G.J.C.M.P.,Vol.5(6):1-5 (November-December, 2016) ISSN: 2319 – 7285

GLOBAL JOURNAL OF COMMERCE & MANAGEMENT PERSPECTIVE
(Published By: Global Institute for Research & Education)

www.gifre.org

An Investigation of the Challenges Faced by Zimbabwean Banks in Managing Non Performing Loans (2009-2014)

Tshuma Nothando[1] & Karasa Nyasha[2]

National University of Science and Technology, Chinhoyi University of Technology, Zimbabwe.

Abstract

The Zimbabwean banking systems has been burdened by non-performing loans. Bad loans have created several problems for commercial banks in Zimbabwe hindering efficient functioning of banks. It is for this reason that commercial banks have adopted non-performing loans management strategies so as to improve financial performance. This study sought to establish the challenges faced by commercial banks in managing non–performing loans (NPLs) in Zimbabwe (2009-2014). A descriptive survey design was adopted as the research design. The population of this study consisted of 12 commercial banks in Zimbabwe. The primary data was collected using structured questionnaires and interviews. The study found that weak judiciary systems, time constraints, poor macroeconomic conditions, ICTS challenges, poor organizational structures, over borrowed clients who lack collateral and subprime lending are the prevalent challenges in Zimbabwe. It is therefore recommended that the government spearheads macroeconomic turnaround by implementing policies that promote economic growth and development. It is difficult for banks to report the real levels of their NPLs without a proper reporting system. Banks should upgrade their ICT systems in order for them to detect the early warning signs of accounts that are going under. Banks do not have adequate capacity to screen and monitor their borrowers and therefore distinguish between good and bad risks. The credit markets have been faced with adverse selection and moral hazard problems attributed to information asymmetry among lenders and borrowers. It is therefore important that lenders supplement their information about borrowers with that of other lenders through the establishment of a credit bureau in Zimbabwe.

Keywords: *Non Performing loans, Subprime lending, Moral hazard.*

Introduction

According to a report by the Reserve Bank of Zimbabwe (2011), the ratio of non-performing loans to total loans for the banking sector was 4.72% which was a marginal deterioration from the 4.24% recorded as at 31 December 2010. The average ratio of non-performing loans for the entire banking sector was 5.83% as at 30 June 2011. The ratio of non-performing loans had averaged below 5% since March 2010.According to the Mid-Year Fiscal Policy Statement (2012), non-performing loans were 9.9% as at 30 June 2012. IMF (2012) also highlighted that non performing loans in Zimbabwe increased from 6% on average at December 2011 to 10% at June 2012. This is higher than the prudential threshold of 5% stipulated under Basel II**.** As at December 2012 the Bankers Association of Zimbabwe revealed that banks were burdened with Non-Performing Loans to the tune of 12.3%. The Mid-Year Fiscal Policy (2013) made known that the level of non-performing loans has been on an upward trend from 1.8% in December 2009 to 13.78% as at March 2013.

The Zimbabwe Economic and Policy Research Unit (ZEPARU) report (2013) attributed the exponential growth in non-performing loans to insider lending among directors, inadequate due diligence on loan application, moral hazard, information asymmetry, high interest on short-term loans and multiple borrowing. Also cited in the report was low project productivity and profitability, poor project monitoring by banks, violation of prudential guidelines, diversion and misuse of borrowed funds, droughts and hazards resulting in poor yields and a harsh operating environment. The problem was that demand for cash was outstripping supply. Mid-year fiscal policy (2013) added that the deterioration of asset quality was largely due to poor loan origination and underwriting standards, siphoning of banks resources through non performing insider and related party loans and poor risk management systems.Various instituitions have been placed under curatorship due to the chronic problem of Non Perfoming loans.This includes banks like Rennaisance,Interfin,Afrasia Kingdom amongst others. Genesis Investment Bank voluntarily surrendered its banking license to the RBZ in June 2012, after failing to realize adequate financing from partners that the bank had been courting since 2009. The RBZ commenced the modalities on liquidating the bank. On July 27, 2012, Royal Bank Zimbabwe Limited surrendered its banking license to the RBZ. Onsite inspection by the RBZ determined that the bank was critically undercapitalized, faced chronic liquidity challenges and liabilities to the RTGS system, had high non-performing insider loans, and had been misrepresenting information to the RBZ.To this end banks have implemented strategies to mitigate the effect of non performing

loans. Despite some banks being under curatorship and licences being rescinded, the problem of Non-Performing loans still ailed most financial institutions which continuously fell into the same pitfall. The question therefore is what are the challenges faced by banks in mitigating non performing loans.

