

MIDLANDS STATE UNIVERSITY



FACULTY OF COMMERCE DEPARTMENT OF ACCOUNTING

RESEACH TOPIC:

**THE EFFECTS OF NON-PERFORMING LOANS ON THE FINANCIAL
PERFOMANCE OF BANKS: A CASE OF POSB 2012-2014.**

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**THIS DISSERTATION IS SUBMITTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS OF BACHELOR OF COMMERCE IN ACCOUNTING HONOURS
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DEDICATION

I dedicate this dissertation to my late mother Teclah, to my Dad, my brother Enos. To my grandmother Juliana who brought me up and taught me the value of hard work, persistence and love, it is to her that I owe my very existence. To my aunties Ceresencia, Josephine, Pelagia and Alpha. Special mention goes to my best friend Tawedzegwa Richard for the love and steadfast support throughout the whole study. Above all to the God of my father Ezekiel Handinawangu Guti.

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ABSTRACT

The study's intention was to investigate how non-performing loans were affecting the operational performance of POSB. The problem under study was the effects of NPLs on the financial performance for POSB. It revealed that, the upward trend in non-performing loans in most banks is a cause for concern since it has resulted in recent bank failures. The objectives were the causes of NPLs at POSB, the effects of NPLs on the financial performance, the relationship between NPLS and performance measures, the effect of credit risk management procedure on NPLs and measures to reduce NPLs. The concept of NPLs was examined by looking at the existing literature from previous scholars and authors who carried researches on NPLs. A descriptive case study research design was used and data was gathered through the use of structured questionnaires and interviews. From the findings, non performing loans have effect on the profitability, interest income and liquidity of POSB and a system of strong controls can help ensure and improve the operational performance and creation of credit reference bureau can reduce non-performing loans. The bank should implement a policy of pledging assets for collateral as well as use of third party credit guarantor on dealing with these default loans.

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CHAPTER 1: INTRODUCTION

1.0 Background of the study

Richard (2011) cited that well functioning banks accelerate economic growth, while poorly functioning banks are an obstacle to economic progress and intensify poverty. Loans form a greater portion of the total assets in banks, these assets generate huge interest income for banks which to a large extent determines the financial performance of banks. Havrilesky and Boorman (2002) outlined that interest on loans contributes significantly to interest income of banks. People's Own Savings Bank's (POSB) income is made up of 85% contributions from interest income (POSB Loan Book 2014). Saunders and Cornett (2011) go on to say that traditionally 85 percent of banks' income is contributed by interest on loans. However, some of these loans usually fall into non-performing status and adversely affect the performance of banks (Bindra 2010). POSB is one of the Zimbabwean banks facing a challenge of growing non-performing loans (NPLs) from 2012 to 2014. Upal (2009) cited that lending is not an easy task for banks because it creates a big problem called non-performing loans or bad loans

Non-performing loans have been growing in the Zimbabwean banking industry. According to the mid-term monetary policy of 2014 non-performing loans had risen to 18.5% by June 2014 from 15.49% in 2013 and 12.2% in 2012. The growth of NPLs in Zimbabwe has exceeded the international benchmark of 5% and is now a threat to financial stability and growth of the economy. Banks in Zimbabwe have been adversely affected by increase in non-performing loans leading to closure of banks such as Interfin bank, Royal bank and Genesis bank in 2012.(Mid-term MPS 2012) . Due to the growth of non-performing loans, POSB has been facing liquidity and cash flow problems as more than 85% of its income is locked up in non-performing loans

According to POSB loan book of 2014, the non-performing loans have been growing from 2012 to 2014. This is shown in Table 1.1 below.

Table 1.1 POSB Trend for Non-Performing Loans (2012-2014)

Year	2012	2013	2014
Total Loans	\$ 2 134 250	\$3 780 954	\$ 4 987 000
Non-Performing loans	\$ 72 565	\$ 219 295	\$ 393 873
Non-performing loans ratio	3.4%	5.8%	7.9%

(Source: POSB loan book 2012,2013,2014)

Table 1.1 above shows an increase in the total value of loans from \$2 134 250 in 2012 to 4 987 000 in 2014. The total value for non-performing loans has also increased from \$72 565 in 2012 to \$393 873 in 2014. Non-performing loans ratio increased by 4.5% from 3.4% in 2012 to 7.9% by December 2014. The ratio of non-performing loans was 5.8% in 2013 and 7.9% in 2014, these ratios exceeded the international benchmark of 5% stipulated by the Basel Committee on Banking Supervision and these ratios are now a threat to financial stability and growth of POSB according to BASEL 1(2004).

