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Banking Sector Profitability Through Investigation of Financial Performance Indicators: The Case of Zimbabwe

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***Abstract**: This study seeks to evaluate banking sector profitability through investigation of financial performance indicators in Zimbabwe from 2011 to 2018, to determine if a relationship exists among performance indicators and what policy measures should be implemented to increase profitability of the sector. Evaluation performance of the banking sector profitability was done through assessment of financial performance indicators such as Return on Assets (ROA), Return on Equity (ROE), Loan to Deposit Ratio (LDR), Non-Performing Loans (NPL), Net Interest Margin (NIM), Interest Coverage Ratio (ICR) and Capital to Asset Ratio (CAR). Secondary data used was extracted from the Reserve bank of Zimbabwe (RBZ) [Central Bank], which was time series in nature. This paper used paired samples test, regression analysis, Ordinary least squares (OLS) regression to determine the profitability and correlation test to examine the relationship among performance indicators. The results of this study displayed that banking sector profitability is driven mainly by performance indicators and more attention should be paid to non-performing loans. This study recommends that the Reserve Bank of Zimbabwe should create strategies to ensure stability, growth and safety of both investors and depositors' interests and observe the capitalization levels of commercial banks which leads to better profitability, to banking sector executive's; maximization use of banks as financial intermediary, discontinue exorbitant bank charges, implementation of new policies and do institutional reforms.*
***Keywords**- Banking sector profitability, financial performance, ROA, CAR, ICR, LDR, NIM, NPL, ROE*

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I. Introduction

Banks have a significant part in the economy and their stability is important and relevant for the financial system. To sustain a firm financial intermediary purpose, banks must be profitable. Beyond the purpose of financial intermediation, the performance of banks has a substantial effect on the economic growth of a nation. According to [1], a profitable and efficient banking sector encourages transmission of funds from savings to investment and this certainly has an effect on the GDP growth of a nation [2]. Lipunga [3] stated that the banking industry is an important sector because of the finance development and mainly the banking system, which stimulates economic growth.

Nevertheless, it is well-known that financial and economic crises have an effect on bank operations. In this environment, it is remarkable to study how change in banks profitability levels over time as they emerge after a crisis. It is also interesting to reveal whether the recognized issues influencing profitability are applicable to banks that went through a crisis. According to Babar and Zeb [4], it is noteworthy to monitor the performance of banks with the executive prerequisites. The investigation of banks financial performance has been the attention of numerous researchers since the Great Depression of 1929 to 1933. Bank performance measurement mainly commercial banks, is well investigated and has obtained increased attention over the years [5]. The financial crisis of 2007 to 2009 revealed the significance of bank profitability in support of nation economy in addition to the economy of the world, displaying the requirement to keep it under observation all the time. According to Marshall [7], the banking crisis may possibly entail the financial crisis which as a result brought the economic meltdown what happened in 2007 in the United States. Financial performance of banks is influenced by the work of internal and external factors. Internal factors signify to the statistics obtained from the financial statements (income statement and balance sheet) and for that reason it may be considered as specific factor of profitability of banks [8]. The magnitude of banks is more noticeable in developing economies because the financial markets are commonly underdeveloped, where banks are considered as the key and only source of funding for common businesses and assistance in accumulation of savings.

In Zimbabwe, during the economic crisis period from 2004 to 2009, financial institutions had severe difficulties in assembling funds, this had an undesirable effect on banks profit levels. Nevertheless, in an attempt to solve the economic crisis, the government of Zimbabwe implemented the use of multiple currencies such as

the United States Dollar, South African Rand, Euro and British Sterling February 2009. This change increased activities of business and banks began to realize profits. The banks in Zimbabwe have been blamed of paying insignificant interest on savings despite the fact that they are charging unreasonable account maintenance fees. Such actions by the banks are viewed as working in contradiction to the requirement for growth of national savings by means of the banking sector, which is significant to the maintenance of liquidity in the economy. The unwillingness by banks to pay genuine returns on savings, combined with excessive administrative fees that consume the savings, which are singled out as the two main drivers of depositors turning away from the formal banking sector [6]. The deposit rates which are low, combined with high bank fees are not favorable for attracting savings. On the other hand, the comparatively excessive lending rates oppose borrowing by the productive sectors thus restraining the economy growth.

