

Descriptive Analysis of the portfolio behaviour of De Novo Commercial Banks in Tanzania Tobias A. Swai¹³

Abstract

The purpose of this paper is to examine portfolio behavior of newly established banks in Tanzania based on the ownership structure i.e. foreign vs local commercial banking firms. A total of 8 banks were observed with 216 data buckets for the period of their first 16 consecutive quarters of operations. Published financial statements of the banks investigated were drawn, summarized and analyzed. A descriptive analysis approach. The study reveals that de novo banks do maintain just the required regulatory capital in their start up and that they do not engage into lending activities in the beginning. On average, banks engage into serious lending on their sixth quarter. However, local banks engage into lending as early as second quarter of their market entry.

Foreign banks suffer more losses in non-performing loans than the local banks during their first 16 quarters of their operations. In terms of capital investment, local banks operate with lower capital base than foreign banks. Foreign banks seem to attract fewer deposits as compared to the local banks though they seem to provide more attractive interest on deposits. The study provides significant contribution on the portfolio behavior of the de novo banks and comparison on ownership creates added value for foreign entry to the commercial banks in Tanzania. The paper also provides managerial insights on how to manage newly established banks and might guide investors on the return on their investment in newly established banks.

Key Words: De novo banks; Commercial Banks, Bank Capital, Deposits.

Introduction

Survival of de novo (newly established) firms has been an area of research interest in Tanzania (Swai, 2011). In particular, failure of newly established firms has attracted attention of policy makers. Increasing evidence attributes the failure of the de novo firms, particularly banks, to their inability to function profitably and vulnerability to financial difficulties (DeYoung, 1999. Goldberg and White (1998) find that de novo banks, defined as banks that are no more than three years old, make more small business loans than do other incumbent. Banking sector however is a special sector which is highly regulated on the entry. It is argued that a failure of one bank have impact to other banks and other sectors of the economy. De novo banks are subject to frequent failures than mature banks. In a situation where there are bank failures across a nation, these failures are likely to cause bank panics that may result in bank runs. Bank runs lead to more bank failures (Calomiris & National Bureau of Economic Research, 2009). Bank failures have huge implications for the economy due to the inter-linkages of the banking sector with other sectors in the economy. The banking sector is an important link in the economy due to its monetary transmission role (Gardner & Mills, 1988; Saunders, 1994). Also, banks are very interlinked, depending on each other for various services such as money transfer, clearing services, loans and deposit services.

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Several studies that exist indicate that de novo banks exhibit more failures than the established banks (Assaf, Barros, & Matousek, 2009) and that if de novo banks are not closely monitored they may cause bank failures as many do deviate from their business plans (FDIC, 2002). Other studies indicate that the newly established banks are more efficient than established banks and they experience rapid growth (Jimborean & Brack, 2009). However, a study by Grigorian and Manole (2002) indicated that new banks are not necessarily efficient.

This study examines the behavior of the de novo banks in Tanzania considering descriptive analysis of 16 quarters of their establishment. The study is important due to the fact that there have been an increasing number of newly established commercial banks in Tanzania market in recent years. Since the liberalization of the financial sector in 1997, more than 50 newly banks have been established. Tanzania has many banks than any other country in the East African region. The study also is important as the country prepares for economic integration within the East African region. In the economic integration of the European Union, integration of the financial regulations had caused de novo banks to consolidate and recapitalize in order to meet new regulations (Assaf, et al., 2009).

In Tanzania, five de novo banks have experienced failures over the last two decades of financial liberalization, within four years (sixteen quarters of financial reporting) of their establishment. De novo banks like any other bank face challenges which include competing for quality staff, quality customers; competition in the banking products and services; operating in thin markets, and many other factors (DeYoung and Hasan, 1998). The higher competition among banks create rooms for the customers to switch from one bank to another for better services including lending products (Chan, Greenbaum and Thakor, 1986). De novo banks in Tanzania whether foreign or locally owned, are subject to the same banking regulations and hence competition for the local banks is higher due to their lack of international experience, managerial skills and technology.