Research Objectives

The main objective of the study was to assess the challenges faced by commercial banks in Zimbabwe in mitigating non-performing loans (2009-2014).

Literature Review

Wanjira (2010) defines Non-Performing Loans as loans which cannot be recovered within certain stipulated time that is governed by some respective laws. Non-performing loan is the percentage of loan values that are not serviced for three months and above (Ahmad and Ariff, 2007). Alton and Hazen (2001) described non-performing loans as loans that are ninety days or more past due or no longer accruing interest. Caprio and Klingebiel (1990), cited in Fofack (2005), consider non-performing loans as loans which for a relatively long period of time do not generate income, that is the principal and or interest on these loans have been left unpaid for at least ninety days.
A non-performing loan requires payments of both interest and principal be past due, and that either event should trigger classification of the loan as NPL (Svartsman, 2003). Similarly according to Long, (1990) it is a loan on which contractual obligations for example interest or amortization payments are not met or debt instruments whose obligors are unable to discharge their liabilities as they become due. A problem loan could also be one in which the original loan repayment terms have been altered because the loan could not be paid in accordance with the bank's requirements and needs restructuring or when collateral margin is depleted to the point when the bank's risk increases substantially (Clarke & Johnston, 1995). Berger and Young (1997) concurred and defined a non performing loan as one which does not perform according to the terms and conditions of the original agreement. He also includes re-negotiated and non- accrual loans in his definition.

Subrahmanyam (2003) defines a non-performing loan as one which is in default. He classifies default in two forms namely debt services default and technical default. Debt services default is where the borrower has failed to meet a scheduled payment of be it interest, principal or both. Technical default is where affirmative or negative covenants on a loan agreement are violated. Affirmative covenants focus on mostly financial ratios that the borrower undertakes to adhere to throughout the period of indebtedness for example a borrower may agree to operate within specific liquidity ratios. Negative covenants are clauses in loan agreements, which limit certain actions like declaration of dividends until the loan has been fully serviced, pledge of any corporate assets before the loan facility expires or even increasing the level of borrowings without the bank’s consent.

The Reserve Bank of Zimbabwe (RBZ) Statutory Instrument 205 of 2000 defines non-performing loans strictly as those loans that have ceased to generate any income for the bank. The supervisory body primarily looks at assets where the lender no longer has hope of having full repayment of outstanding financial obligations in the form of both principal and interest. For prudence purposes interest on such accounts is suspended and will only be booked once it has been collected. The regulator’s view is much more objective because the whole essence of creating assets is to earn income and the lender will be able to realize income on an asset when it performs. Failure of an asset to perform would force the lender to set aside provisions to cushion the institution against potential losses emanating from the loan in service default.

From the various researchers, it could be deduced therefore that a non-performing loan is one that is not serviced for a certain period as stipulated by the regulatory authorities commonly ninety days and the original conditions of the loan contract would have been wavered. Of essence also in the definition is the fact that both interest and amortization payments would be past due. Chakraborty (2005) stated that banks face several challenges in managing Non-Performing Loans. He further argued that despite the availability of various avenues of recovery the mindset of the borrowers from the beginning should be tuned in such a way that he is willing to repay rather than turn into a willful defaulter.