POSB's profit levels have declined from 2012 to 2014 because of increased costs on provision for credit losses arising from non-performing loans (POSB Story book 2014). Hasan and Wall (2004) pointed out that high rates of non-performing loans are associated with high rates of provision for credit losses. According to Saba et al (2012) increase in non-performing loans is the main reason for reduction in the earnings of a bank. Table 1.2 below shows the effects of NPLs on the income and profitability of POSB from 2012 to 2014.

Table 1.2 POSB Interest income and profit (2012-2014)

Year	2012	2013	2014
Interest income	\$ 6 127 000	\$ 5 100 000	\$ 4 400 000
Profit	\$ 2 470 000	\$ (209 000)	\$ (340 288)

(Source: POSB financial statements 2012-2014)

POSB's profits have declined by 160% from 2012 to 2014 as shown in table 1.2 above. The decrease in profitability was due to the decrease in interest income which was caused by increase in non-performing loans. According to POSB's unaudited financial statements of 2014, 85% of POSB's income is interest income contributed by interest on loans; therefore a decrease in interest income leads to a significant decrease in profitability. A 35% decrease in interest income led to 160% decrease in profitability as shown in Table 1.2 above. Saunders and Cornett (2011) outlined that 85 percent of the banks' income is contributed by interest on loans and usually a decrease in interest income which is caused by a rise in non-performing loans may lead to decrease in the bank's profit and in most cases results in losses.

Diawan and Rodrick (2002) suggested that growing NPLs increases the uncertainty regarding the capital position of banks and therefore limit their access to financing; this in turn increases the bank's lending rates and thus contributes to lower credit growth. POSB's access to financing from RBZ and CBZ has been limited by 65% from June 2012, this was because the bank was failing to pay back the money due to its inability to collect its loans which are becoming bad loans (POSB Story Book 2013). Due to cash flow challenges the bank is now selling 49% of its shareholding in order to raise cash to finance its operations which is now a threat to the bank's growth as this can lead to a takeover. According to POSB News Bulletin of 2014, 85% of the bank's income is locked up in NPLs and this reduced the bank's cash flow. Due to reduction in cash flow the bank reduced its maximum daily cash withdrawal for individuals from \$7500 to \$5000 with effect from May 2012 to December 2014 and this led to a 13% increase in the number of dormant and closed accounts as well as a 35% decrease in the bank's total market share.

Fofack (2005) argues that if non-performing loans are left unsolved they can compound into financial crisis. According to McNulty et al (2012) it is very crucial to reduce non-performing loans for the individual performance of a bank and the economy's financial environment.

Therefore the essence of this research is to find factors behind non-performing loans, effects of non-performing loans on POSB and measures put in place to reduce and solve the problem of non-performing loans.

1.2 Statement of the problem

The sustainability of banks depends largely on their ability to collect their loans as efficiently and effectively as possible. Non-performing loans have been growing at POSB since 2012. As a result of NPLs POSB is facing high provisioning costs for credit losses, limited access to financing, lower credit growth, liquidity and cash flow challenges, decrease in profitability and market share, which is now a cause of concern due to their consequences on the performance of the bank and the economy as a whole, hence the research into the factors behind non-performing loans, effects of NPLs on POSB and measures to reduce them.

1.3 Main Research Question

What effects does non-performing loans have on the financial performance of banks?

1.4 Main Objectives

- i. Finding the causes of non-performing loans in Zimbabwean banks.
- ii. Examining the effect of credit risk management procedure on NPLs.
- iii. Evaluating the effects of non-performing loans on the financial operations of banks.
- iv. Examining the relationship between non-performing loans and financial performance of banks.
- v. To establish effective measures to reduce the problem of non-performing loans in banks.

1.5 Sub-research questions

- i. What are the causes of non-performing loans in Zimbabwean banks?

- ii. What are the effects of credit risk management procedure of non-performing loans?
- iii. What effects does non-performing loans have on the financial operations of banks?
- iv. What is the relationship between non-performing loans and financial operations of banks?
- v. What measures can be put in place to effectively address the problem of non-performing loans in banks?

1.6 Significance of the study

- i. To the Student

This research was carried out in partial fulfilment of the requirements of Bachelor of Commerce in Accounting Honours Degree with Midlands State University. The research also helped the writer in developing research skills.

- ii. To the University

The findings of this research can be used as a source of reference by other students who wish to carry out research on NPLs.

