Asset Quality and Ownership Structure: Case of Zimbabwean Banking Industry

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Abstract
The objective of this paper is to investigate the influence on various ownership structures on the asset quality of Zimbabwean banks. The proxy for asset quality used in this paper is the ratio of non-performing loans to loans ratio. The Zimbabwean banking industry is composed of foreign banks, indigenous banks and state banks. Evidence from both developing and developed economies on the subject matter is still inconclusive reveal previous studies indicate conflicting results. The paper employed an Analysis of Variance (ANOVA) at 5% level of significance and it was realized that ownership structure has a significant effect on the quality of assets for Zimbabwean banks with foreign banks taking the lead followed by indigenous and state banks thus suggesting that state banks needs to improve their policy framework so that the loan clients meet their obligations. Moreover, Banks should evaluate loan clients so that the value of nonperforming loans will be reduced and this improves the asset quality of banks.

Keywords: Asset Quality, Banking Industry

1.0 Introduction
Ownership structure of banks has been described from the perspective of the ownership identity with the majority shares in the banking industry that is whether the majority shareholder is state, domestic or foreign (La Porta et al., 2002). State owned banks promotes financial development through the issuance of cheap developmental funds however, the quality of their loan portfolio tend to be inefficient as they lack safety nets for their assets. According to Barth et al (2004), state owned banks support government initiatives which range from economical to political hence clients lack the incentive to honour their obligations of settling the loans thus reducing the quality of their assets. On the other hand, foreign owned banks enhance policy framework in the banking industry and provides competition to domestic banks thus improving the quality of banking assets in the process (Beck et al., 2004).

Asset quality of banks has been described as an estimation of bank assets principally loans and losses as measured by a lender’s credit standard and liquidity of securities held in the investment portfolio (Siron, 2003). If assets are packaged for resale to investors in the secondary market, the criterion for determining quality of assets is what is expected to be received in the market if the loans are sold hence asset quality has to do with change off analysis then marketability of credit portfolio. Also Flannery (2001) defined asset quality as an evaluation of an asset to measure the credit risk associated with it. It has been regarded by Markowitz (1991) as a measure of the likelihood of default of a loan or lease combined with a measure of its marketability. In general asset quality can be summarized as the left hand side of the bank balance sheet.

According to the central bank of Zimbabwe, commercial banks are licensed and regulated to the provisions of Banking Act 1999. Over the study period from 2009 to 2012, there were eighteen licensed commercial banks composed of two state owned four foreign owned and twelve domestic owned banks. Prior to 2008, the Zimbabwean banking sector had a myriad of problems emanating from the hyper-inflation largely driven by political tension which plagued the financial sector. Furthermore, the weak institutional framework lacked the strength to support the banking industry. Over the same period real income was eroded by inflation and banks registered massive losses as indicated by an 80% default rate on loans (Financial Gazette, 2008). The formation of the unity government in 2010 brought some stability and confidence in the financial sector. The dollarization of the economy brought sanity in the financial sector and this was compounded by the competitive interest rates. The Banking industry registered a 6.4% increase in asset quality as measured by the ratio of non-performing loans to loans (Financial Gazette, 2012). However, the asset quality at individual banks varied hence this paper seeks to provide answers on whether the quality of assets is influenced by ownership structure of these banks.

2.0 Literature review
Iannota et al (2007) found that public sector banks had poorer loan quality and higher insolvency risk than other types of banks while mutual banks had better loan quality and lower asset risk than both private and public sector banks. They also found that a higher ownership concentration was associated with better asset quality, lower asset risk and lower insolvency risk. Cornett et al (2010) found that state-owned banks held less core capital and had greater credit risk than privately-owned banks prior to 2001. In addition, from 1997 to 2000, the 4-year period after the beginning of the Asian financial crisis, the deterioration in asset quality and credit quality of state-owned banks was significantly greater than that of privately-owned banks, especially for the countries that were hardest hit by the Asian crisis. However, state-owned banks narrowed the gap with privately-owned banks on cash flow returns, asset quality and non-performing loans (NPL) in the post-crisis period of 2001–2004. Furthermore, increases in domestic blockholder ownership of banks appear to improve the asset quality, of the banking sector, while increases in foreign presence adversely affect the asset quality.

