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   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

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THE IMPACT OF CREDIT RISK ON THE PERFORMANCE OF TANZANIAN COMMERCIAL BANKS

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ABSTRACT

The aim of this study was to access the impact of credit risk on Tanzanian commercial banks' profitability. The study used only secondary data which were sourced mainly from the annual reports and accounts of the sampled eight largest Tanzanian commercial banks from 2006-2013. Banks' profitability was measured by the ratio of banks' total income to total assets (ROA) and credit risk were measured by two ratios which are the ratio of Non-Performing Loans to Loans & Advances (NPL/ LA) and the ratio of Loans & Advances to Total Deposits (LA/ TD).Multiple regression model were used to estimate the relationship between banks' profitability and credit risk variables. The results of the study revealed that there is a negative relationship between credit risk and Tanzanian commercial banks' performance and that the relationship is statistically significant. A 100% increase in the ratio of NPL/ LA reduces ROA by 13.6% while a 100% increase in the ratio of LA/ TD reduces ROA by 4%. Since credit risk exposes banks to great risk of illiquid and distress, Tanzanian commercial banks' management must put in place adequate credit policy which will ensure that credit risk is reduced and banks' profitability level is improved.

KEYWORDS

Banks' performance, credit risk, return on assets, non-performance loans, liquidity.

INTRODUCTION

Commercial banks in any economy perform an important role of intermediation (Vedastus, 2010; Kimmei, 1987 and Mutaitana 1999). They accept deposits which are the financial surpluses of some groups and then channel them into other groups which have a financial deficit in a society (Nicholaus, 2006; Evelyn, 2010; Kolapo, Ayeni & Oke, 2012; and Anthony, 2011). Through this process, The borrowed funds are directed to variety of productive use and hence they facilitate the better allocation of national resources - shifting capital from those who do not have the desire or the ability to make use of the funds to those who are willing and able to assume the risks of capitalistic enterprise (Vedastus, 2010; Evelyn, 2010; and Anthony, 2011). It is obvious seen that loans provided by these commercial banks act as a catalyst of economic development in any nation since they provide finances to individuals and firms who have better use of resources (Kolapo et al, 2012). Through this role of intermediation commercial banks contribute positively in both financial growth and economic growth of the country (Psillaki, Tsolas, and Margaritis, 2010; Mutaitina, 1999; and Anthony 2011). It can be appreciated that the failure of commercial banks in any country affects adversely the financial and economic growth and sustainability of any nation (Kolapo et al, 2012).

The important role played by commercial banks of intermediation involves accepting deposits from customers and the extension of loans to individuals and firms in different sectors in the economy. It must be noted that the basic activity of any commercial bank is lending – loans extension (Kargi 2011; and Samuel, Julius, and Samuel, 2012). The substantial income of commercial banks is generated from this activity of lending – through loans as interest income (Kolapo et al, 2012; and Samuel et al, 2012). Abreu and Mendes (2000) documented that, since commercial banks earn more than 80% of its income from lending as interest income, a commercial bank which want to be more profitable have to offer more loans. From the nature of the business of banking, the value of loans held by commercial banks represents a larger proportional of total assets compared to other assets held by banks (Anthony & Aaron, 2010). It is clearly seen that commercial banks which offer more loans are in a good position to realize more interest income hence improve their profitability position. Despite the fact that interest income earned from loans is the main source of commercial banks' revenue, loans impose banks to several risks such as liquidity risk, capital adequacy risk and credit risk (Muhammad, Shahid, and Shahid 2012; Cooperman, Gardener & Mills, 2000). In all risks , credit risk is the most expensive risk banks are exposed to, since it directly threatens the survival of banks in terms of solvency (Chijoriga, 1997; Gieseche, 2004; and Kolapo et al, 2012).

