

Drivers of X-Inefficiency in Co-operative and Community Banks in Tanzania

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ABSTRACT

Over a span of years efficiency in Tanzanian Community Banks (CBs) has been found to be low. However, the specific and macroeconomic drivers of inefficiency have not been uncovered. The study applied explanatory sequential research design by examining relationship between variables through analyzing quantitative panel data. panel data was used and utilized nine (9) community banks except three banks which emerged recently. Using tobit regression and triangulation approach the study analyzed the drivers of inefficiency and found that gross loans to total deposit (GltD), bank size (logassts), return on average assets (RoAA) and capital adequacy ratio (Car1) were statistically significant and negatively related to most bank inefficiency measures; while Net interest margin (Nim) was statistically positively related to inefficiency. The effect of macroeconomic factors on inefficiencies was not uniform; with GDP having an unexpected positive effect on inefficiency. The corresponding relationship is seemingly explained by the decreasing contribution of agriculture to GDP in Tanzania. Policy-wise, these findings imply that bank regulators should encourage community banks to increase their asset base in order to reduce inefficiencies. Moreover, community banks' management need to reconcile between GltD ratio and liquidity as higher GltD ratio may compromise optimal liquidity in banks. On the effect of Nim, management should revisit their pricing policies in order not only to reduce inefficiencies but also to attract deposits from clients. On the effect of GDP on inefficiency, community banks need to diversify in other sectors of the economy so as reduce dependency on agricultural lending.

Keywords: Drivers of inefficiency, Cooperative banks, Community banks, X-inefficiency