Literature of behavior and operation of de novo banks in developing countries is scant. Several of such studies have been done in European Union (e.g. Assaf, et al., 2009) and United States of America (e.g. DeYoung, 1999; Hunter and Srinivasan, 1990; Seelig and Critchfield, 1999). The objectives of the study is thus to examine the portfolio holding behavior based on the four years of consecutive operations of de novo banks. In so doing the study examines deposit, profitability, assets allocation and capital structure of the banks.

Overview Banking Sector in Tanzania

Commercial banking sector in Tanzania is one of the oldest business ventures in the country (Swai, Lwiza and Ndanshau, 2016). Established in 1905, banking sector was in colonial operation until 1966, with limited branch network and operations. All foreign banks were nationalized to form the National Bank of Commerce in 1967. Deregulation of the banking sector was initiated in 1990s to liberalize the financial from state economy, due to the static nature of the economy and failures of in the operation of state banks (Wangwe and Lwakatare, 2004). The liberalization of the commercial banks in the 1990s paved a way to new regulations which allowed formation of private banks – both locally and foreign. The banking sector in Tanzania is highly competitive. Available information from the Bank of Tanzania, 2016 indicated that as of December 2016, the sector has 56 banks, whereby 36 are commercial banks, 12 community banks, three financial institutions, two development financial institutions and

three deposit taking microfinance institutions. Seven (7) banks are state owned and 49 privately owned banks, of which 29 were foreign owned. BOT report on banking supervision 2015 (BOT, 2016); indicates that the banking institutions in Tanzania had 728 branch network. Most of the branches were located in major cities of Dar es Salaam, Arusha, Mwanza, Mbeya and Moshi. Dar es Salaam had 263 branches which constituted 36.13 percent of all branches, followed by Arusha, 51 branches (7.01%); Mwanza 49 branches (6.73%) Mbeya, 41 branches (5.63%); and Moshi 33 branches (4.53%). Moreover, during the same period, 3,299 bank agents were in operation.

There has been an increase in the banking operations in the country for the past five years. The sector has witnessed a growth of total assets from TZS 14.5 trillion in 2011 to TZS 27.2 trillion in 2015 being an increase of more than 87.6%. Also related to this there has been an increase in the interest income and number of employees in the sector. The details of the performance of the commercial banks in Tanzania are presented in Tables 1.

Table 1: Summary of Financial Soundness Indicators

Ratios	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15
Capital adequacy					
Core capital to total deposit	12.34	12.76	13.54	13.39	14.24
Total capital to Total Risk Weighted Assets and Off Balance Sheet	17.59	17.44	18.06	17.41	18.92
Total capital to total assets	10.52	10.52	11.03	11.16	12.03
Liquidity					
Foreign exchange liabilities to total liabilities	37.00	34.36	35.03	35.73	39.73
Liquid assets to demand liabilities	40.1	38.34	36.26	35.93	37.25
Liquid assets to total assets	36.41	33.98	32.39	30.98	30.65
Liquid assets to customer deposits liabilities	46.08	44.82	43.66	41.93	42.52
Total loans to customer deposits	64.34	68.72	71.35	74.33	78.76
Earnings and profitability					
Non-interest expenses to total income	56.08	67.87	67.00	67.24	68.64
Return on assets (ROA)	2.53	2.58	2.55	2.51	2.49
Return on equity (ROE)	14.47	13.88	13.08	12.56	12.16
Asset quality					
Gross non-performing Loans to gross Loans	6.81	8.01	6.43	6.83	7.88
NPLs net of provisions to total capital	17.51	22.41	14.26	16.02	18.59
Net loans and advances to total assets	49.22	49.84	50.85	52.89	54.62

Source: Extract from Bank of Tanzania (2016)

According to the Bank of Tanzania Reports, as at 31st December 2015, the largest four banks in terms of total assets held 48.58 percent of the total assets of the banking sector, 47.54 percent of total capital, 49.82 percent of total deposits and 49.40 percent of total loans advances and overdrafts. These banks are CRDB Bank PLC, NMB Bank PLC, National Bank of Commerce and Standard Chartered Bank. Top 10 banks consisted of 69.31 percent of total assets, 71.09

percent of loans and 71.71 percent of the total deposits. Local banking institutions' share of the total banking sector's assets was 52.75 percent. The government liberalized the financial sector in 1991 by allowing more private (local and foreign) players following the recommendations of Nyirabu Commission on 1988. It was until 1990s after the Banking and Financial Institutions Act of 1991 and enactment of Bank of Tanzania (BoT) Act of 1995 the financial sector was comprised with foreign investors after the new reforms in the financial sector.