- iii. To the organisation

The findings and recommendations of this research will help POSB to adopt effective measures to reduce the problem of increasing NPLs.

1.7 Assumptions

- i. The prevailing economic conditions remained constant during the time of study.
- ii. Respondents have sufficient knowledge of NPLs and are going to be honest and give relevant information.

- iii. The researcher assumed that data from respondents was sufficient to work out findings and conclusions and that the sample data was a true representation.

1.8 Delimitations

The research was only limited to POSB and it covers a time period of three years from January 2012 to December 2014. This research focuses on the effects of NPLs on the financial operations of banks, and the information used in this research is based on data obtained from POSB Chiredzi. The researcher's respondent's category will include bank managers, loans officers, credit analysts and recoveries officers.

1.9 Limitations

- i. Company Policies

It took more than expected time to get some data since company protocol, policies and procedures had to be followed in order to access the relevant data. Due to confidentiality management could not disclose some of the information which they considered confidential to their organisation. However to overcome this constraint the researcher used some of the published data and told the respondent that the data they provide was only to be used for academic purposes.

1.10 Definition of key terms

- i. Bank

Is an institution that acts as a financial intermediary by matching supply and demand of funds (Beck et al 2011).

- ii. Non-performing loans Are loans that are ninety days or more delinquent in payment of interest and or principal (Brexley and Nenninger 2012).

iii. Dormant account

A savings account with a negative balance and have shown no activity for more than six months (POSB Product Manual 2013).

1.11 Abbreviations

POSB	People's Own Savings Bank
NPLs	Non-Performing Loans
MPS	Monetary Policy Statement
RBZ	Reserve Bank of Zimbabwe
CBZ	Commercial Bank of Zimbabwe

1.12 Summary

The areas discussed in this chapter give an insight to the research study. The chapter outlines the aspects that guide the concept of the research study. In addition the chapter gives a brief background of the effects of non-performing loans on the financial performance of banks in Zimbabwe.

CHAPTER 2: LITERATURE REVIEW

2.0 Introduction

According to Murumba (2013) literature review serves to identify several ways to obtain an understanding and getting an insight of gaps in the previous researches and a basis for future researches. Therefore in this chapter the researcher examined what other scholars have established pertaining to non-performing loans and coming through existing literature relevant to the problem study to be undertaken.

2.1 Causes of non-performing loans in banks

According to Farhan et al (2012) NPLs are caused by several variables which are separated into two parts. Warue (2012) as supported by Vatansever and Hepsen (2013) agree that the first part of variables are called bank specific variables which includes bank size, types of ownership, absence of credit bureau and lending rates. Messai and Jouini (2013) go on to say that the second part of the variables is referred to as macro economic variables which consist of inflation, GDP growth and unemployment.

2.1.1 Bank size

According to Messai and Jouini (2013) there is an inverse relationship between the size of a bank and non-performing loans. They agreed that large banks are more diversified therefore have reduced NPLs rate than small banks. Hu et al (2010) confirms that there is a negative relationship between bank size and non-performing loans. Therefore large banks are said to have low rates of NPLs whereas small banks will have high rates of NPLs than those of large banks. Their view is supported by the findings of the research done by Negera (2012) who pointed that growth in the size of a bank leads to reduced NPLs.

Negera (2012) established income benefits and reduced NPLs resulting from the growth of a bank, therefore large banks have low NPLs ratio than small banks. POSB is one of the largest banks in Zimbabwe but it still faced high rates of NPLs above the minimum threshold of 5% from 2012 to 2014 (POSB Loan Book 2014). Therefore it is in the essence of this research to find more evidence if large banks are really associated with benefits of reduced NPLs. Furthermore Vogiazas and Nikoladiou (2012) found that there is a negative relationship between bank size and NPLs in their research on the Romanian Banking industry. Warue (2012) outlines that large banks and small banks have different clients, different technologies and have different effects on competition therefore different rates of non-performing loans as well, with small banks having high NPLs than large banks.

However, an opposing view from other scholars focused on the amount of loan concentration in banks, and concludes that banks with great amount of loans have high risk of non-performing loan ratio (Guy 2011). Vazquez et al (2012) goes on to say that large banks have significant exposure to high risk credit and they tend to suffer significant increase in NPLs due to deterioration in their credit quality. Large banks practise risk lending by increasing the amount of loans to poor quality clients who may fail to repay thereby causing NPLs (Louzis et al 2011, Stern and Feldman 2012). On the other hand, Bellas et al (2014) examined banks' performance across different size of banks and conclude that there is a positive relationship between bank size and level of NPLs. POSB is one of the oldest and largest banks in Zimbabwe with a total of 460 000 customers by December 2014 and have the highest rate of NPLS which is above the minimum threshold of 5 % since January 2012 (POSB loan book 2014). Due to its wider customer base the bank is increasing its leverage and extending its loans to low quality borrowers as a way of obtaining the customer certification policy which was introduced in 2012.

