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Research paper entitled
**“An analysis on the trend of personal loans in
Commercial banks of Botswana”**

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Abstract

Personal loans are the fastest growing products of unsecured credit facilities in spite of high interest rate, due to smart positioning of the product by financial institutions. Personal loans are the easy option of people for financial requirements as they do not attract encumbrances and with a little practical formality to obtain them. The researcher focuses on the current trend of personal loans and the factors that influence the trend from different perceptions of lenders and borrowers. The researcher also reviewed that the recent growth in personal loan is healthier in the banking system and at the same time, the consumers are utilizing it for the right purposes. This study observed that there is a growth in dispersal of personal loan by commercial banks. The report provides comprehensive analysis of the trend, information and insight on to the driver supporting the growth of personal loans in the financial market of Botswana. Each factor that was considered in setting the trend of growth in personal loans is elaborately scrutinized in both supply and demand perspective. Commercial banks are taken as population for this study as they are the major personal loans lenders in Botswana. A random sample method is used to collect data using questionnaires and interviews with the consumers and the lenders.

Key word: Personal loans, Commercial Banks, Unsecured loans,

Introduction and Background

Botswana is one of the African countries with a stable and steady growth economy. Banking system was not that stronger, two decade ago in Botswana, but recently, banking sector is growing faster and playing a large role in the financial market. The Bank of Botswana licenses a range of financial institutions, including commercial and merchant banks, representative offices and bureaux de change. There are ten commercial banks, one building society and four development financial institutions in Botswana. Among these financial institutions, commercial banks are the major lenders of personal loans. ABN AMRO (Botswana) ltd and ABN AMRO Bank Botswana (OBU) ltd work with Diamond and Jewelry group to meet their needs and therefore they are not considered as commercial banks for this study. Commercial banks offer personal loans with almost the same features.

In Botswana, two decades ago, micro and indigenous bankers were offering unsecured loans at higher interest rate that may sore the cash flow affordability of consumer. Nowadays, the commercial banks have taken over their role and are offering unsecured loans. This is the evidence of the growing banking sector in Botswana.

Personal loans are disbursed for personal use and repaid in fixed term with fixed monthly repayments without any collateral. The commercial banks are very strict in approving it because of the high default risk and no security to recover the loaned amount. The product is smartly positioned in the display of financial market by the commercial banks to attract the customers in spite of high default risk. They are also attracted by the fair interest rate comparing with indigenous bankers. Personal loans offer an instant remedy for peoples' financial constraints so they would not mind to take it since it is an easy way of soliciting funds for personal use without collateral.

The reason why commercial banks are competing against each other and increase the disbursement of personal loans is high interest rate that improves the profitability of the commercial banks. The commercial banks provide huge amounts to household borrowing than its regular deposits. There are possibilities for high rate of bad debts. It causes huge losses to financial institutions and may result in financial downturn that would affect the economy of a country.

Objectives

This study is carried out to

- find out the current trend of personal loans in Botswana;
- find out the factors that influence the growth of personal loans in Botswana;
- compare the different commercial banks' performance on personal loans;

Literature Review

According to the South Africa National Credit Regulator (NCR), there has been an increase in personal loans over some years especially during the last two years due to the factors that are easy to obtaining credit, no collateral , sustainability, consumption led economy, cost of credit and consumers satisfaction. The NCR report shows that the total amount of unsecured lending

has grown from R7bn to R29bn. It concluded as the current high growth in unsecured personal loans will rise by a high rate, so perpetual research is required. The market is expected to mature which will moderate the returns that can be made by credit providers.

There was interest rate turbulence during the recession particularly between 2007 and 2008. Towards the end of 2009, the financial crisis comes to an end. The lending rates add to the cost of doing business and other economic activities. Therefore, the lower lending rates moderate borrowing for expenses and increase the likelihood of more businesses and consumers adding banking loans to their financing options. The fund raised through borrowing contribute to growth in investment and consumptions which tend to increase overall economic activities. In Botswana, unsecured lending interest rates charged to clients at prime lending rate and additional charge over the prime lending ranges from an average of 6 to 12 per cent. The commercial banks charge interest rate on an average of 15.5% to 21.5% based on the risk profile of the borrowers. The other lenders like micro lenders can charge up to 35% interest on loans. (Gazette 28 Nov 2013).

Christos C. Frangos (2012), study on the factors affecting customers' decisions for taking out bank loan reveals that lending rate is the main factor, service quality and social factors like marital status also affecting the decision for taking out the loan among Greek people. This study mostly concentrated on the factors that influence the choice of their bank to take a loan not considering some other possible factors that might affect the decision for getting loans.