The liberalization of the financial sector in 1990s came with costs to the economy following the failures of some of the commercial banks. Six banks have failed so far after the liberalization of the financial sector namely, Meridian Financial Services (T) Ltd., which was liquidated and sold to Stanbic Bank Tanzania in 1995, Tanzania Housing Bank (THB) which closed operations completely in 1993, Greenland Bank which was forced by the BOT to close its operations in 1999, First Adili Bank which was taken over by its debtors in 2000 and being under the management of BOT with a new name Azania Bankcorp. Trust Bank Tanzania Limited was the fifth bank to be in trouble in 2000 following the systemic effects of failure of Trust Bank Kenya in 1999. Finally, in May 2003 Delphis Bank Tanzania was put under management of BOT due to the poor financial performance of the bank and lack of enough capital to absorb the losses. Except for the Tanzania Housing Bank, all other five banks failed during their three years of operations. Also, four out of the five banks were foreign owned banks.

Literature Review

Empirical Literature Review on De Novo Banks

On de novo banks, studies indicate various variations of assets and liabilities composition (DeYoung, Goldberg, & White, 1999; DeYoung & Hasan, 1998). Brislin and Anthony (1991) found that de novo banks have difficult time to control their expenses. Also in their study they found that de novo banks do tend to specialize in single types of loans. They indicated that ROE and ROA increased rapidly during the first four quarters of operations. Ownership structure of commercial banks can have influence on the allocation and choice of assets. Ownership creates some confidence in offering loans and deposit mobilization by the commercial banks. Considering the 2007/09 financial crises, it is believed that most banks that had local presence, for example, community banks and purely focused on one sector or economy within a country did not face a huge impact like multinational banks. Studies also indicated existence of different in the performance between locally owned banks and foreign owned banks in allocation of assets and liabilities (Bank for International Settlements, 2018).

Evidence worldwide shows that entry of foreign commercial banks and hence, foreign ownership have improved efficiency and competitiveness of the banking sector (Claessens, Demirgüç-Kunt, & Huizinga, 1998; Clarke, Cull, Martinez Peria, & Sánchez, 2002; Micco, Panizza, & Yañez, 2007; Satta, 2004; Sengupta, 2007; Unite, Tabios, & Sullivan, 2002). There are, however, some different findings which indicate that foreign banks entry is no longer associated with competitiveness. It is also evidenced that foreign banks have different funding sources and different allocations of their choice assets, and that acquisition of small banks in local economies has no impact on their lending behaviour inclined to foreign firms (De Haas & Naaborg, 2006; Swai, 2013). There are also differences, which exists between government owned banks (Jia, 2009; Sapienza, 2004) in risk taking behaviour and performance compared to other privately or jointly owned banks.

It can be noted from the literature that there are a lot of discussions regarding the role of bank ownership in economic development of countries, which are affected by the way the banks allocate their resources. There is also a mixed feeling on the role of foreign owned banks in competitiveness of the banking sectors measured by the reduced interest rate spread.

Bank Ownership and Its Implication to Capital Structure and Portfolio

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Lending and Concentration

A study by Akhavein, Goldberg and White (2004) examined lending by small banks to small farms. It was indicated that De novo banks have tendency to lend to small businesses, but experience difficulties to lend to small farmers. As the bank increase in size such lending decreases. Fries, Neven, Seabright and Taci (2006) found that foreign banks have low marginal cost of services, while domestic banks earned higher margins in their first years of establishments.

Performance of De novo banks

Several studies indicates that de novo banks performs poorly in their first years of operations and various factors and conditions are result of such. DeYoung and Hasan (1998) indicates that loan strategy is important aspect for performance of de novo banks. De novo have most of the non performing loans (DeYoung, 1999) and thus risky. Performance of the banks is found to be associated by the factors within control of the managers' i.e. indigenous factors such as risk management, concentration as well as business strategy (Arshadi and Lawrence, 1987). They found that de novo banks to perform well market concentration, effective credit policies, high capitalization and expense control are important variables of consideration for de novo banks.