Credit risk is one of the factors that affect the health of an individual bank. The extent of the credit risk depends on the quality of assets held by an individual bank. The quality of assets held by a bank depends on exposure to specific risks, trends in non-performing loans, and the shareholding of the bank (Baral, 2005). Aburime (2008) asserts that the quality of assets of a bank depends on shareholders and management ability to foresee, avoid and monitor risks, possibly to cover losses brought about by risks arisen. Hence, in making decisions on the allocation of resources to asset deals, a bank must take into account the level of risk to the assets. Poor asset quality and low levels of liquidity were the two major causes of bank failures during the Asian crisis. Poor asset quality led to failure of state and domestic owned Kenya in the early 1980s and during that period 37 banks collapsed following the banking crises of 1986-1989, 1993-1994 and 1998 (Mwega, 2009). According to Waweru and Kalani (2009) many of the financial institutions that collapsed in 1986 were domestic and state banks and they failed due to non-performing loans (NPLs) and that most of the larger bank-failures, involved extensive insider lending, often to politicians. Hempel et al (1994) observed that foreign banks have good asset quality as noted by high loan growth and often assume more risk as credit analysis and review procedures which are less rigorous, however performance is efficient as measured by returns in such loans indicating a risk and return trade-off. In contrast Kosmidou (2008) applied a linear regression model on Greece 23 commercial banks data for 1990 to 2002, using the ratio of loan loss reserve to gross loans to proxy asset quality. The results showed foreign banks have good asset quality compared to domestic and state banks. This was in line with the theory that increased exposure to credit risk is normally associated with foreign banks that have the resource to take high risk decisions and are able screen and monitor credit risk.

In particular, private domestic banks appear to be more “aggressive” in their lending than foreign banks. They hold significantly less liquid assets than foreign banks, and correspondingly hold more assets in the form of loan. Empirically, Leech and Leahy (1991) found in the United Kingdom, a negative relationship between the ownership concentration and the asset quality and profitability. Lin and Zhang (2009) using a panel of 60 Chinese banks over the 1997–2004 reported that the Big Four state-owned commercial banks have worse asset quality than other types of banks. Similarly Micco et al (2006) further examined the relationship between bank ownership and asset quality for banks in 119 countries and found out that in developing countries, state-owned banks have poorer asset quality than their domestic counterparts. The same view was postulated by Sapienza (2004) who discovered that lending behavior of state-owned banks in Italy was affected by electoral results of the party affiliated with the bank and Dinç (2005) shared the same view and concluded that government-owned banks in emerging markets significantly increase their lending in election years relative to private banks mainly because politicians can reward their allies and punish their opponents through their influence on government-owned banks. However, there is direct evidence that lending by government banks is based on political rather than social objectives. Using a sub-set of the data used in this paper on 22 countries, Dinc (2002) showed that loan forgiveness and restructuring of old loans and issuance of new loans increases more for government banks relative to private banks during election years hence poor asset quality for state owned banks. Also Micco et al, (2006;) posted the same political view, and argued that government control of financial institutions politicizes.
resource allocation for the sake of advancing certain political agendas like obtaining votes, bribing office holders and, by pursuing such objectives, asset quality is hampered (Shleifer and Vishny, 1997). In addition, state-owned banks perform poorly and only survive due to government support (Mian 2006). Similarly Barth et al (1999) have shown that higher government ownership of banks in 1970 was associated with inefficient bank performance hence slower subsequent financial development and lower economic growth. Barth et al (1999) further examined the relationship between state ownership and banking sector development measures and found out that government ownership of banks is negatively related to favorable banking

Foreign presence can help mitigate connected lending problems and improve asset quality (Giannetti and Ongena, 2007). The conclusion was reached through a study of banks in Eastern European countries and discovered that foreign lending stimulates growth in firm sales and assets, hence improving its asset quality. Micco et al. (2004) also documented that foreign banks exhibited higher nonperforming loans than their private counterparts. Regarding foreign bank entry. Barajas, Salazar, and Steiner (2000) showed that foreign bank entry resulted in deterioration of the Colombian domestic banks’ asset quality.