The low quality borrowers are failing to repay their loans thereby creating NPLs at POSB. This situation gives practical evidence of what was outlined by different scholars who agreed that there is a positive relationship between banks size and NPLs (POSB loan book 2014).

2.1.2 Type of ownership

Louzis et al (2011) found that distributed ownership of company resources results in high NPLs which may lead to a poor performance of the firm as the motivation of shareholders to supervise management is weakened. Tanaskovic and Jandric (2014) as supported by Klein (2013) find a link between types of ownership and NPLs. They argued that state owned banks have poor monitoring and control of loans due to little resources allocated to them by the government to monitor lending risks which leads to high loan default and NPLs, thereby supporting the view of Louzis. POSB is one of the Zimbabwean state owned banks and according to the Annual Financial Statements (AFS 2012-2014) only \$20 000 was allocated to the bank to monitor lending risk and this amount was supposed to be shared among the 32 branches of the bank. These resources were not sufficient to monitor credit risk which led to high loan default during the period 2012-2014, thereby giving support to the Jandric view.

Shehzad et al. (2010) carried a research from a panel of 500 banks and found practical evidence that ownership type has a positive impact on the non performing loans ratio. They go on to say that dispersed ownership has an adverse impact on the loan portfolio of banks. Novaes and Werlang (2012) carried a research in Brazil and Argentina and concluded that government owned banks record low profits because of high amount of non-performing loans attributed to the government. Their findings are in line with the situation at POSB during the period 2012 to 2014 when the banks was state owned it recorded the highest levels of NPLs. The bank is now going the privatisation route by selling 49% of its shareholding so as to reduce the problems of NPLs associated with state ownership (POSB News Bulletin 2014).

The prevailing situation at POSB in 2012-2014 also supports the conclusions made by Micco et al (2013) who examined 50 000 financial institutions with different ownership in 119 countries. They concluded that state owned banks have the highest rate of NPLs.

A different perspective asserts that dispersed ownership does not have an effect on firm's performance. Azofra and Santamaria (2011) on their research on banks in Spain found out that dispersed ownership results in high efficiency, increased profitability and reduced NPLs. According to Marco and Fernandez (2012) private owned banks have high levels of NPLs than government owned banks. Negera (2012) ascertained that government owned banks have the lowest rates of NPLs because ownership has no significant influence on the rate of NPLs. POSB is a state owned bank but it has the highest level of NPLs therefore more evidence need to be gathered in this research to find if ownership has no influence on NPLS. Louzis et al (2011) carried out a practical research to examine these different views and loan quality was used as the risk indicator but evidence is inconclusive.

2.1.3 Lending rates

According to Nkusu (2011) one of the major causes of NPLs or bad loans is lending rates. There is positive correlation between the interest rate and non-performing loans (Adebola et al 2011, Louzis et al 2011; Espinonza and Prasad 2010). An increase in interest rate weakens loan payment capacity of the borrower therefore non-performing loans and bad loans are positively correlated with the interest rates (Nkusu, 2011). As far as interest rate policy is concerned it plays very important role in NPLs growth rate in a bank. In support of this Jabukit and Reininger (2013) outlined that high lending rates increase the borrower's debt burden leading to high NPLs. POSB increased its interest rate by 3% during the period 2012 to 2014 and this increased the debt burden on many clients who failed to repay their loans leading NPLs.

According to Beck et al (2010) as supported by Adebola et al (2011) there is a positive relationship between interest rates and NPLs. Bloem and Gorter (2010) studied causes and management of NPLs, according to them high interest rates cause NPLs.

Moreover, Asari et al (2011) also found significant relationship between NPLs and interest rates. According to Darsh and Kabra (2010) banks which charges high lending rates to their clients have the greatest rate of non-performing loans. Bofondi and Ropele (2011) also found that lending rates are the major element boosting non-performing loans. Increased lending rates accelerate credit losses which will result in increased NPLs. This is further supported by the research of Bunic and Melecky (2012). According to the POSB loan book (2014) the lending rate increased to 15% from 2012 to 2013, this increase in lending rates was also followed by a 3.4% and 5.8% increase in NPLS in 2012 and 2013 respectively. The lending rate was further increased to 18% with effect from January 2014 which resulted in an increase in NPLs to 7.9% by December 2014. Therefore this scenario proves what was said by previous researches that lending rates are positively associated with NPLs.