Credit risk is defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms (Ogilo, 2012). Bank of Tanzania (hereafter BoT) (2012) documented that Credit risk arises from the potential that an obligor is either unwilling to perform on an obligation or its ability to perform such obligation is impaired resulting in economic loss to the institution. Furthermore, BoT (2012) indicated that banks are exposed to credit risk when they are engaged in foreign exchange operations. BoT (2012) explained that this occurs when a domestic borrower is involving himself in an export business and fails to compete in a foreign markets due to domestic currency appreciation and as a result he become unable to repay the domestic loan.

Since the majority of assets held by banks are loans and the substantial part of banks' total income is interest income earned from loans, when these assets (loans) are impaired the bank experiences a direct loss (Shahbaz et al, 2012). It should be noted that when a borrower default to repay a loan, a bank losses the principal amount lent and the interest income which was expected to be earned on a loan (Samuel et al, 2012). The result of such act affect bank in two main ways; first, the level of banks' total assets are decreased this lead to another risk known as liquidity risk and capital adequacy risk, and second, the lost interest income affect the banks' profitability in a negative way. So it can be appreciated that the impact imposed by credit risk on the stability and survival of banks is severe since it lead to high level of loan losses and non-performing loans which eventually lead to bank failure (Ogilo, 2012). Huge losses caused by credit risk hinder banks to offer more loans and as a result it adversely affects economic performance as well (Muhammad et al, 2012). To show how bad credit risk may become, Ahmad and Ariff (2007) documented that several banks in Thailand and Indonesia collapsed during the global financial crisis due to high non-performing loans and increase in credit risk. The common sources of credit problems are credit concentration and credit process issue (BoT, 2010). Other sources of credit risks are; high interest rates, unfavorable laws and regulations relating to lending, when a government is providing a huge number of licenses to establish new banks, government interference in lending practices and inadequate supervision from the central bank (Kithinji, 2010).

One of the risks which is mostly linked to credit risk is interest rate risk (Kolapo et al, 2012). They argued that when interest rates are high or subject to variations the chance that the borrower will default increases. In line with Kolapo et al (2012) observations, Drehman, Sorensen, and Stringa (2008) documented that credit risk and interest rate risk are basically linked to each other and non-separable. These two risks are related in this way; when interest rates charged on loans are high, the loan obligation becomes unbearable to a borrower in terms of monthly/quarterly payment of interest plus principal amount and as result a borrower fail to honor his obligation – defaults. The name given to the percentage of loan values that are not serviced for three months and above is known as non-performing loans (Ahmad & Ariff, 2007). So credit risk increases the level of non-performing loans.

Since credit risk affects banks' profitability in a negative way as there is a loss of interest income and it negatively impact the values of banks' assets thus resulting into liquidity risk, capital adequacy risk and financial distress; banks need to devote its substantial resources (time, human, financial and physical) to manage such a risk which can lead to bank failure. Credit risk must be managed not only to improve banks' profitability but also to improve the national economic development and sustainability since they play an important role of intermediation which assures better allocation of capital in the economy (Psillaki, Tsolas, and Margaritis, 2010). In other word, huge losses caused by credit risk reduce the level of banks' profitability which in turn hinders the ability of banks to offer more loans which lead into negative performance of the economy (Muhammad et al, 2012). At international level, as the initiatives to deal with the issue, Basel committee has issued some guidelines for banks to adhere to in order to manage credit risk. Domestically, in the year 2010 the BoT has issued a document known as "Risk Management Guidelines for Banks and Financial Institutions" which stipulates the techniques to mitigate and manage various risks; one of those risks being credit risk.