According to McNaughton, (1996), collateral is a tangible asset in which a bank takes securing interest. Such security should be safe and easily marketable. This may include land titles, houses, balances on savings accounts and guarantees. Security takes many forms, but can usually be categorized in one of two ways. First, it may be either direct (provided by the borrower) or indirect (provided by a third party). A charge by deed by way of legal mortgage creates a direct, and either legal or equitable, claim over the asset or class of assets referred to in the deed, subject to the mortgager’s right to the equity of redemption (that is, to redeem the mortgage by repayment) In realizing the mortgage property, one of the main things to be handled by the bank is fixing the value of the asset to be sold by auction. Developing countries the substantive law as well as the procedural law is silent about the criteria to be followed by banks in fixing the price of the asset to be auctioned (European Mortgage Securitization: guide 2002) . Sometimes however the security held by banks is not sufficient to fully cover the loan principal and interest repayments.

Jianfeng (2013) stated that Korea, Thailand, and Japan’s experiences demonstrate that a key factor to succeeding in NPL recovery is a transparent and user-friendly insolvency law framework that gives creditors adequate protection. All of these countries have made significant improvements and/or additions to their bankruptcy

and securitization legislations over the last nine years. The resolution of NPL in any country requires both strong legal and financial frame work. Appropriate legislation alone would not create an environment conducive to business activities. Laws are only as good as the institutions that enforce them. It is vital therefore; the courts and other organs responsible for enforcing the laws and resolving disputes to fully engage with lending financial institution (Blaz 1996)

According to Coase (1998), if the business laws of a country are not market friendly and the law enforcement agencies are inefficient, business costs such as transaction costs to arrange, monitor and enforce contracts would be high. Litigation costs would inevitably rise. Where inefficiency exists, uncertainty prevails, and in such an environment prudent decision making, which is vital to business activities would be difficult.

Debt recovery through courts has been the usual practice in different countries but due to the complex procedure and to minimize judicial process, most countries gave banks the right to recover loans by themselves. This process looks easier when the loan is securitized. The recovery of loans by banks provides for the management or sale of mortgaged property by banks without a court order (Brown 2004).It is also important to note that that the recovery process through legal system with or without collateral is equally costly and lengthy. The court fee is payable on the amount of default or on the amount to be recovered and not on the value of the security (Govil,2000).

Moral hazard (or adverse selection) is a concept with relevance to a variety of principal agent relationships characterized by asymmetric information (Brownbridge 1998). In some cases, lending proposals are not supported with financial data and in a situation where these financial data are available; they have been deliberately falsified to satisfy the loan officer. In some cases, proposals with inherent defects are made by highly reputable individuals within the society, which are approved by the credit officer because of other non-banking considerations. With the apparent defects in such credits, the risks are high and the chances of recovery are remote (Ponnu and Ramakrishnan, 2004).The problem of information asymmetry inhibits the successful management of NPLs by various financial institutions.

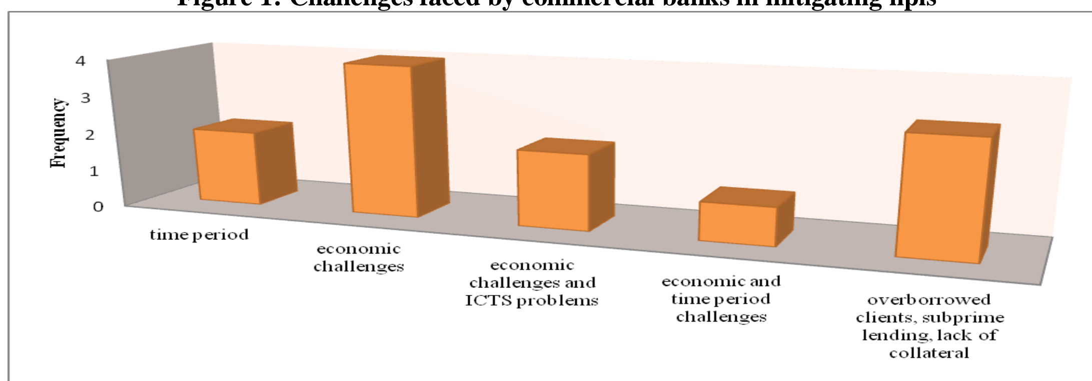
A credit policy should be built on three major variables and these include credit terms, credit standards and collection procedures (Pandey 1995, Van Horne, 1994 and Kakuru 2001). McNaughton, (1996) defines a credit policy as a set of guidelines designed to minimize costs associated with credit while maximizing the benefits from it. He also notes that a good credit policy should be one that ensures operational consistency and adherence to uniform and sound practices. A good credit policy should involve effective initiation, analysis, credit monitoring and evaluation. A credit policy is one of the essential tools in an organization. It is a primary tool as well as a procedure established to provide management with reasonable assurance that the credit system is functioning as it should. Therefore if a credit policy does not sufficiently guide the users on the management of Non-Performing loans challenges will arise.