However Kofi (2012) has different perspective and explains that lending rates are not a cause since they are relevant to clients who paid the principal and failed to pay the interest only. If a client is in arrears of the principal amount and interest it cannot be concluded that increase in interest rates causes NPLs (Kofi 2012). This view is supported by Gremi (2013) who found a negative relationship between interest rates and NPLs explaining that interest rates have little impact on NPLs. Muriithi (2013) studied commercial banks in Kenya and found that interest rates and NPLs have a negative relationship. Vatansever and Hepsen (2013) as supported by Messai and Jouini (2013) concluded that interest rates have no effects on the rate of non-performing loans in banks.

2.1.4 Absence of credit bureau

According to Bankers Association of Zimbabwe (BAZ 2012) a credit bureau gives consolidated record of all the borrowers in each and every bank in the country and other micro finance lenders. Absence of Credit Bureau has caused an increase in NPLs as lenders find it difficult to access information about the creditability of the borrowers (Auronen 2010). The theory of asymmetric information tells us that it may be difficult to distinguish good from bad borrowers which may result into adverse selection resulting in non-performing loan problems (Richard 2011). Due to the absence of a credit reference bureau in Zimbabwe POSB had difficulties in finding credit information for loan applicants. As a result during the period 2012-2014 was issuing loans to bad clients who had other loans from micro lenders. These borrowers failed to repay their loans because they were overburdened with debts. This increased the NPLs for POSB during that period. According to Winiski (2010), due to absence of credit bureau borrowing all over the show is becoming a common practise for most people. Adebola et al (2014) said the major cause for high rate of NPLs is lack of credit reference bureau leading to banks giving loans to over burdened clients who may fail to repay. Adverse selection has led to significant accumulation of non-performing loans in banks (Bofondi and Ropele 2011).

In the absence of a credit bureau, individuals are borrowing everywhere and failing to repay their loans. Furthermore in 2012 Banker's Association of Zimbabwe (BAZ) president said the country should establish a credit bureau to curb the growth of non-performing loans and avoid loan default in the banking sector. Negera (2012) noted that major cause of NPLs is the absence of credit reference bureau and argues that credit information is not freely available to lenders therefore increases the risk of loan default. Bordo and Haubrich (2010) assert that banks will experience high rates of NPLs in the absence of credit reference bureau.

They go on to say that without Credit Bureau, borrowers have a common practise of repaying loans only when they plan to maintain their lending relationship. Louizis et al (2014) concludes that the absence of a Credit Reference Bureau in a country plays a significant role towards the creation of NPLs in banks. In November 2014 the credit analyst at POSB discovered that during the period 2012 to 2014 55% of the bank's loan clients had more than two loan credits in other banks and finance lenders (POSB Loan Book 2014). These borrowers were borrowing all over the show and over burdened with debts which made them to fail to repay their loans which turns into NPLs status. The credit analysts outlined that due to the absence of a credit reference bureau in the country from 2012 to 2014, the bank had no reference of the borrowers and it end up giving loans to over burned clients which led to a 7.9% increase in NPLs by December 2014(POSB Loan Book 2014) This shows practical support evidence to the Louizis et al view.

2.1.5 Macro economic factors

Vazquez et al (2012) denotes that macro economic factors have a broad impact on the credit worthiness of banks. Bunic and Melecky (2012) conclude that macro economic factors are significant factors that influence banks' credit risk decisions. Messai and Jouini (2013) analysed non-performing loans for a panel of banks and found empirical evidence that macro economic factors have strong impact on NPLs. Adebola et al (2011) also found that problem loans are highly sensitive to changes in macro economic conditions. Hou et al (2012) as supported by Vatansever (2013) argue that macro economic factors are the most important factors in determining the causes of NPLs. Klein (2013) and Louizis et al (2011) conclude that of all the macro economic factors GDP growth, unemployment and inflation rate have significant impact on the creation NPLs.