In the view of Felicia OmowunniOlokoyo (2011), commercial banks loan advance, volume of deposit, investment portfolio, interest rate, and cash reserve requirements ratio and their liquidity ratio are the major factors that determine the commercial banks' lending behavior in Nigeria. The researcher used secondary data and analytical method of research to conclude this study.

Shafinar Ismail (2013) studied on the determinants of personal loans borrowings with the hypothesis on the factors like knowledge about personal loans (how to manage the finance of earnings and borrowings), media awareness (instruments that help to publish the information about financial management), Perception towards personal loans, family influence and religious/ethical belief. The researcher found out that media awareness, religious/ethics belief had the strong effects towards personal loans in Malaysia while South African researchers

found that application process, cost of the loans, no collateral and advertisement strategy were influencing the trend in personal loans. The findings were arrived at using by a sample of only one Mabank's employees with a minimum.

Bank of England also found the trend for consumer credit was increased for the past four years. There was turbulence in interest rate through out the periods but in 2013, it fell down. The quarterly report says that the trend of the third quarter of 2013, considerably increased due to the fall in interest rate due to increased competition between lenders.

Bank seta International executive development program study on what is the future of unsecured lending for the South African financial services (2012) revealed that the unsecured loans are mostly borrowed by middle income people. This is extended to lower income class as well. The reason for growth in unsecured loans especially personal loans, is the right pricing model that the financial institutions learnt from the financial crisis and other inherent risks, occurred during the recession period. The same study compared the factors that influenced the trend of unsecured loans between Uganda, South Africa and U.K. Uganda differs significantly from South Africa in various aspects but the micro lenders of both countries are playing a dominant role in providing financial services to low income market and big retail banks are seeking to grow in the market.

Mokhtar S found that the age and gender of the borrower also contribute to loan repayment behavior. Business type, repayment period, repayment mode and repayment amount also determinants of repayment as the same play as the factors of growth in personal loans and unsecured loans. In Malaysia microcredit was introduced to eradicate the poverty and encourage the independency. Micro lenders are attracting more young borrowers who may be already defaulter with other micro lenders that result in high rate of bad debts.

Methodology

The study is a combination of qualitative and quantitative paradigm. Primary and Secondary data were used for this research. Secondary data was extracted from the Annual reports of Bank of Botswana and other commercial banks Brochures, prospectus, journals, previous researches internet and e-books. Two sets of questionnaire were set, one for Commercial banks and the other one to consumers of personal loans. Open ended questions and some short answer questions were asked in both the questionnaires.

The population of interest for his study is Commercial banks and their clients who consumed personal loans during the last five years from 2009 to 2013. All Commercial banks and 100 borrowers from different Commercial banks in Botswana were taken as random sample. Equal amounts of sample were not taken from each bank as they all differ in size of the sales and number of clients. The head offices of commercial banks were interviewed by the questionnaire as they are the only source of information and branches of commercial banks do not have the marketing and communication departments who can liaise with researchers. Data was collected from commercial banks and their reports for the period of five years from 2009 to 2013.

Findings and Data Analysis

Bank of Botswana Financial Statistics (2014) reports that more than half of bank lending about 58 % is to household due to acceleration in unsecured loans including personal loans. This report covers only borrowing from commercial banks and does not include any other credit providers like micro lenders, National Development Bank, Botswana Savings Bank etc. Overall the year on year increase in credit to the household sector accelerated from 21% in December 2012 to 24.2% in December 2013 driven by growth in mortgages (43.3%) and personal loans (19.1) (BOB, MPS 2014)

The personal loans are offered only to employed class. The customer must have salary account with the banks. The commercial banks used the following factors as their market strategy to increase disbursement of personal loans

Target market

Targeted market for this product is lower income, middle income and self- employed people. 100% of commercial banks target middle income class while the other 50% percent of the bank target lower income and self-employed people as well.

Processing Time

All banks double up their speed of processing time to attract customers. They take a minimum of one day and a maximum of five days. This is one of the prominent strategy used in the competitive market of credit.