Methodology

Data Sources and Variables

The paper utilize quantitative financial data (panel data) for the understanding of the portfolio behaviour of the de novo banks. Panel data has various advantage one being that it provides informative data, more variability, less collinearity, more degrees of freedom and efficient (Gujarati, 1999). Quarterly data for start-up commercial banking firms from 2002 – 2012 were obtained from the publications of the financial statement for all banks in operation. Banking financial data is regulated and hence it has common reporting variables. A total of 8 (3 local and 5 foreign) commercial banks out of 36 established banks between the 2002 to 2017 were considered in a panel data series for their first four years of operation in quarterly basis due to the availability of published data. These banks are Bank ABC, Bank M Tanzania, Mkombozi Bank, I and M bank, Bank of Baroda, Commercial Bank of Africa, DCB Commercial Bank PLC and Bank of India. None of these banks are state owned banks. The quarters were classified as Quarters 1 to 16 indicating their first quarter and 16th quarter which is the last quarter in the fourth year of subsequent operation.

Data Collection Procedures and Management

Data was be collected from published financial statement of commercial banks from 2002-2012. First reporting period was Quarter 1 2002 and the last one was Quarter 4 of 2012. The period is chosen due to the fact that the data was publicity available following the 1997 financial disclosure regulation. The data collected were entered in a spread sheet programme corresponding bank reporting variables and time of quarterly reporting. Data were coded, and summarized and presented in tables and charts to identify relationships and patterns. Absolute figures were not considered for the data and hence what was examined is ratio based analysis. Four (4) banks were established in 2002, and the rest were established in 2004, 2007, 2008 and 2009 one bank each of the years.

Analysis, Interpretation and Results

Bank Capitalization

Banks are subject to minimum capital requirements. As noted by Hunter and Srinivasan (1990) capitalization is an important determinant of de novo bank success. Observations of the data indicated that banks tend to increase their paid up capital after the first and second years of operation i.e. in Quarter 5 and 9. Further analysis indicated that foreign banks maintain on average higher capital than the local banks. Various indicators for the bank capital ratios for the average of the 16 quarters are as shown in Table 2.

Table 2: *Paid Up Capital Investment of De novo Banks*

Ratio	Local Banks	Foreign Banks	Total
Capital/Total Assets (%)	26	26	26
Capital /Total Loans [TTL] (Times)	3.68	1.2	2.09
Capital /Risk Weighted Assets [RWA] (%)	71	86	80

The trend of the total capital and related variable for the quarters are as indicated in figure 1.