REVIEW OF LITERATURE

THEORETICAL LITERATURE REVIEW

It is obvious that banks which are able to offer credits to borrowers who are willing and able to repay the loan will tend to have a low level of non-performing loans and loss on loans hence facing a low credit risk (Kolapo et al, 2012). To ensure that banks issue loans to borrowers who are willing and able to repay the loan, the principle of know your client must be employed by any bank which wants to reduce credit risk (Angela, 2010; Demirguc-Kunt & Detragiache, 1997; Kane & Rice 1998; and Marcellina, 2007). Know your client principle requires the bank to investigate on the capabilities and willingness of a borrower to repay the loan (Shahbaz et al, 2012). This means that, before banks offer loans to potential borrowers, they must first collect useful information on which to base their decision whether to lend or not (Saunders & Wilson, 1999). Failure to do so may result in to the bank offering a loan to a borrower who is not capable and unwilling to service a loan thus incurring a loss (Marcellina, 2007). The tendency of offering a loan to a wrong borrower is known as adverse selection. Adverse selection occurs whenever the bank offer a loan to a borrower due to the fact that the bank had no accurate information about the condition, character, and capacity of the borrower to repay the loan, but if those information could have been known before to a banker, the decision to lend the money to a borrower could have changed (Marcellina, 2007). For this reason, the bank must have all relevant information about the borrower before the decision to offer the loan is made.

The main source of borrowers' information is from the borrower himself. The information like type of the business, risks of his business, intended use of the money, financial statements of his business, the sources of loans' repayment, and other commitments he has from other institutions can be easily obtained from the borrower himself through for example interviews. From external sources, banks can obtain information about the character of the borrower from the firms which provide the information on credit status of individuals and firms such as credit rating agencies and credit reference bureau (Simson & Hempel, 1999). After reliable sufficient information about the borrower is already available to the bank, the bank uses such information to access the application of the borrower and pricing the loan accordingly (Ogilo, 2012). The argument is that, loans must be offered to a customer only after relevant information about the capacity and character of borrower is available (Angela, 2010; and Samuel et al, 2012). Both qualitative and quantitative techniques are used to analyze such information (Griffith & Persuad, 2002). It is proved that this principle of know you customer reduces the level of non-performing assets and thus reduce credit risk.

Through the process explained above banks manage risks which arise through credits (BoT, 2010). The whole process is documented in the banks' guidelines which stipulate how credit risk must be identified, measured and controlled. The guidelines concerning the issuance of credits to customers must be documented and communicated to all levels of staff (BoT, 2010). All staff especially those dealing with credit authorization must comply with that guideline and a substantial part of management must supervise if such guidelines are being adhered to or not (Ogilo, 2012). The bank which has tight standards on issuance of credits may reject a customer who could have turned to be a good borrower thus loosing revenue (Bonim & Huang, 2001). On the other hand a bank which adapt lenient lending policy on issuance of credit may attract a lot of customers and issue a large volume of loans but it is placing itself in a danger of issuing loans to customers who will default to repay hence it will realize huge losses in terms of loan losses and non-performing loans which affect the banks' profitability in a negative way (Muhammad et al, 2012). From the argument presented above, it is necessary for banks to adopt credit control policies which are standard, not lenient nor too tight to increase its profitability position and at the same time to reduce credit risk (Greuning & and Bratanivic, 1999). Each commercial bank must have adequate and proper credit control policies in place so the probability of issuing a loan to a borrower who will default is reduced (Angela, 2010).

EMPIRICAL LITERATURE REVIEW

Since credit risk seriously threaten the survival of banks as it expose banks for more risks such as liquidity risk and capital adequacy risk; thus various researchers devoted their time to investigate the impact of credit risk on banks profitability. Here under is the presentation of several empirical reviews which were carried in the area.

Kithinji (2010) collected the data on banks' total loans, non-performing loans and on the performance for the period 2004-2008 trying to investigated the impact of credit risk on the performance of Kenyan commercial banks. The data used in this study were all secondary and were obtained from the audited financial statements of respective banks. He observed that the credit risk is negative related to banks' performance in Kenya, but their relationship is insignificant. His findings implied that the profitability level of commercial banks in Kenya is not influenced by the amount of loan & advances offered and non-performing loans. He further suggested that since the amount of loans & advances and non-performing loans does not influence banks' performance in Kenya, there must be other variables which influence banks profitability in Kenya.