Precisely, this research addresses the following objectives:
- To evaluate if Zimbabwean banking sector profitability has considerably improved from 2011-2018,
- To determine if a relationship exists among financial performance indicators,
- What policy measures should be implemented increase the profitability of the banking sector.

The objective of this study is to examine banks profitability in Zimbabwe for the period 2011 to 2018. Sufian and Chong [9], stated that the expertise of the fundamental factors that have an effect the profitability of bank is vital not only for bank executive, but also for various stakeholders such as governments, bankers' associations, central banks and other financial authorities. Additionally, banks are a unique set of organizations whose liabilities and assets, economic functions, regulatory restrictions and operations make them an essential subject of examination, specifically in the circumstances of the developing financial sectors [10].

II. Literature Review

The aspects influencing bank profitability have been extensively analyzed in the literature. Banking sector performance is not only affected by the bank specific factors but as well as external factors for instance nature of the macroeconomic atmosphere. The bank profitability determinants have been generally considered as either internal or external [1]; [11]. Internal determinants are those that can be regulated by the executive therefore are dependent on the decisions made [12]; [13]. In recent years, studies concerning the assessment of performance of banking sector, have seen an increase. Ayanda [15] stated that there are several empirical studies on assessment of performance on commercial banks, though much of these researches were done in developed nations and less in developing ones.

Mehta and Bhavani [14] investigated the effect of numerous variables on profitability of banks of the UAE commercial banking sector (domestic), concentrating on a sample of 19 banks over eight years (2006 to 2013) and with the use of balanced panel data. The empirical outcome of this research evidently implied that upholding a high capital adequacy ratio, cost efficiency, and improvement of asset quality were the greatest significant variables that possibly will impact the bank's profitability for all measures of profits. The authors determined that banks might have improved their profitability by expanding into non-traditional revenue source. In conclusion, this investigation placed the profitability enhancing model which banks may use to escalate their performance.

Ozgur and Gorus [16] examined the effect of macroeconomic factors and bank-specific on bank deposit profitability in Turkey. To exhibit the importance of research variables the authors used OLS method to create multiple regression analysis. Results of this investigation recommended that equity over total assets, net interest revenues to average total assets, non-performing loans to total cash loans and central bank policy interest rate, have a substantial effect over (ROA) return on assets whereas non-interest income over total assets, operational expenses to average total assets, market share of deposit banks in banking sector and exchange rate were not statistically substantial. Certainly, result of this research provided supportive indication that financial crisis negatively affected by the performance of banking sector in Turkey. It was concluded that the effect of recent global financial crisis on performance of banks is significantly negative.

Olalekan and Adeyinka [17] examined the impact of capital adequacy on deposit-taking banks profitability in Nigeria. This study measured the effect of capital adequacy profitability on domestic and foreign banks in Nigeria. The authors utilized secondary data form the available financial statements of banks (2006–2010). The results from this study showed a positive and significant relationship between bank profitability and capital adequacy. This suggests that capital adequacy plays a key role in the determination of bank profitability by deposit-taking banks.

Abel and Le Roux [18] examined the determinants profitability of banking sector in Zimbabwe (2009 - 2014). Results showed that banking sector profitability in Zimbabwe is generally determined by bank-specific

factors such as dependent on bank-level management variables. This outcome is very valuable for suggesting the best policies to bank executive on how they can improve the profitability for the banking sector. The authors reasoned that profitability of banks hold a relatively higher amount of capital, liquid assets and a lower level of NPLs together with efficient expense management. It was concluded that the Zimbabwean banking sector profitability can be improved by improving expense management, liquidity, and increasing the quality of assets.