Regarding reforms, asset quality of NPL, both foreign and private ownership showed a negative impact in Malaysia during a period of 2001 to 2008 thus both foreign and private owned banks indicated have poor quality of asset as measured by a decrease in loanable funds. Firth et al (2009) suggested that political connections played an important role in gaining access to bank finance, and loans of state-owned commercial banks mostly flowed to the state-owned enterprises (SOEs), and often became non-performing loans easily. Ferri (2009) stated that state-owned commercial banks burdened with non-performing loans from SOEs had higher non-performing loans ratio than city commercial banks. Lin and Zhang (2009) found that the Big Four state-owned commercial banks had the worst asset quality than other types of banks except the policy banks Furthermore, increases in domestic blockholder ownership of banks appear to improve the asset quality, profitability, and liquidity of the banking sector, while increases in foreign presence adversely affect the asset quality, but improves the liquidity of the remaining banks. Micco et al. (2004) examine the relationship between bank ownership and bank performance for banks in 119 countries. They find that in developing countries, state-owned banks have lower profitability, higher costs, higher employment ratios, and poorer asset quality than their domestic counterparts.

Barth et al (1999) noted an improved asset quality as a result of foreign entry in Poland during 1993-1999 study period because of the sophisticated evaluation of pricing and credit risks hence causing an increase in the allocation of credits to the private. The same conclusion was noted by Martinez and Peria, (2001) who recorded an improvement in asset quality as a result of foreign entry in Malaysia over a period of 10 years from 1990. Also Clarke et al (2001) found similar results in India and concluded that foreign entry have brought technical ways of valuing risk in the Indian baking sector hence resulting in banks increasing their loan portfolio thus an increase in the asset quality sector may be improved since it is expected the evaluation and pricing of credit risks to be more sophisticated (Perroti and Gelfer 1999)

3.0 Methodology.

Banks were grouped in to three panels consisting of foreign owned banks, state owned banks and locally owned banks. A multi stage sampling technique where banks were first put into strata and banks from each strata were chosen based on data availability. Table 3.1 below shows the sampled banks in each panel over the study period from 2009 to 2011. An ANOVA table is used to analyse the effect of ownership structure of banks on asset quality in which the F calculated was compared with the F critical. From the analysis if F calculated is greater than F critical then ownership structure will have an effect on asset quality otherwise it will have no effect. Furthermore, a least square difference (LSD) is carried out in order to find which ownership structure is performing more on situations where ownership structure has an effect on bank performance measure.Data for was obtained published financial statements over the study period.
Table 3.1 Number of Banks in each sector

<table>
<thead>
<tr>
<th>Bank class</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Owned</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Foreign Owned</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Domestic Owned</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: RBZ annual report 2011

4.0 Discussion of results

Asset quality was measured by the ratio of Non-Performing Loans to total deposits ratio Total loans. A higher percentage represented more non-performing loans hence poor performance hence the bank with good asset quality is represented by lower asset quality ratio as measured by Non-Performing Loans to total deposits. Figure 4.7 presents the annual asset quality ratios for banks of all the sectors from year 2009 to 2011.

Figure 4.9: Asset Quality Measures

Source: Bank scope database

From figure 4.9 above foreign bank (FC) recorded the lowest Non Performing Loans to total deposits ratio of 0.14% thus representing best asset quality than other banks in 2009 .foreign banks continues to record good asset quality but this time it was Foreign bank A (FA) which recorded 0.37% and this continues to 2010 with FC recording 0.13%. This supports the idea that foreign banks are able to evaluate customers such that only credits worthy clients get the loans.

A trend analysis for the general movement of mean asset quality sector by sector is shown below. A decrease in the trend line represents an improvement in asset quality otherwise it’s a decrease.

Figure 4.10: Trend Analysis for the means of Asset Quality
Source: Bank scope data base

From figure 4.10 above it has been discovered that the asset quality of foreign banks was better than state owned and domestic banks but it worsened from 2009 reaching a peak of 2.69% in 2010 and improved there on to 0.32% in 2011. Regarding domestic banks asset quality worsened at a decreased rate from 2010 to 2011 than from 2009 to 2010. State banks asset banks were generally stable in from 2009 to 2010 only improving by a marginal 0.01% from 2.75% but worsened o 5.94% by end of 2011 hence showing high non perfuming loans because of their political and social view which will result in non interest loans.