Kargi (2011) assessed the relationship between credit risk and banks' profitability for the period of 2004 to 2008 of commercial banks in Nigeria. Secondary data were collected from annual financial statements of respective banks and multiple regression model were used to test the relationship between the variables. The ratio of net profit to total assets (ROA) was used as a measure of banks' performance. Two ratios which were used to measure credit risk were (i) Non-performing loans to loans and (ii) Loans & advances to total deposits. The finding concluded that, there were a negative significant relationship between credit risk and banks' profitability in Nigerian commercial banks. In other words, the amount of loans & advances, non-performing loans and deposits influence banks' profitability in a negative way. The increase of these variables which represent credit risk means that they expose banks to great several risk such as liquidity risk and capital adequacy risk.

Muhammad et al (2012) assessed the relationship between credit risk and banks' profitability in Nigeria by incorporating six commercial banks which were chosen by using a non-probability method for the period 2004-2008. Data were collected from annual financial statements of respective banks for the period under study. In their study, credit risk which was assumed as independent variables were represented by the ratio of Non-performing loans to loan & Advances and the ratio of total loan & Advances to total deposits. The ratio of profit after tax to total asset (ROA) was representing the banks' performance. The collected data was later fitted on the multiple regression models to test the relationship which exists between those variables. Their findings show that there is a negative relationship between the ratio of non-performing loans to loans & Advances and the ratio of profit after tax to total asset (ROA) though that relationship is not significant. They also document that they observed a negative relation between the ratio of total loan & Advances to total deposits to total deposits.

Samuel et al (2012) investigated the relationship between commercial banks' profitability and credit risk in Ghana by taking into consideration six commercial banks in their sample which were chosen using purposive sampling techniques for the period 2005-2009. The study employed secondary data only which were obtained from annual financial statements of respective banks for the period under study. The multiple regression model were employed to test the relationship which exist between the variables in the model. The ratio of Net profit to equity fund (ROE) were considered as a measure of banks' profitability and stood as a dependent variable in the model. Three ratios which were employed to represent credit risk in the model were (i) Non-performing loan to total loans and advances, (ii) Net charge off (impairment) to total loans & advances and (iii) Pre-provision profit to net total loans and advances. In general they observed that credit risk as positive and significant relationship with banks' profitability in Ghana. Their observations implied that as the probability of borrowers to default

increases, commercial banks in Ghana realizes more profits. It shows that the impact of credit risk plays very minimal role in profitability as the actual result is against the expected relationship.

Kolapo et al (2012) assessed the impact of credit risk on commercial banks' profitability in Nigeria by using a sample of five commercial banks which are rated to be the topmost commercial banks in Nigeria drawn from the population of 25 commercial banks for the period 2000-2010. Data used in the study were secondary data obtained from audited annual financial statements of respective banks. Ratios were calculated from the figures obtained from annual financial statements and were pooled into a panel data set and estimated using multiple regression. The ratio of Net profit to total bank asset (ROA) was used as a dependent variable in a regression analysis model representing banks performance. Ratios which presented credit risk in the regression model were Non-performing Loan to loan &advances (NPL/LA) and total loan and advances to total deposits (LA/TD). In conclusion they observed that ratio of Non-performing loan to loan & Advances is negative related to banks' profitability, implying that the increase in the ratio of non-performing loans to loan &advances reduce the banks' profitability (ROA). They observed also that the ratio of Loan & Advances to deposits is positively related to banks profitability, implying that the increase in this ratio increases the profitability (ROA) of banks in Nigeria.

IMPORTANCE OF THE STUDY

Since commercial banks in any nation play an important role in the development of the economy as they act as intermediaries, studying the factors which influence their performance is inevitable. As discussed in the literature review, one of the factors which influence banks' profitability is credit risk. This study will evaluate how credit risk influences Tanzania commercial banks' profitability. We did not come across any literature which investigated the relationship between credit risk and Tanzanian commercial banks' profitability. So this study will be able to provide the evidence on how credit risk influences banks' profitability and the findings of this study will be used by policy makers and banks' management to make informed decisions which will improve the performance of banks. Also the findings of this study will be used by other researchers in their literature reviews when studying the impact of factors influencing commercial banks' performance in Tanzania.

OBJECTIVE OF THE STUDY

The objective of this study is to access the impact imposed by credit risk on Tanzanian commercial banks' profitability.