Methodology

The study adopted a descriptive survey design. The target population for the study was made up of Commercial Banks drawn from the major cities, Harare and Bulawayo. The research covered commercial banks in Bulawayo and Harare due to time and financial constraints. The assessment was carried at twelve of the fifteen commercial banks Random sampling was the main sampling technique that was used to select the commercial banks whilst judgmental sampling was used for the selection of heads of credit, risk managers and credit recoveries officers. Primary data was collected from these respondents through questionnaires and interviews. Apart from primarily administering questionnaires, the researcher also intertwined the responses from questionnaires with publications done by the various banks on the various areas of the research. This helped to fully analyze the responses from the primary data collected Published financial statements, journals, the internet and RBZ publications, and other reports were used amongst the secondary source of data.

Research Findings

Figure 1: Challenges faced by commercial banks in mitigating npls



Source: Primary data

The length of the time it takes for banks to effectively recover their debts is one of the major challenges that was noted by 25% of the banks. They explained that the judiciary system is highly bureaucratic and hence it takes a long time to get a court judgment. They cited that they have been incidents where the defaulters have appealed to a superior court which further delays the process. 8.3% also argued that restructuring also prolongs the time it takes to fully recover debts. However banks can reduce time taken in lawsuits by coming up with a legally enforceable agreement at the pre-trial conference stage as noted by 50% of the respondents.

The banking sector has not been spared from the ill effects of the poor macro economic conditions. 58.3% of the population noted that companies are failing to pay up their debts because of the inconsistent cash flows from their business which has been aggravated by the liquidity crunch. Most people are also not receiving their salaries on time; this negatively affects the financial institutions plans to manage NPLs. The economic environment also does not support derivative trading hence there is no securitization as noted by 25% of the respondents. 33.3% of the respondents revealed that the macroeconomic environment is not supportive of effective NPL management. It is also relevant to note that Zimbabwe is facing challenges that other countries like China and German faced in their financial crises as noted by Fung and Ma (2002).

ICTS challenges were a problem that was noted by 16.7% of the sample population. Failure to effectively run a client database can make the process of NPL management difficult. 8.3% also noted that every bank's effort to thwart the challenge of NPLs should be sufficiently supported by an effective internal ICTS system which aides the proper NPL reporting. 16.7% of the population also asserted that poor organizational structures in lending institutions also affect debt recovery. 8.3% believed that if internal controls are not in force, it will be difficult to hold individual officers responsible for either authorizing or collecting loans. Bank officers would then lack the incentive to pursue debt recovery actively. These internal challenges however were not experienced by every bank under study with 83.3% of the respondents correcting this by devoting more resources to NPL management.

Some clients were over borrowed; this then reduced their repayment capacities as noted by 25% of the respondents. This could also be related to the sub-prime lending that took place at the onset of the dollarization era. 8.3% of the respondents agreed that banks were aggressively lending to different clients in a quest to gain market share. As a result proper credit analysis was not done. 16.7% noted that their NPLs were as a result of lending to related companies. The presence of intercompany guarantees made it impossible for the banks to recover the loans in full. The problem is related to inadequate screening methods employed by the banks in the lending process.