An ANOVA was carried out to test the null hypothesis that ownership structure does not have an effect on asset quality against the alternative hypothesis that ownership structure has an effect on asset quality. To test that the F calculated from the ANOVA table is compared with the F critical at 5 % significance level. If the F calculated is greater than the F critical then the null hypothesis will be rejected otherwise it will be accepted. If accepted LSD will be carried to find the sector which has good asset quality than another. If the mean of one sector is greater than the LSD of other sectors then the sector with the higher mean will be the one with good asset quality. Below is the Analysis of variance table and this showed that ownership structure has an effect on bank asset quality.

4.1: ANOVA table for ownership structure and asset quality

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>SS</th>
<th>Df</th>
<th>MS</th>
<th>F</th>
<th>P-value</th>
<th>F crit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between Groups</td>
<td>0.0034692</td>
<td>2</td>
<td>0.0017346</td>
<td>4.3442912</td>
<td>0.02313476</td>
<td>3.354130829</td>
</tr>
<tr>
<td>Within Groups</td>
<td>0.0107816</td>
<td>27</td>
<td>0.0003991</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>0.0142512</td>
<td>29</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Anova: Single Factor**

**SUMMARY**

<table>
<thead>
<tr>
<th>Groups</th>
<th>Count</th>
<th>Sum</th>
<th>Average</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>State</td>
<td>6</td>
<td>0.164</td>
<td>0.028233</td>
<td>0.000993</td>
</tr>
<tr>
<td>Foreign</td>
<td>12</td>
<td>0.143</td>
<td>0.012103</td>
<td>0.000255</td>
</tr>
<tr>
<td>Domestic</td>
<td>12</td>
<td>0.433</td>
<td>0.035855</td>
<td>0.000277</td>
</tr>
</tbody>
</table>
Table 4.1 shows the findings in of ownership structure and asset quality nexus. The results represented in Table 4.1 shows that the F calculated is greater than F critical suggesting that ownership structure has an impact on the asset quality of bank. Since the results suggest that the ownership structure has an influence on asset quality, there is need to assess the ownership identity with the greatest influence on asset quality. This has been achieved by performing the Least Squares Difference (LSD) which observe the structure of the bank with lower non-performing loans.

**Table 4.2: LSD Table for Asset quality**

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Diff</th>
<th>LSD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign</td>
<td>0.03210833</td>
<td></td>
<td></td>
</tr>
<tr>
<td>State</td>
<td>0.02823333</td>
<td>0.01612500</td>
<td>0.02050088</td>
</tr>
<tr>
<td>Domestic</td>
<td>0.03585250</td>
<td>0.00761917</td>
<td>0.02050088</td>
</tr>
</tbody>
</table>

The results shown in Table 4.2 shows that mean for foreign banks is more than the LSD of both state and domestic banks suggesting that foreign banks have good asset quality than both domestic and state owned banks. The results suggest that foreign owned banks have a good asset quality thus confirming the notion that foreign banks are able to evaluate the creditworthiness of their clients before they issue out loans. Also the weak institutional framework which is exposed to political interference within state banks is confirmed by these results.

5.0 **Conclusion and recommendations**

The research concludes that ownership structure has an effect on asset quality. This view was supported by Hempel *et al* (1994) who observed that foreign banks have good asset quality as noted by high loan growth and often assume more risk as credit analysis and review procedures which are less rigorous. In addition, Kosmidou (2008) applied a linear regression model on 23 Greek commercial banks and found that foreign banks have good asset quality compared to domestic and state banks. Furthermore Micco *et al* (2006) observed that foreign owned banks registered good asset quality in his study of 116 countries in developing hence ownership structure has an effect on asset quality with foreign banks registering health asset quality. From the findings the paper recommends that commercial banks in Zimbabwe need to strengthen their institutional framework so that the non-performing loans are reduced. Also, there is need to increase foreign ownership of banks as they lead to improved asset quality. In conclusion, there is need for intergration of policies in the banking industries so as to minimize the occurrence of non-performing loans thus improving the asset quality of the banking industry in general.

**References**


