker wait for long even if loan has been misutilized right at the beginning. Unlike creditor, the information of wrong doings of the borrower reaches the banker very late and the delay reduces the chances of recovery. If information system is geared up and timely action is taken, it will not only improve the chances of recovery of the loans and overdrafts but also ensure proper use of funds.

2.1 On Services marketing

A service is any act or performance that one party offers to another that is essentially intangible and does not result in the ownership of anything.

Services industries are quite varied. A good part of the business sector with its; airlines, banks, computer service, bureaus, hotels, insurance companies, and real estate firms is in the service business.

Services have four major characteristics that greatly affect the design of marketing programs.

Services are considered to be;

- Intangible
- People dependent
- Inseparable from consumption
- Normally in standardized
- Perishable
- Subject to fluctuating demand

In marketing services, the 4p's of marketing mix which include; promotion, product, price, and place are discussed but another paramount 'p' is people where by they are the targeted element in the market.

Therefore bank as one of the service industry in the business sector, its marketing tools are managed to attain organizational goal.

of legal framework, for supervision and regulation of the banking system, to ensure adherence to sound bank prudence.

Davies (199:93) says, " Bankers have many options for spotting problem accounts that if handled correctly could help the customer. Also he noted that warning signs are quite often overlooked until the position is critical and by then it may be too late to take appropriate remedial action.

However, Davies comes up with the following principle reasons for debts failing:-

- The lending officers to apply the canons of lending when assessing a proposition.
- The lending officers, failure to monitor the lending regularly.
- The lending officers, failure to exercise firm control after noticing a deteriorating position.
- Fraud by customer.

2.3 Basic principles of lending

2.3.1 Safety

i) The sum of advances and sum of repayments should be clearly known. This should be supported by data such as projections of trading profit and loss account and the balance sheet.

ii) The availability of suitable security does not mean that the loan given is good that is security is available but customers' confidence honest is lacking.

Lack of confidence costs double to liability.

iii) A safe loan is normally described as one which is repayable as demanded from the customer normally income or business revenue.

2.3.2 Suitability

Loan is normally granted only for purpose, which is in line with type of business trade, or activity of the customer this is important to avoid diversion of funds.

CHAPTER THREE

3.0 Research methodology

3.1 Research Design

The research design was a case study; where by CRDB BANK was used as a case study.

3.2 Area of study

The study was conducted in Dar es Salaam at CRDB Bank – Head Office.

3.3 Units of Inquiry

The units of inquiry were carried with the full participation of the staff in different departments and the bank clients.

3.4 Data collection methods

- i) Documentary review
- ii) Interview
- iii) Structured questionnaire
- iv) Observation

i) Documentary review

Documentary review included revisiting all necessary Bank records for the customers who received loans and the customers who haven't yet re-paid the loans.

ii) Observation

Observation was considered by the researcher as the most ideal for providing information that was closely related to the actual existence in the real situation. Moreover the method used was considered to result in the basic information of the survey; this was free from respondent's subjective bias. Observation was made during follow-up to customers' business and where the securities, which

are pledged to the bank, have been allocated. Through this, the researcher was able to see the physical items, sometimes comparing what has been put in the bank records to the actual existence of the materials e.g. stock, house etc.

iii) Personal interview

The method was applied simply because some of the staff and customers were not in the position to put their ideas in questionnaires therefore they preferred to be interviewed. In addition, interviews were used to gather information and the data which was obtained provided answers on the questions set to the respondents.

iv) Structured questionnaire

This is another method, used by a researcher on data collection. Questionnaires were prepared and distributed to various customers.

3.5 Data analysis

Data were analyzed qualitatively and quantitatively using different ways such as:

(i) Editing

Data obtained from interview and questionnaires were checked to ensure completeness.

(ii) Coding

Answers (data) from respondents were analyzed into meaningful categories of information so as to enable proper reading.

(iii) Tabulation

Regarding to editing and coding data, the information of similar categories were transformed into tables for presentation of statistics.

The following table below summarizes the percentage accrued both in the upcountry and Dar es Salaam landed property as below the required forced sale value of 65%.

LOCATION AND VALUE	AMOUNT REALIZED	Percentage of the landed property after sale
MOSHI 8,000,000/=	6,000,000/=	20.00%
AZIKIWE-DAR ES SALAAM 5,000,000/=	20,000,000/=	30.70%
MUSOMA 5,000,000/=	3,500,000/=	13.46%
BUKOBA 97,000,000/=	8,500,000/=	21.46%
LUMUMBA 4,000,000/=	5,000,000/=	11.36%
ARUSHA 5,000,000/=	9,000,000/=	13.84%

Source: CRDB Annual report 2004/2005

The table above shows the percentage of landed property in both upcountry and Dar es Salaam region after sale to recover the loans.