Erina and Lace [19] were able to find a correlation between macroeconomic indicators and bank-specific factors in Latvian commercial banks for 2006 to 2011. They performed a survey of scientific literature and analyzed the indicators of commercial banks profitability with the use of regression analysis, descriptive statistics and data correlation. The authors determined that profitability had a positive effect on management, operational efficiency and portfolio composition, despite the fact that it had a negative effect on credit risks and capital as computed according to ROA, whereas according to ROE, negative influence on credit risk and operational efficiency, positive influence is employed on composition of the capital portfolio. With interest to macroeconomic indicators, the authors uncovered that GDP growth rate has a positive impact on profitability as measured by ROE and ROA.

Menicucci and Paolucci [20] assessed and analyzed the relationship between profitability and bank-specific factors in European banking sector in order to establish the effect of internal factors on attaining high profitability. This research employed regression analysis which was done on unbalanced panel dataset that is related to 28 European banks (2006 to 2015). Regression results uncovered that bank size and capital adequacy ratio have positive impact on profitability of banks in Europe, while lower profitability level results in higher asset quality. Results from this investigation also suggest that banks are profitable tend to have higher deposit ratio. The results provide a remarkable insight into the practices and characteristics of profitable European banks. First, the findings offer new comprehensive insights into the issues affecting the profitability of European commercial banks, proposing that more awareness should be committed on bank-specific factors in order to rise their profitability. Secondly, the study provided an aid for investors in their decision-making process and maybe useful for considering for profitable investment opportunities in European banking sector.

Adam [21] examined the financial performance of Erbil Bank for Investment and Finance in Iraq from 2009 to 2013. The author utilized numerous financial performance indicators for instance financial ratios analysis to determine the financial position of the bank, and a wider range of statistical tools were also used for investigation purpose of numerous variables which would have an effect on banking system in general, so as to investigate if these variables were considerably connected with Erbil Bank financial performance. The results of this research present a positive behavior of Erbil Bank financial position and some of its financial factors variables have an effect on bank financial performance. It was concluded that the general financial performance of Erbil Bank was progressing in terms of profitability ratios (NIM, ROE ROA), liquidity ratio and assets quality or credit performance.

Elsiefy [22] disagrees that banks with adequate investment in liquid assets have the capability to survive liquidity crisis. The test is to define the ideal amount of liquidity given by the return/risk trade-off. The author disagreed that higher liquidity equated to the average for the sector likewise reveal banking institution inefficiency. The lower the liquidity the higher will be the profitability, by denoting that there is a negative relationship between liquidity and profitability.

In general, the existing literature delivers a relatively comprehensive explanation of the effect of industry and internal specific of bank profitability determinants, nevertheless the consequence of the macroeconomic environment is not sufficiently dealt with. Time dimension of panel data used in these empirical studies was too small to pick up the effect of control variables linked to the macroeconomic environment.

III. Performance of Banking Sector in Zimbabwe

Table 1: Architecture of the Banking Sector

Type of Institution	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Commercial Banks	12	13	13	13	13	13	13	13
Building Societies	4	4	4	4	5	5	5	5
Savings Bank(s)	1	1	1	1	1	1	1	1
Merchant Banks	10	6	5	2	0	0	0	0
Total Banking Institutions	**27**	**24**	**23**	**20**	**19**	**19**	**19**	**19**

Source: Reserve Bank of Zimbabwe

The performance of the sector in Zimbabwe continued to be resilient as displayed by satisfactory condition and distinguished by adequate asset quality, adequate capitalization, an expanding asset base and sustained improvement in earnings performance.