METHODOLOGY

The main objective of this study is to investigate the relationship which exists between credit risk and profitability of Tanzanian commercial banks over the period of 7 years (2006-2012). The population of this study was all commercial banks which operate in Tanzania as at the end of 2012. The sample of eight commercial were chosen to study the population. The population is represented by the following commercial banks; CRDB Bank Plc, National Microfinance Bank (T) Ltd Plc, National Bank of Commerce Ltd, Standard Chartered Bank (T) Ltd, Exim Bank (T) Ltd, Stanbic Bank (T) Ltd, Citibank (T) Ltd, and Barclays Bank (T) Ltd. The study used secondary data only which were sourced from annual financial statements of respective banks. The reasons for the choice of banks included in the sample are outlined here under:

- The banks which were included in the study are the top largest commercial banks in Tanzania. Out of the amount of total assets owned by Tanzanian banking sector as at the end of 2011 which were Tanzania shillings 14, 281, 738 million, the amount of assets owned by these eight largest commercial banks totaled Tanzania shillings 10, 565, 638 million which represented more than 73% of total assets in the industry (Serengeti Advisors, 2012; and Ernest & Young, 2012).
- These eight largest commercial banks in Tanzania account for over 70% of total deposits from customers in Tanzanian banking sector.

This study employed the model used by Kargi (2011) when he was assessing the relationship between credit risk and profitability of commercial banks in Nigeria. Also Kolapo et al (2012) on his study "Credit Risk and Commercial Banks' Performance in Nigeria" used the same model. Furthermore, Samuel et al (2012) when they were investigating the relationship between commercial banks' profitability and credit risk in Ghana employed the same model. In all these studies, profitability (performance) were measured with Return on Assets (ROA) and stood as dependent variable. Credit risk was measured by the ratio of Non-performing loans to loan & Advances (NPL/LA) and the ratio of Loan & Advances to total deposit (LA/TD). In short the function of banks performance was the ratio of non-performing loans to loans &advances (NPL/ LA) and the ratio of total loan & advances to total deposits (LA/TD). Mathematically this model can be expresses as follows:

ROA = $F\left(\frac{NPL}{LA}, \frac{LA}{TD}\right)$ ……………………………………………………………………… (1)

Where;
ROA: Return on Assets
NPL: Non-Performing Loan
LA: Loan and Advances
TD: Total Deposit

To test the relationship between credit risk and banks' profitability the multiple regression model used was as follows:

ROA = $\left(bo + b1\frac{NPL}{LA} + b2\frac{LA}{TD} + e\right)$ …………………………………………… (2)

Where:
ROA= Bank net income/ total assets
*b*0-b2= coefficients
NPL/LA= Non-performing loan/ loan & Advances
LA/TD= Loans & Advances/ total deposits.
e= error term.

RESULTS AND DISCUSSION

The data were analyzed using descriptive statistics, correlation matrix and pooled on multiple regression model. It was run on SPSS to test the relationships which exist between credit risk and commercial banks profitability in Tanzania. The results of empirical model are presented here under.

DESCRIPTIVE STATISTICS

Mean and standard deviation of the three variable s of the study are calculated and presented in table 1.

TABLE 1: DESCRIPTIVE STATISTICS

Parameter ratios	Mean	Standard deviation	N
ROA	0.025292	0.0158530	56
LA/TD	0.577700	0.1676300	56
NPL/LA	0.070100	0.0695900	56

Source: authors' compilation from the banks financial statements

From table 1, the mean of the analyzed data are; ROA (0.02529), LA /TD (0.5777) and NPL/ LA (0.701) while the Standard deviation are; ROA (0.015853), LA/TD (0.16763) and NPL/LA (0.6959). The descriptive statistics provides us with valuable information about the normality of the data. The ratio of net income/ total assets (ROA) which is 2.53% it is deviated from the mean at 1.59%. The ratio of loan & Advances/ total deposits is 57.78%, it is deviated from the mean at

16.76%. The ratio of non-performing loan/ loan & Advances is 7.01%, it is deviated from the mean at 6.959%. The conclusion which can be drawn from descriptive statistics is that, the mean was a good fit of the data since the standard deviation was close to the mean. In other words, the value of the data lied closer to the mean.