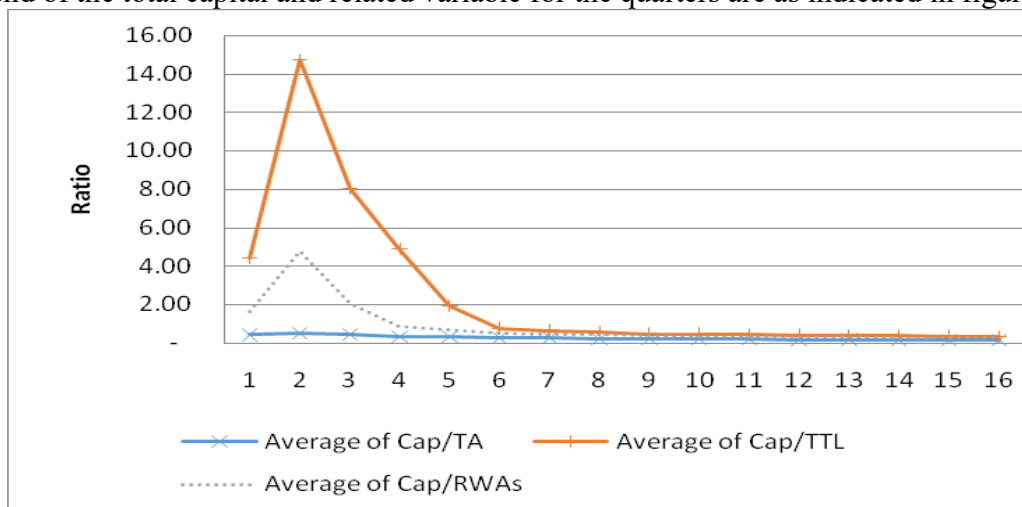


Figure 1: Quarterly Capitalization of De novo Banks

Figure 1 indicates that de novo banks engage into investments heavily after the 6th quarter. This time may be regarded as a comfort time for the bank to have developed its network of clients especially on loan products. However, local banks seem to lend more early – as early as quarter 2 of their operations than the foreign banks. This may be due to the fact that local banks have an advantage of understanding the market, and familiar with the business environment more than the foreign banks.

Deposit mobilization

Deposits are key drivers to the bank capital. Banking business is to transform deposits to other financial products for a profit. Banks which invest on securing cheap deposits is better off in terms of profitability. Confidence on deposit taking depends on various motives behind the depositors. De novo banks they attract more time deposits and current deposits than saving deposits. This may be due to the saving culture of the people, newness of de novo banks in the market and the nature of the clientele served. Banks are believed to serve more business customers than individual customers. Also banks reward more on time deposits than on savings deposits, while benefiting from current deposits. Table 3 presents the summary of the results for the 16 quarters of their operations.

Table 3: Deposit Mobilization by De novo Banks

Ratio	Local Banks	Foreign Banks	Total
Time Deposits (%)	24	10	61
Current Deposits (%)	87	62	24
Savings Deposits (%)	19	27	15
Total Deposits Growth (%)	51	31	38

There might be several reasons for bank customers to have confidence on the local banks – this may be due to the integration with other services e.g. the use of Umoja switch whereby about 20 banks shares one network of automated teller machines (ATMs), ability for the local banks to enter into mobile money transactions and money transfer services. Figure 2 presents the trend of

the De novo banks savings and total deposits growth over the 16 quarters of reporting. Our observation indicated that none of the foreign banks entered into joint sharing of ATMs or launched technology solutions for provision of banking services in their first 4 years of operations.

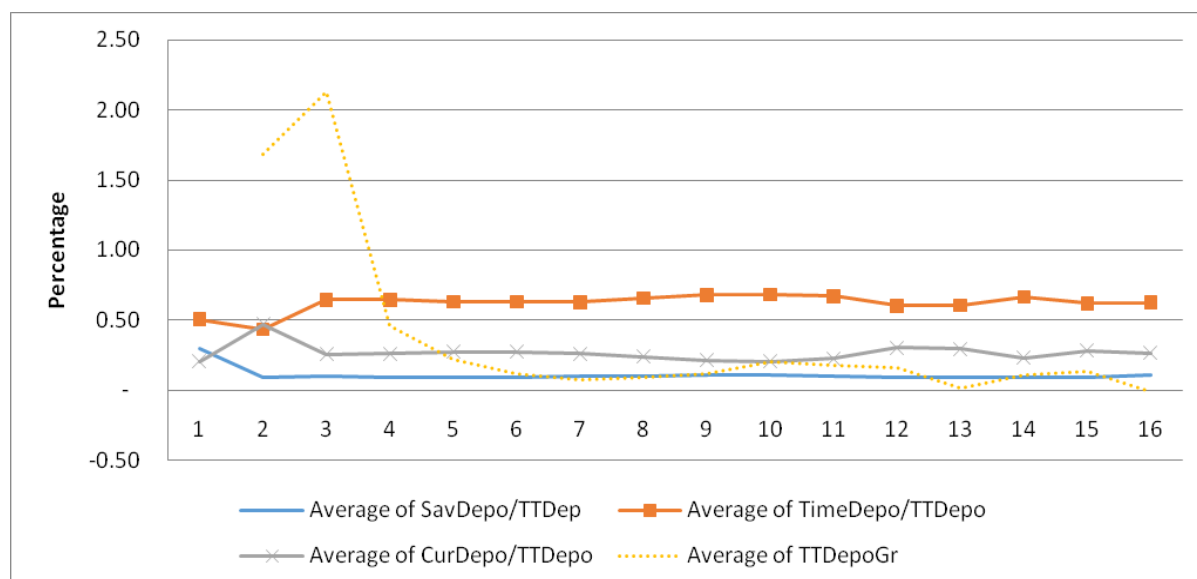


Figure 2: Quarterly Trend in Deposit Mobilization by De novo Banks

Banks seems to experience higher growth of deposits in the first years of operations, declining over time. The savings deposits decrease while time deposits increase over time. In some cases banks experience negative growth of the deposits – especially foreign banks experienced this scenario for the period studied.