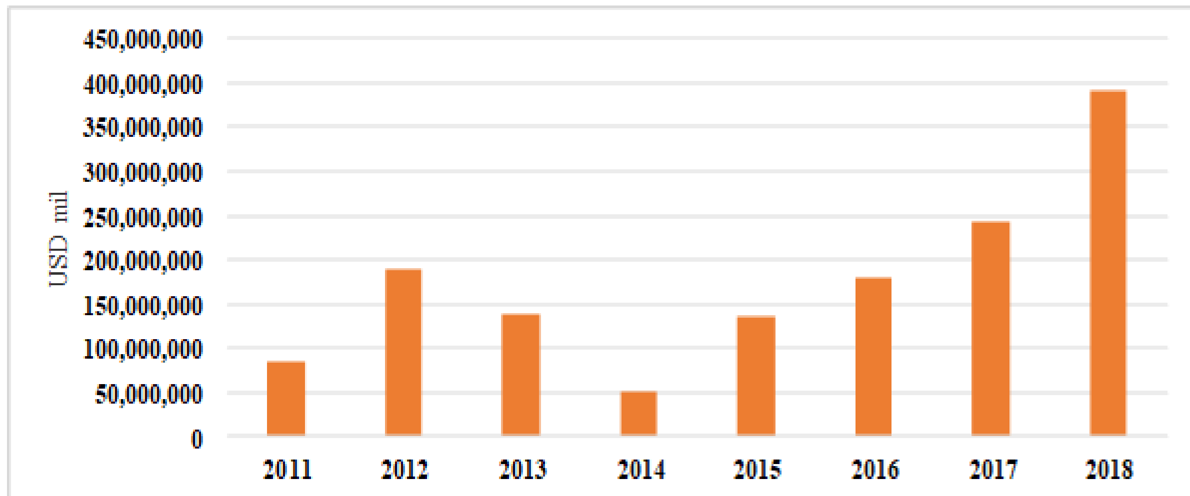

Figure 1: Banking Sector Net Income

Source: Reserve Bank of Zimbabwe

The main reason for the improvement in financial performance of Zimbabwean commercial banks is the decrease of level of non-performing loans (NPL) from 15.92% in 2013 to 6.92% in 2018 (Fig. 2). The increase of NPL (2011 to 2014) was an outcome of weaker performance of the economy of the banking system, which was result of the new currency introduced in 2009.

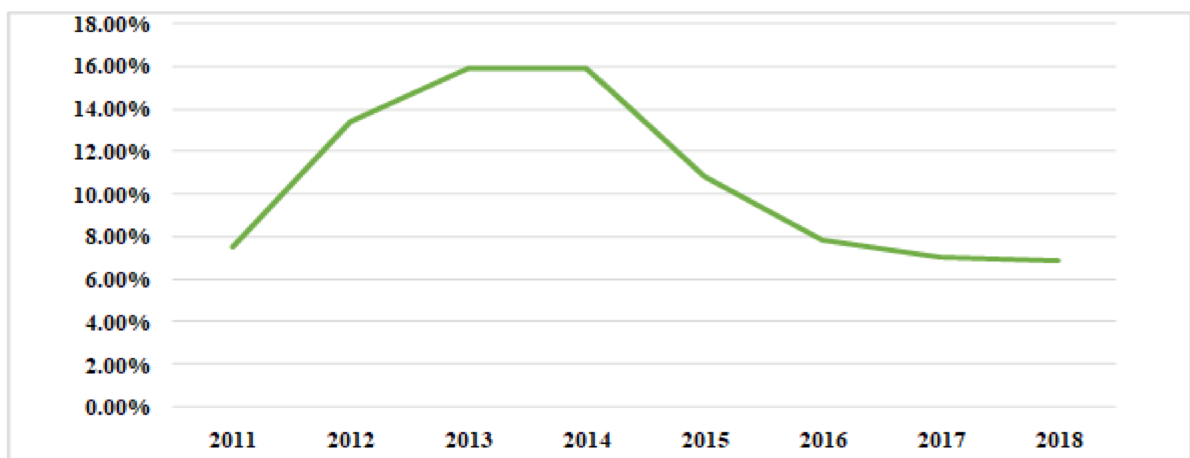

Figure 2: Trend in Non-Performing Loans

Source: Reserve Bank of Zimbabwe

The analysis of financial performance trend of commercial banks is carried out based on the financial performance indicators: Return on equity (ROE), Return on average (ROA) and Net interest margin (NIM), for the period 2011 to 2018 (Fig 3).