CORRELATION MATRIX

The Pearson's correlation coefficients between variables were calculated so as to provide with us the information about the direction of relationship between variables and presented in table2.

TABLE 2: CORRELATION MATRIX

	ROA	LA/ TD	NPL/ LA
ROA	1.000		
LA/ TD	-.367	1.000	
NPL/ LA	-.559	-.086	1.000

Source: authors' compilation from the banks financial statements

Table 2 shows that all variables which were used in the model to measure credit risk are negatively correlated to banks' performance. This indicates that, as any of the credit risk variable (LA/TD or NPL/LA) increases, the banks' profitability position decreases. The expected relationship between ROA and LA/TD normally should be positive because as the increase in this ratio implies increase in share of deposits in earning assets and consequently causes increase in ROA

REGRESSION ANALYSIS

To test the overall fit of the model and to what extent credit risk influence performance, the model summary and coefficients are calculated presented in table 3 and 4and discussed hereunder.

TABLE 3: MODEL SUMMARY

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.697(a)	.486	.464	1.16112	.486	21.307	2	45	.000	1.643

a Predictors: (Constant), NPL/ LA, LA/ TD

b Dependent Variable: ROA

Source: authors' compilation from the banks financial statements

From the table 3 it can be observed that the value of R^2 (coefficient of determination) tells us that credit risk can account for 48.6% of variation of banks' profitability. In other words, 100% increase in credit risk cause the variation in profit at about 48.6%. This model summary impliedly tells us that, about 51.4% of variations in banks' performance is not caused by credit risk. It means, when credit risk explain about 49% variations of banks' performance, other variables influence banks' performance for about 51%. Furthermore, to test how well our model generalizes, Adjusted R^2 was compared to R^2. In fact the difference between R^2 and Adjusted R^2 was very small, about 0.022 (0.486 – 0.464). This concludes that the model was fit for the data and the findings drawn from this model can be generalized for the whole population (Tanzanian commercial banks)

Durban – Watson statistic was used to verify assumption of autocorrelation. Following the guide provided by Andy (2009) who stipulated that as a very conservative rule of thumb, values less than 1 or greater than 3 are definitely cause of concern. From the results presented in table 3, we can conclude that the autocorrelation assumption was held firm since the Durban-Watson statistic is 1.643 which lies between 1 and 3.

In order to check whether the assumption of multcollinearity was not violated, Variance Inflation Factor (VIF) was used to check this assumption. The guideline given by Andy (2009) was employed. Andy documented that

- If the largest VIF is greater than 10 then there is cause for concern
- If the average VIF is substantially greater than 1 then the regression may biased
- Tolerance below 0.1 indicates a serious problem
- Tolerance below 0.2 indicates a potential problem.

From the results presented in table 4, our model show that the VIF values are all below 10 and the tolerance statistics are all above 0.2; therefore, we can confidently say that there was no collinearity within our data. To calculate the average VIF we use the following formula:

$$\frac{\sum_{i=1}^{k} VIF_i}{k} = \frac{1.007 + 1.007}{2} = 1.007$$

The average VIF is 1.007 which is very close to 1, so we confirm that in our model collinearity is not a problem.

TABLE 4: COEFFICIENTS

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B		Collinearity Statistics	
	B	Std. Error	Beta			Lower Bound	Upper Bound	Tolerance	VIF
(Constant)	.058	.006		8.917	.000	.045	.071		
LA/ TD	-.040	.010	-.418	-3.901	.000	-.060	-.019	.993	1.007
NPL/ LA	-.136	.024	-.595	-5.550	.000	-.185	-.086	.993	1.007

a Dependent Variable: ROA

Source: authors' compilation from the banks financial statements

From table 4 above the regression result of the model which was used in this study clearly show that all independent variables which were used which were of course measuring credit risk are negative related to banks' performance. The empirical model can be presented as:

ROA= 0.058 – 0.040 LA/ TD – 0.136 NPL/ LA + *e*

The interpretation of the regression result is as follows;

- In the event of absence of credit risk, there will be 5.8% increase in banks' profitability.
- The variable NPL/ LA is negatively related to banks' performance and the relationship is very significant (0< .001). The results show that 100% increase in the ratio of NPL/ LA reduces ROA by 13.6%.
- There is significant negative relationship between banks' performance and the variable LA/ TD. The parameters on the model indicate that as the ratio of LA/ TD increase by one unit (or 100%), banks' profitability decrease by 0.04 units (4%).

The result of this study show that there is a significant relationship between Tanzanian commercial banks' profitability (measured by ROA) and credit risk as measured by NPL/LA. However the relationship between ROA and LA/ TD) is marginal negative which is against expectation. This indicates that, as the ratio of credit risk variables NPL/LA increases, banks' profitability (ROA) decreases. The ratio of non-performing loan to loan and advances expresses the percentages of borrowers who default in relation to total loans and advances. The significant relationship which was observed between this ratio and banks' profitability was telling us that, in relation to loans and advances offered, as the number of borrowers who default to repay increases, the assets of banks decreases since the principal amount extended as loans will not be recovered rather they will be written off as expenses and profitability level of banks decreases since there is no interest income received from such loans. This observation is in line with Kolapo et al (2012), Muhammad et al (2012), Samuel et al (2012), Kithinji (2010) and Kargi (2011)

Loans and advances offered must be financed by customers' deposits. Customers' deposits are the cheapest source of capital a bank can get. The ratio of LA/ TD was expressing the percentage of loans financed by customers' deposits. This ratio show that there it is negative related to banks profitability. It impliedly tells us that as this ratio increase, the bank is exposing itself to liquidity risk and financial distress. Banks management should try to increase the deposit base while

observing their lending rates so that this ratio could be reduced. The increase of this ratio send the signals that the bank is almost near to finance its loans from other sources of fund such as borrowing on inter- bank market which is expensive compared to customers deposits. As the ratio of LA/TD increases it indicates that the bank is financing its loans from expensive sources which in turn erode the profitability of banks. This findings is in line with the finding of Kolapo et al (2012), Muhammad et al (2012), Samuel et al (2012), Kithinji (2010) and Kargi (2011)

CONCLUSION AND RECOMMENDATIONS

The objective of this study was to assess the impact of credit risk on Tanzanian commercial banks' profitability. The result of the study concluded that Tanzanian commercial banks' profitability is statistically significant negative related to credit risk. As the level of non-performing loans in relation to loans and advances increases and the level of loans and advances in relation to total customers' deposits increases, the profitability of banks' is decreasing and they are further exposing them to liquidity risk and distress. Therefore, in order for Tanzanian commercial banks to avoid such risks (credit risk, liquidity risk and distress) which can result into bank failure; banks' management must put in place adequate credit policy which will positively affect profitability. Inadequate credit policies in banks negatively affect profitability since banks will realize huge loan losses and there will be the increase in the level of non-performing loans which eventually leads to financial distress.

SCOPE FOR FURTHER RESEARCH

Despite the fact that commercial bank plays a great role in Tanzanian economy, studies carried in regard of the factors which influence commercial banks' profitability are still relatively few. As we tried to review literatures on the factors which determine the performance of commercial banks, we come across only one study carried by Vedastus (2008), which investigated the relationship between banks' assets (both tangible and intangible) and banks' profitability. Our study on the other hand has focused on the impact of credit risk on commercial banks' profitability. So there are still a need to carry a research on other factors which may possibly have the impact on Tanzanian commercial banks' profitability such as liquidity risk, capital adequacy risk, operational efficiency risk and interest rate risk. Academicians and researchers should carry more studies on factors which influence banks' performance so that their studies could bring in right those factors which drive banks' profitability. Based on the evidence in their studies, policy makers and banks' management will be able to make informed decisions which will improve the performance of banks.

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