Investments

Banks invests in various assets. The main ones are investment in loans – which is divided to loan term loans (for a period of 1 year and above) and overdraft loans. On average 53% of the 16 quarter loans are provided as long term loans. Local banks have an average of 71% of the total loans. This may be contributed to the fact that local banks attract less business oriented customers or considers overdraft as most risk ones as compared to long term loans. There is a steady growth of loans increasing from 16% in quarter 2 to 76% in Quarter 5. Foreign banks invest more heavily in Government securities than the local banks. Foreign banks also possess more cash balances as opposed to the local banks. Table 4 provides analysis of the de novo bank investments for their 16 quarters.

Table 4: Analysis of Key Ratios Based on the Investment of De novo Banks

Ratio	Local Banks	Foreign Banks	Total
Total Loans/ Total Assets	30	17	22
Long term Loans / Total Loans (%)	71	42	53
Net Loans /Total Assets (%)	45	39	41
Loans/Deposits (%)	69	70	69
Investment in treasury Bills/Total Assets (%)	6	11	9
Cash /Total Assets	25	32	29

Consistent with the findings DeYoung (1999), banks are reluctant to lend especially in the three years of their operation as indicated in Appendix 1. Foreign banks appetite to lend is quite low. Surprising, given their newness nature, local banks lends 71% of its loans to long term loans.

Performance Analysis

Performance of the commercial banks is measured based on the ROA and ROE analysis.

Table 5: Performance Analysis of De novo Banks

Ratio	Local Banks	Foreign Banks	Total
Return on Assets (%)	4	4	4
Return on Equity (%)	26	14	18
Assets Growth (%)	23	11	15
Interest Income /Total Income (%)	88	73	78
Interest Income /Total Loans (%)	15	10	12
Interest Expense /Interest Income (%)	37	38	38

As it is indicated from Table 5, it seems both foreign and local banks exhibit the same ROA but more ROE is realized from the local banks due to the low capital investment as well as more returns based on the investment avenues such as investment in treasury bills which attracted about. Although a study by DeYoung (1998) didn't consider aspects of local banks (although it considered community banks which may be local in the states they serve), the findings indicated that profitability is low for de novo banks as compared to their counter parts. Also Brislin and Santomero (1991) found that de novo banks have higher expenses. This may be same due to the establishment costs.

Local banks have even and steady growth in assets than local banks, while foreign banks experienced negative growth of assets and with very low growth compared to the local banks. Banks rewards almost the same to their depositors. On the Non-performing loans analysis it shows that banks do incur lots of bad debts in their first 16 quarters of operations. Foreign banks are much affected on the bad loans than the local banks. This is consistent with a study by DeYoung (1999) who found that De novo banks have almost all NPLs for American banks. NPL may be articulated to among others lack of experience of foreign banks in the understanding of the sector dynamics, unfaithfulness of the local borrowers as well as difficulties in searching for creditworthy borrowers. This problem may be addressed given the development of the banking sector and development of information sharing through various platforms such as risk forums

and human resources forums of the commercial banks. Other developments include the establishment of the credit reference bureaus – an initiative which was undertaken by the Central bank after 2012.

Conclusion, Recommendation and Policy Implications

This paper describes the behaviour of the de novo banks in Tanzania. The data was collected from the publication of the bank financial statements (both Income and Balance Sheet statements). A total of 8 (3 local and 5 foreign) banks were observed with 216 data buckets for the period of their respective 16 consecutive quarters of operations. The results reveals that de novo banks in Tanzania do maintain little capital in the start-up and they do not engage into lending activities in the beginning – up to quarter 6 on average. Local banks, however; engage into lending as early as quarter 2 and foreign banks suffer more losses in non-performing loans than the local banks. In terms of capital investment, local banks operate with lower economic capital base than foreign banks. Foreign banks seem to attract fewer deposits as compared to the local banks though they seem to offer more attractive interest rates on deposits. This is due to the confidence the public may have on de novo foreign commercial banks. It also revealed that several bank failures in Tanzania resulted from banks operated for less than 16 quarters.