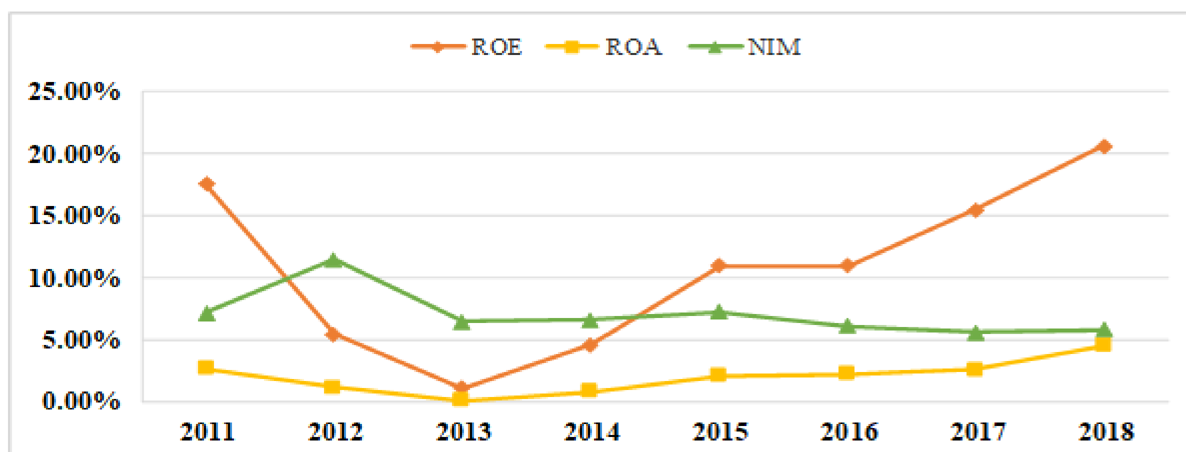

Figure 3: Commercial Banks Key Earnings Indicators

Source: Reserve Bank of Zimbabwe

IV. Research methodology

The main objective of this investigation is to analyze financial performance indicators, to determine profitability of banks in Zimbabwe for the period 2011–2018. The population of this investigation incorporates all operating banks in Zimbabwe. Consistent with (Sufian and Chong 2008 and Ayanda et al. 2013) this investigation used secondary data from the published financial statements of the banks in Zimbabwe for period 2011–2018 to calculate the relevant coefficients and ratios. The collected data were analyzed by the use of descriptive statistics, ordinary least squares and paired samples test. Mean and standard deviation are used to analyze the general trends of the data. Correlation has been used to study the relationship between the dependent and independent variables.

Consistent with the extant literature, study variables were calculated as follows:

- ROA = Net Income / Average Total Assets;
- ROE = Net Income / Average Shareholders' Equity
- LDR = Total loans/ Total Deposits
- NPL = Non-Performing loans/ Total Loans in Portfolio
- NIM = Investment Returns- Interest Expenses/ Average earning Assets
- ICR = Earnings before Interest and taxes / Interest expense
- CAR = Total capital (Tier 1 capital + Tier 2 capital) / Risk Weighted Assets

V. Data Presentation and Interpretation

Descriptive Statistics

Table 2: Descriptive Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	8	.00	.05	.0205	.01363
ROE	8	.01	.21	.1085	.06815
LDR	8	.40	.80	.6563	.16556
NPL	8	.07	.16	.1202	.04004
NIM	8	.06	.11	.0730	.01997
ICR	8	1.01	3.19	1.5150	.75810
CAR	8	.12	.16	.1359	.01173