Conclusions and Recommendations

Conclusively, the study shows that commercial banks are experiencing severe challenges in improving their asset quality. This is in line with the conclusions of Chakraborty (2005) who revealed that banks face several challenges in managing Non-Performing Loans especially the macroeconomic environment and ICTS challenges. It is difficult for banks to report the real levels of their NPLs without a proper reporting system. Banks are recommended to upgrade their ICT systems in order for them to detect the early warning signs of accounts that are going under. If these signs are treated early, it is possible that the non-performing accounts can be nursed back to health. Zimbabwe is currently going through macro-economic challenges and the tendency is for banks to pursue profitability while neglecting setting aside adequate provisions; this can trigger a banking crisis especially when provisions are inadequate. When setting provisions for restructured loans, banks need to properly grade these loans with a view of ensuring that the loans previously had performance issues. In Zimbabwe, such loans should be graded sub standard so that specific provisions are set aside since these have high chances of turning bad. Government is encouraged to loosen the judiciary system to make it less bureaucratic so that the length of time it takes to recover loans is seriously reduced.

References

Aggarwal R (1991), Designing Effective Credit Recovery Management and Control System, *IBA Bulletin, Bombay, P.8 to 12.*

Ahmad, N.H. and Ariff, M. (2007).Multi-country Study of Bank Credit Risk Determinants, *International Journal of Banking and Finance,* 5(1), 135-152.

Alton R. G and Hazen J. H (2001), "As Economy Flounders, Do We See A Rise in Problem Loans?, *Federal Reserve Bank of St. Louis.*

Berger N. A and De Young R (1997), Problem Loans and Cost Efficiency in Commercial Banks, Washington DC. *Journal of Banking and Finance*, 21(6, 849-870

Blaz, M. and Schiffman, H. (1996), Insolvency Law Reform for Economies in Transition: A Comparative Law perspective, *Butterworth Journal of International Banking and Financial Law,*

Brownbridge, M. (1998) Financial distress in local distress in local banks in Kenya, Nigeria, Uganda and Zambia: Causes and implications for regulatory policy, *Development Policy Review,* 16, pp. 173-188

Caprio G Jr and Klingebiel D (1996), Bank Insolvency: Bad Luck, Bad Policy or Bad Banking, *Annual World Bank Conference on Development Economics*.

Chakraborty K.C. (2005), Management of NPAs Trends and Challenges, *Chartered Financial Analyst P. 30 to 33,*

Clarke, P.S., Johnston Jr, D.H. (1995). The Problem Loan Problem Solver: Step-by-Step Strategies for Resolving Bankruptcy, Lender Liability and Other Problem Loan Situations. *Chicago: Probus Publishing*.

Coase, R. (1998) The wealth of nations, *Economic Inquiry, 15, pp. 309–325*

Fofack H (2005), Non-Performing Loans in Sub-Saharan Africa: Causal Analysis and Macroeconomic Implications, *World Bank Policy Research Working* Paper No. WP 3769
Govil A.(200), Need for Revival of Loss Making Branches, *Indian Bank Association Bulletin, Bombay, P.24*,
Jiangfeng L.I. (2013) Non-Performing Loans and Asset Management Companies in China: Legal and Regulatory Challenges for Achieving Effective Debt Resolution and Recovery, Peking *University School of Transnational Law*
Kakuru Julius (2001); Finance and Business division
Long, F.M. (1990). Financial Systems and Development. *The World Bank Policy and Research Series,* 15: 52–65.
Mc Naughton (1996); Building strong & responding to change *Financial Stability Institute, Occasional Paper, 453*
Pandey I.M (1995); Financial management 6th Edition, *Prentice Hall*
Ponnu C.H., and Ramakrishnan T.N. (2004) Management Of Non-Performing Loans (Npls) Of Banking Institutions In Malaysia- *A Decade of Change. Kuala Lumpur*
Subrahmanyam, V. (2003). Treatment of Non-Performing Assets (NPAs) in Macroeconomic Statistics. *Contributions to IMF Discussion Group*.
Svartsman, I. (2003). The Treatment of Non-Performing Loans and Interest Accrual. *Contributions to IMF Discussion Group*
Van Horne J. C. (1994); Financial management and policy, *prentice Hall private Ltd. India*
RBZ (2011) Monetary Policy Statements. Reserve Bank of Zimbabwe.