The amount realized in recovering period is very minimal compared to the expected value. The amount realized does not fetch 65% a provide in the policy as forced sale to determine the amount of the loan

4.1.2 Interest rate

The bank interest rate charges on loan are too high in relation to marketing and economic situation in country.

The interest rate charge on the Bank varies from 8% to 25% per annum.

Interview conducted by the researcher to the customers of the bank, 95% suggested the need of the Bank policy to change its interest rates so as to motivate them in renewing their loans.

Higher interest rates leads by the borrowers as the critical aspect which hinder their business to protect and peace failure to recover their loans.

Higher lending rates lead to high default rates by firms and entrepreneurs and contribute to crippling of the economy

Currently the country leads average saving rates stand at 3.3% while the lending rates is 16.7%. This indicates the failure of many people to borrow from the financial institutions leading to decreasing rate of loan recovery.

4.1.3 Poor securities

Poor securities are leads to the low rate of credit payment. This factor indicates that the ability to release credit facilities granted to borrowing firms or individuals will be determined by sufficiently securities held.

Some customers don't have here required collateral. Most of the outstanding loans and overdrafts for borrowers partly are secured or unsecured at all.

The study visits done by the researcher to selected customers, who had pledged securities revealed that only few customers offered perfect securities.

This is not perfect during recovery stage. The realized value is not sustained due to depreciation in value and buyers perception to the property.

During the past three years to 30/9/2004 total number of loan accounts classified as loss were 15million amounting to Tshs. 3,939 million distributed among branches due to weak securities which cannot fetch full amount after it is realized, decreased borrowers, cumbrances to securities, guarantees by minors, collapsed business issues which credits were granted and cumbersome court cases.

The following table below defines the accounts classified as loss for the quarter ended September 2005 branch wise

S/N	Branch Name	Number of Acc	Proposed Amount for Charge off (Tsh.000)
1	Arusha	3	3,226/=
2	Azikiwe	37	1,548,112/=
3	Bukoba	3	28,771/=
4	Dodoma	2	10,892/=
5	Holland-Handeni	5	48,942/=
6	Iringa	21	261,379/=
7	Kahama	0	0
8	Kigoma	0	0
9	Lumumba	10	936,291/=
10	Lindi	1	26,704/=
11	Mtwara	0	0
12	Mbeya	26	335,806/=
13	Moshi	0	0
14	Morogoro	9	198,183/=
15	Musoma	1	3,133/=
16	Mwanza	5	84,441/=
17	Shinyanga	2	20,213/=
18	Singida	3	40,928/=
19	Sumbawanga	2	13,217/=
20	Songea	1	5,465/=
21	Tower-clock	1	5,780/=
22	Tanga	17	366,800/=
23	Tabora	0	0
24	Vijana-City	2	605/=
	TOTAL	151	3,938,888/=

Source: Quarter period reported September 2005.

From the above table the situation revealed 151 accounts of borrower customers were classified as loan with total Tshs. 3,938,888/= due to failure to repay back loans on time, for the Bank to loose its book of accounts at the end of the year those accounts are crossfire loss. Higher interest rates and unprofitable business are the reasons for the failure of customers to repay back the loans on time.

4.1.4 New Land Act 1999

The provision of this law Land Act has brought enormous effect in the recovery policy of commercial banks in the country.

As the lending of commercial Bank found under the written law of the country, New Land Act of 1999 has its impact on the recovery rate of the bank as mortgages of the dweller's property guided by the new Land Act.

The land Act provided that the consent by a spouse is mandatory in the creation of a mortgage. In effect the Act has recognized the rights of a spouse under the law of marriage.

The following deficits has been identified in the Act pertaining to recovery process.

- In case of polygamous marriage, it is not clear whether consent will be required by all spouses
- The Act practices no remedy to the lender where the borrower or mortgagor deliberately hides the fact that he has a spouse. It is not easy for a lender to check in the registrar of births, marriages and deaths. The same is not easy in the case of ascertaining existence of a marriage.
- The Act seems to be supportive of defaulters as it's lengthen the recovery process due the bureaucratic procedures. The Act is not supportive to the bank hence hinder recovery rate process with huge cost incurred by the bank to the borrowers

- Poor follow up and less performance which affected the loan performance
- Legal procedure and functioned against the bank in delaying recovering the loans such that as the end of December 2004 there was 315 un covered loan of which were injunctions and over 90% of all not paid on time.
- High interest rate and poor follow up procedures.
Tshs 2.5 and 4. billion was estimated dues and over dues respectively

Against the for-gone amount of 1.billion dues and Tshs. 0.58 billion over dues were collected on time ,therefore was Tshs. 1.058 billion. or 27.1% of the target customers.