Source: Authors' calculations

Table 2 presents the descriptive statistics of this investigation variables used in modelling the commercial banks performance from 2011 to 2018. As can be seen from Table 2, ROA has the lowest mean value .0205 and the standard deviation of .01363 implies that ROA has a lower variability. ROE standard deviation is slightly higher than ROA, .06815 indicating average of 10.6% performance of how effectively

management used assets to create profits. Loan to deposit ratio has a mean of .6563 and a standard deviation of .16556, which reveals that the banking sector relied on its own deposits to create loans for customers, with no outside borrowing. Non-performing loans had a mean of .1202 and standard deviation of .04004, this implies that the average NPL was 12% which is a sign displaying that most loans are not being on time. Net interest margin has a mean of .0730 and standard deviation .01997, this shows that the banking sector has invested efficiently. Interest coverage ratio has a mean of 1.5150 which shows that the banking sector is able to pay the interest on outstanding debt, however it is to be noted that the ICR is considered to minimum ratio acceptable. Finally, capital to asset ratio has a mean of .1359 and standard deviation of .01173, which indicates that banking sector in Zimbabwe is holding an average of 0.06 more than the minimum requirements of banking sector set by the central bank (Reserve bank of Zimbabwe CAR requirement is 0.08).

Correlation analysis

Correlation by Pearson is commonly used to evaluate the connection between two or more variables that are continuous. To assess the connections between the variables, the correlation analysis was done to grasp the connection amongst these variables and to evaluate how severe is the relation.

Tables 3 displays that ROA and ROE have a strong correlation significant at 0.01 level, meaning that the banking sector corporate performance has considerably improved during the period under review.

LDR has negative significant correlation at 0.05 level with ROA implying that loans used from deposits in generating revenue are not being fully utilized.

Non-performing loans is negatively correlate to ROA, while having .941 correlation with loans to deposit ratio. Net interest margin is having no relation with any of variables.

Interest coverage ratio is correlated to ROA at significant 0.01 level meaning that banking sector has been profitable to honor debt payments, on the other hand being negatively correlated to LDR and NPL. This may be as a result that interest coverage ratio is more related to management being able to honor debt payments.

Lastly, capital to asset ratio has the weakest correlation with all variables. This weak correlation may signify that the banking sector is not facing any volatility in earnings directly to leverage.

Table 3: Correlation matrix

	ROA	ROE	LDR	NPL	NIM	ICR	CAR
ROA	1						
ROE	.960**	1					
LDR	-.774*	-0.686	1				
NPL	-.735*	-0.654	.941**	1			
NIM	-0.258	-0.224	0.636	0.452	1		
ICR	.841**	0.706	-.912**	-.806*	-0.511	1	
CAR	0.084	0.049	-0.349	-0.322	-0.598	0.091	1

Source: Authors' calculations

Regression and Ordinary Least Squares (OLS)

The primary objective of this investigation was to examine whether the banking sector has been profitable in Zimbabwe. The results below of regression analysis and OLS present the profitability of Zimbabwean banking sector measured by financial performance indicator ROA comparing via two models:

According to table 4, the results displays that all variables are statistically significant, having positive connection with profitability measure of return on assets. R-square is 1.000, which indicates that explanatory variables included in this investigation to determine profitability together are completely explained. F-statistics 5078.58 with p-value 0.01 used to determine the overall impact of the regression model.