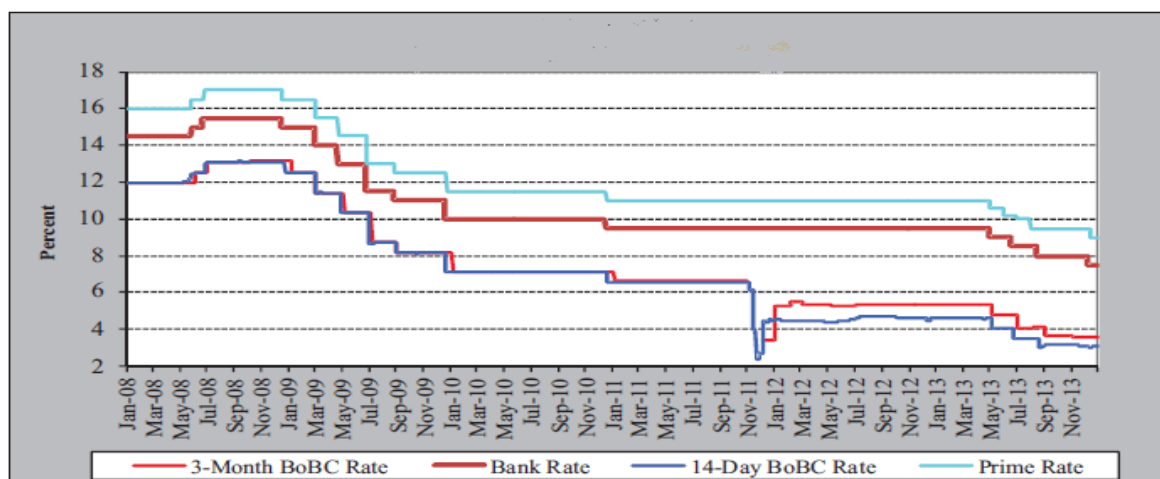
% of banks	Time taken
38	24 hours
25	2 – 3 days
25	3 -4 days
13	5 days

Limit of loan amount

The minimum loan amount varies from P5,000 to P15,000 and the maximum limit from P50,000 to P250,000 depending on the customers' level of income. The commercial banks use their customers' income level to determine the minimum and maximum loan amount. Those who want to get a higher amount of loan but their banks offer lower amount are attracted by the higher limit banks. The repayment can be made in 24 months to 72 months according to the convenience of consumers.

Interest Rate

Unsecured lending interest rate charges to clients at prime lending rate and additional charges over the prime lending is ranging from an average of 6 to 12 per cent. The commercial banks charge interest rates on an average, of 15.5% to 21.5% based on the risk profile of the borrowers. The bank rate fall down from 14% in 2009 to 7.5% in 2013 eventually prime lending rate also decelerated from 19% in 2009 to 9% in 2013 as shown in the chart below.



Source: Bank of Botswana

There is no fixed rate of interest on personal loans as it is determined based on the credit worthiness of the customer and the amount of loan. Some banks charge however prime lending rate plus five percent on loans.

Administration/Process fees

This is another important strategy used by the banks to attract more customers and improves the revenue base. From P200 to P500 charges as administration fees in addition to process fees ranges from 0.50% to 1.17% of the loan amount or the minimum amount of P111.30 to maximum of P4000.

Life Insurance

This is offered and made compulsory by all the banks to enable the loan to be paid off in case of death or disability. This is an extra cost for all credit consumers. Some banks allow their customers to attach their own life insurance policy with personal loan as if they have already one.

Other features

The above factors are common with different features but the following are unique features for the respective banks

- Top up loan after 12 months consistent repayments from existing loans;
- Improved eligibility criteria;
- Entering into new arrangements of credit with institutions for their employees;
- Business expansion by opening more branches at convenient places;
- No down payments;
- Paying instalments after three months;
- Introducing different loans schemes.

Consumers' Perception

Consumers expressed the following perspectives and experience about the personal loans. 72% of respondents said the banks are friendly in processing applications in terms of time taken to

approve, the requirements and customer service while 26% of respondents denied and 2% of them never expressed their opinion.

Purpose of Loan

Purpose of Loans	% of respondents
Family expenses	32
Buy households	14
Holiday trips	1
Other	53
TOTAL	100

Other purposes include buying a car, plot, building materials for building new house or renovation and educational expenses.

The factors that influenced consumers to choose personal loans are easy to obtain, no collateral, cheaper, flexible payment, the combination of all these and their own reasons.

Factors	% of respondents agreed
Easy to obtain	26
No collateral	11
Cheaper	4
Flexible payment	19
All the above	7
Others	32
Total	100

Most of the respondents, who expressed as others, indicated that there was no other choice for them and only personal loan offered by all banks readily available.