Collection and recovery rate for the 2004 and 2005 finance year are summarized in the following table.

Collection and recovery rate for the period 2004 – 2005.

Target group collection	Recovery rate
3.95 billion	27.10%

Source: CRDB Bank report cumulative performance 2004 – 2005.

The above table shows the collection and recovery rate in the Bank for the year 2004 to 2005. The loan amount for collection was Tshs 3.9 billion, where by only Tshs 1.058 million loans made out of the targeted amount. This represents 27.10% of recovery rate made during the year 2004 and 2005. This is due to impact of collection and procedures in the bank which hinder the recovery process and effect of loan recovery.

Conclusion

A current and effective loan policy is a tool to help management ensure that a bank's lending function is operating within established risk tolerances. Such a policy is more likely to be consulted and followed by staff and contributes to uniform and consistent board-approved practices. Therefore, insured institution staff, borrowers, and regulators will be well served by the implementation of a process that helps ensure that a bank's loan policy remains comprehensive, effective and up to date.

Recommendation

A bank's loan policy is not a static document, but rather should be revised as the institution, business conditions, or regulations change. A comprehensive annual review, in addition to more limited reviews as needed, will help ensure that a loan policy does not become outdated and ineffective. The frequency and depth of the reviews will depend on circumstances specific to each institution, such as growth expectations, competitive factors, economic conditions, staff expertise, and level of capital plan should prompt a modification to the policy. Pertinent criticisms and recommendations made during recent audits and regulatory examinations should be considered during the updating process.

In certain situations, a loan policy can be updated effectively through addendums or supplemental memorandums, but if carried too far, such "cobbling together" can result in a cumbersome and disorganized document. It is best to merge supplementary materials periodically into a logical place in the main document. The updating process should also include identifying obsolete or irrelevant sections of the policy. For example, a bank might have entered a new field of lending a few years ago and modified its loan policy at that time. However, when it became obvious its downs the operations. The loan policy should reflect the decision to exit that lending niche.

Compliance testing, conducted as part of the updating and audit processes, will help management determine whether staff is aware of and adhering to the provisions of a loan policy. An institution's board of directors should demonstrate their commitment by emphasizing that noncompliance is unacceptable. Loan staff, executive officers, and directors should be able to demonstrate some level of familiarity with all provisions – more with the provisions that affect their daily responsibilities. Awareness and knowledge of the policy's specific provisions can be promoted through periodic training that stresses the need for the policy to

**CUSTOMER'S QUESTIONNAIRE
QUESTIONS;**

For multiple choice questions to seek the appropriate.

1. For how long have you been a customer of CRDB BANK?

- a) 1 year
- b) 2-3 years
- c) 4-6 years
- d) 6years and

2 How does CRDB Bank lending policy satisfy you?

- a) Very good
- b) Good
- c) Fair
- d) Poor

3 Do you think there is annual benefit to be a customer of the bank?

YES ()

NO ()

4 Why do you think so?

.....
.....

5 For how long have you been receiving loans from CRDB BANK?

- a) 1 year
- b) 2-3 years
- c) 3-6 years
- d) 6 years

6 Does the interest rate changed by CRDB BANK on loan discourage recovery rate?

YES ()

NO ()

If yes, give your opinion

.....
.....

- 7 What do you understand about the lending procedures of CRDB BANK upon loan recovery?
- a) good
 - b) fair
 - c) poor
- 8 What should be done by the bank to motivate customers in repaying back their loan payment?

.....
.....

Questionnaire to the CRDB Bank Staff.

Dear respondents

I am Albert Mushumba a third year student of Kampala International University pursuing micro-finance management. I kindly request you to answer the attached questions so as to help me accomplish my academic as a partial fulfillment on the award of Bachelor of Micro-Finance Management.

I have chosen you to be my respondent, because of the part; you play at CRDB Bank specifically in loan department.

I hope your answer will be sourcefull to my research report and will be held with high confidence as per research conducting ethics.

Thanks for your.

For multiple choice tick the appropriate one.

Questions

- 1 What is your position on credit management of the bank?
- a) Director
 - b) Manager
 - c) Credit loan
 - d) Member of loan committee
 - e) Approving the loan

Does the security enable the bank for a borrower to secure loan, such as building shuttle and permanent asset discourage recovery rate?

YES ()

NO ()

If yes or no, give your opinion.

.....

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