Policy wise, we recommend increased supervisory oversight of de novo banks. We also recommend for joint ownership involving local and foreign firms in the establishment of banking firms to exploit advantage local and foreign banks have. The study also contributes to the understand on the marketing of the de novo banks to attract depositors, improvement of the credit analysis and understanding of the local culture by foreign de novo banks, to reduce the impact of non-performing loans which may lead to bank failures. The paper also provide insights to investors as to when they should expect to reap from investment and some risk consideration for de novo banks in Tanzania. The results may suffer several weaknesses including the fact that the banks didn't start at the same time and may exhibit certain learning process as well as economic prosperity for the later established banks.

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Appendices

Appendix I. Summary of Investment Related Ratios

Quarter	Average of LTLoan/TT L	Average of NetLoan/T A	Average of Loan/Depo s	Average of InvGS/T A	Average of Cash/T A	Average of OtherAs/T A	Average of TTL/TA s	Averag e of NPLGr
1	0.42	0.28	0.86	0.31	0.15	0.05	0.06	
2	0.43	0.25	0.64	0.14	0.31	0.08	0.08	(0.06)
3	0.47	0.23	0.44	0.06	0.33	0.10	0.10	(0.53)
4	0.55	0.28	0.53	0.11	0.32	0.08	0.14	(0.49)
5	0.48	0.35	0.62	0.08	0.31	0.06	0.16	0.10
6	0.48	0.38	0.68	0.07	0.29	0.05	0.18	(0.06)
7	0.47	0.43	0.72	0.08	0.29	0.05	0.19	1.06
8	0.51	0.44	0.77	0.08	0.30	0.04	0.22	0.36
9	0.54	0.46	0.74	0.06	0.31	0.04	0.24	0.85
10	0.56	0.47	0.75	0.09	0.29	0.04	0.26	1.93
11	0.55	0.50	0.76	0.11	0.26	0.04	0.27	1.43
12	0.56	0.47	0.71	0.10	0.30	0.04	0.26	9.57
13	0.58	0.50	0.74	0.09	0.30	0.04	0.29	0.30
14	0.58	0.49	0.73	0.07	0.29	0.05	0.30	0.60
15	0.60	0.49	0.69	0.09	0.30	0.03	0.31	0.23
16	0.60	0.50	0.72	0.13	0.27	0.02	0.31	0.29
average	0.53	0.41	0.69	0.09	0.29	0.05	0.22	1.47

Appendix 2: Summary of Bank performance Ratios – All the Banks

Row Labels	Average of ROA	Average of IntEx/IntY	Average of ROE	Average of IntY/TTY	Average of IntY/TTL	Average of TAsGr
1	0.02	0.16	0.16	0.71	0.13	
2	0.03	0.22	0.14	0.81	0.11	0.61
3	0.03	0.36	0.14	0.74	0.38	0.29
4	0.18	0.33	0.09	0.79	0.06	0.26
5	0.02	0.43	0.10	0.76	0.08	0.16
6	0.02	0.38	0.13	0.76	0.09	0.15
7	0.03	0.37	0.18	0.77	0.12	0.05
8	0.04	0.41	0.17	0.76	0.11	0.19
9	0.02	0.42	0.14	0.75	0.07	0.07
10	0.03	0.41	0.21	0.81	0.09	0.16
11	0.04	0.39	0.27	0.81	0.11	0.08
12	0.04	0.40	0.27	0.80	0.13	0.19
13	0.03	0.41	0.17	0.78	0.09	0.00
14	0.03	0.43	0.19	0.79	0.09	0.12
15	0.03	0.44	0.20	0.79	0.11	0.09
16	0.03	0.44	0.26	0.81	0.13	0.04
Average	0.04	0.38	0.18	0.78	0.12	0.15