53% of consumers have never been educated about the terms and conditions of personal loans while 46% of them agreed that they are educated and 1% not sure whether they had been told or

not. Comparison of cost is another important step to be taken to benefit the lower cost of loans but 63% consumers never compared the cost as they go to the bank with whom they have salary account and 37% compared the cost. 62% of the consumers expressed that will take personal loans if any financial needs arise while 36% refuse to go for it again due to interest rate and processing fees are too expensive and affecting 33% of consumers in fulfilling their basic needs while 62% balancing the repayment of loans and basic needs.

Conclusion

All the commercial banks are competing against each other in persuading customers by introducing different schemes and simplifying the process of application. All the banks are aware that the shorter the processing time and longer the tenure bring more customers so they approve the application in a short while and allow them to take their time to repay that is convenient for them. The larger loans and longer tenure, help consumers to increase the cash flow affordability.

Interest rate is the major income from personal loans to the commercial banks. Higher interest rates are charged on personal loans to maximize the profit but the customers' credit profile is considered when determining the rate of interest. Different rates are fixed to different consumers. The consumers have never been told what the interest rate charged until they sign the agreement. So the customers are not in a position to compare the cost of loans between banks. Tariffs are published by all the banks as a compliance of Central bank credit policy. Only tariff rates would not be a sufficient factor to make informed decision and compare the cost of the loans. Most of the consumers turned from micro finance to formal finance that is offered by commercial banks at lower interest rate than micro financiers. For credit providers, the margin could be higher on personal loans but for borrowers, not too high as comparing with cash loans and other indigenous bankers. It seems that the commercial banks are paying more interest in getting larger market of personal loans as it brings high margin to them. Interest penalties and charge on early repayments are followed as per the Central bank credit policy.

Life insurance is offered by all the banks to the consumers to pay off the loan in case of unfortunate events. Most of the consumers are not aware of other privileges. One of them is that they can attach their private life insurance policy with the personal loans that would reduce the cost.

Home loans and Auto loans can be availed at lower interest rates to buy a car or plot and for construction. The consumers are using personal loans as an easy option and readily available at higher interest rate to invest on assets due to complexity of home loans or mortgage loans. Personal loans are quick solution to many financial problems of the community if financial institutions do not push borrowers into more financial problems as to increase their profitability and people do not avail it for irresponsible purposes.

The majority of the consumers are not making informed decisions in choosing the loans but still most of them willing to take personal loans again and again if they need finance. The repayment and basic needs are well balanced by them even though the personal loans are one of the expensive modes of solving the financial constraints. In the past five years, disbursement of personal loan has increased and expected to grow further due to more income from mining companies comeback and lower interest rates. No harm to consumers due to personal loans as the survey reveals that 62% of consumers expressed that they are not affected by repayment and the same percentage of consumers indicated that they go for personal loans again if financial need arise. The report uncovered that most of the customers well plan to take loans and repay it without any hassle as it is provided only to employed people.

Limitations

Banks particularly those who are non-listed companies hesitated to provide some financial information that hindered to compare the income level of different banks from personal loans to find out the past trend. A few consumers of emerging banks were used in the survey as it was hard to find them. The risk of default and its effect was not studied from any perspective.

Recommendations

All the banks need to continue with their strong features like approval time, larger amount of loan, longer tenure, improved schemes etc. and maintain the credit limit for personal loans based on the income level and ability of repayment. Commercial banks can educate their customers on terms and conditions, all other hidden information and how to use the loans.

Bank of Botswana credit policy should regulate the purpose of personal loans in a way that can release the consumers from the personal financial constraints because many consumers borrowed

for acquiring or improving the assets at higher interest rates while there are options to avail loans for respective purposes at lower interest rates. Banks should simplify and make friendly process of other loans application as well. So the consumers can improve the standard of living without any trauma.

Bank of Botswana also needs close monitor on the risk of debt repayment to keep up the financial stability as the rate of credit expansion to household; which is dominated by personal loans in an environment of slow growth in incomes, could increase the rate of bad debts.

The emerging and new banks should introduce new schemes to get their share of the market. The consumers will have more choices to choose from them. Banks can also offer some incentives or special schemes to low risk customers to encourage to comeback and persuade such new customers to go for personal loans.

All banks can use credit score card system to determine the interest rate and indicate it before even the customers apply for loans. It helps consumers to compare the cost and make an informed decision.

The consumers should be responsible in using loan fund and repayment to maintain credit worthiness to qualify for further loans at lower rate of interest and take loans for responsible purpose. Consumers should come forward to learn more about loans, cost of loans and other hidden charges that affect them. Prioritize financial needs in a way that will not affect the cash flow affordability of basic needs.

There is need for further research in this area to overcome the limitations of this study. The further study can include all credit providers including micro lenders and others on the ground.

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