Model 1 displays the outcome of regression analysis through evaluating the profitability to banking sector by ROA as dependent variable. Established from the regression results, multiple regression equation of Model 1 is displayed as follows:

ROA= -25.689 + 81.754*ROE+12.5179*LDR -7.7362*NPL+9.4644*NIM+35.0957*ICR+21.0626*CAR
(1)

Table 4: Regression Analysis

	Model 1: Regression	Model 2: OLS
Constant	0.025	-0.0720
Return on Equity	0.008	0.1436
Loan to Deposit Ratio	0.051	0.0465
Non-Performing Loans	0.082	−0.0700508
Net Interest Margin	0.067	0.0808
Interest Coverage Ratio	0.018	0.0131
Capital to Asset Ratio	0.030	0.2138
R-Square	1.0000	1.0000
Adjusted R-Square	1.0000	0.9998
Standard error	0.0002	0.0002
"F"	5078.5760	5078.5760
p-value	0.0110	0.0107

Source: Authors' calculations

Model 2 presents the regression results from OLS, which is a generalized linear modeling technique. The results are similar to model 1 regression, signifying that the banking sector in Zimbabwe has been profitable. However Non-performing loans -0.07 meant that more of these loans were affecting profitability less significantly.

ROA = -0.0720 + 0.144*ROE + 0.0465*LDR - 0.0701*NPL + 0.0808*NIM + 0.0131*ICR + 0.214*CAR (2)

Paired Samples Test

Table 5: Paired Samples Test

	Paired Differences			Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	
ROA - ROE	-0.08799	0.05519	0.01951	0.003
ROA - LDR	-0.63583	0.17632	0.06234	0.001
ROA - NPL	-0.09966	0.05091	0.018	0.001
ROA - NIM	-0.05254	0.02693	0.00952	0.004
ROA - ICR	-1.49451	0.74668	0.26399	0.001
ROA - CAR	-0.11536	0.01722	0.00609	0.001

Source: Authors' calculations

From table 5 above, we can see that Sig. (2-tailed) is lower than significance (0.05), implying strong evidence against null hypothesis; therefore, we reject null hypothesis and accept alternative hypothesis, i.e. all variables are positively related to ROA.

VI. Conclusion

The objective of this research was to examine banking sector profitability through investigation of financial performance indicators for Zimbabwe from 2011 to 2018 and the secondary objective was to determine if they is any relationship among the profitability indicators. This research used a balanced panel data of 8 observations from the banking sector that were analyzed with the use of paired samples test, correlation matrix, regression and ordinary least squares. This investigation concludes that return on equity, loan to deposit ratio, net interest margin, interest coverage ratio and capital to asset ratio are the determinate factors that have impact on profitability of the banking sector and that the profitability of the banking sector in Zimbabwe may be improved by paying more attention to non-performing loans..

VII. Recommendations

To Reserve Bank of Zimbabwe (Central Bank)

- Reserve Bank of Zimbabwe should create strategies to ensure stability, growth and safety of both investors and depositors' interests and observe the capitalization levels of commercial banks.

To Banking Sector Executives

The results delivered in this study uncovered that the composition of return on equity, loan to deposit ratio, net interest margin, interest coverage ratio and capital to asset ratio significantly induces profitability. Bank executives should therefore continuously monitor these indicators by shedding excess cash and investment in interest earning assets, such as purchasing more fixed assets and leasing and issuing loans to clients and paying more attention to trend in non-performing loans.

- *Maximization use as Financial Intermediary*

Banks ought to make better use of their exceptional position among financial intermediaries concerning the function of delivering payment mechanism which facilitates them to collect important information on clients of their services.

- *Stop exorbitant bank charges*

The banking sector should reduce charging high interest rates and exorbitant bank charges as this reveals that by undertaking such risky investment strategies (for instance lending at high interest rates) which, if ineffective, would threaten the soundness of the bank. This was one of the many factors that caused many banking institutions in Zimbabwe to close.

- *Implementation of new Policies*

It is important that new policies should be implemented because that will encourage competition, contribute to rising efficiency, particularly in risk management, product development of banks and providing institutional improvements.

- *Institutional reforms*

Even the institutions that provide a bank market structure that is competitive as well as satisfactory banking regulation. Developments are required to create public creditor registers and evaluation of collateral and protection creditor rights.

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