2.1.5.1 Unemployment

According to Nkusu (2011), Messai and Jouini (2013) and Bellas et al (2014) there is a positive relationship between unemployment in the economy and non-performing loans. This is supported by the researches carried out by Vogiazas and Nikolaidou (2011), Vatansever and Hepsen (2013). The unemployment rate in Zimbabwe increased from an average of 7.6% in 2012 to 11% in 2014(ZIMSTAT DATA 2014).Due to the high rates of unemployment many people lost their jobs and among them were those with loans to POSB. These clients failed to repay their loans due to loss of source of income which led to high NPLs at POSB during the period 2012 to 2014. A further explanation of this relationship is given by Farhan et al (2012) as supported by Tanaskovic and Jandric (2014) who argue that an increase in the unemployment level in the country negatively affects the incomes of the individuals which increase their debt burden. Louzis et al (2011) studying banks in Greek as supported by Bofondi and Ropele (2011) studying Italian banks found that when borrowers lose their source of income they fail to repay their loans and these loans may turn into non-performing loans status, similarly an increased unemployment in the economy also negatively affects the demand of the products of firms which ultimately affects the sales of the firms, this ultimately leads to decline in revenues of the firms and results in non-performing loans.

Furthermore during the period 2012-2014 Hippo Valley Estates retrenched 7000 workers and 5000 of them were clients at POSB who had been given loans. The 5000 workers who lost their jobs also lost their source of income and their debt burden was worsened and they failed to repay their loans due to loss of income. This contributed to the increased rates of NPLs at POSB from 2012-2014. Thereby supporting the view outlined by (Nkusu 2011) that there is a positive relationship between unemployment rate and NPLs.

However, Klein (2012) has an opposing view from the research carried out in Europe and found that the relationship between unemployment and NPLs is insignificant. Geza (2012) goes on to say that there is no significant relationship between unemployment and NPLs in the Ethiopian commercial banks. Gremi (2013) studied banks in Albania and concluded that there is a negative relationship between unemployment and NPLs.

2.1.5.2 Inflation

There is a practical confirmation of positive relationship between the inflation in the economy and non-performing loans (Muriithi 2013, Bunic and Melecky 2011). Nkusu (2011) explained that this relationship can be positive or negative. Higher inflation can reduce the loan payment capacity of borrowers by reducing the real value of their income (Nkusu 2011). According to Zimstat data (2014) the inflation level in Zimbabwe rose from 8.2% in 2012 to 8.5% in 2014 this reduced the real income value for POSB clients and they failed to repay their loans causing high NPLs at POSB. Vogiazas and Nikolaidou (2011) investigated determinants of non-performing loans in the Romanian banking sector by taking the data from December 2001 to November 2010 and found that inflation rate influence the credit risk of the country's banking sector.

Farhan (2012) concludes that the relationship between inflation and non-performing loans can be positive or negative depending on the economy of operations. Louzis et al (2010), Dash and Kabra (2010) also agreed and concluded that inflation is one of the major determinants of NPLs. Fluctuations in the inflation rates in Zimbabwe during the period 2012 to 2014 are eroding the real income value for POSB clients thereby weakening their repayment capacity giving rise to NPLs for that period.

According to Klein (2013) increase in the inflation rate reduce the borrowers' real income when wages and salaries are fixed thereby reducing their ability to repay their outstanding debts leading to an increase in NPLs.

However, Djiogap and Ngomsi (2012) argue that inflation is insignificant in explaining the non-performing loans of banks. Their view was supported by Carlos (2012) who carried a research in Italy and Spain and concluded that the relationship between NPLs and inflation is insignificant. Gremi (2013) as supported by Jabukik and Reininger (2013) assert that increase in inflation leads to low NPLs in the sense that it reduces the real value of the debt which helps borrowers to repay. Otasevic (2013) goes on to say that inflation erodes real value of default amount thereby enhancing more payment which will lead to reduced NPLs. Tanaskovic and Jandric (2014) concluded that the relationship between inflation and NPLs is insignificant.

2.1.5.3 Growth in Domestic Product (GDP)

Louzis et al (2011) argues that there is negative relationship between growth in gross domestic product and non-performing loans. Messai and Jouini (2013) also found that there is a negative relationship between GDP growth and NPLs, therefore an increase in GDP results in lower rates of NPLs in the economy. This view is supported by Louzis et al (2011) and De Bock and Demynates (2012) who agree that growth in GDP increase the income which enhances the loan payment capacity of the borrower which contributes to lower NPLs. POSB faced high NPLs from 2012 to 2013 this was due to decrease in GDP growth in Zimbabwe from 4.4% in 2012 to 3.2% in 2014 (MPS 2014). Tanaskovic and Jandric (2014) concluded that increase in gross domestic product has a strong relationship with the volume of non-performing loans in the banking sector.

According to Jabukik and Reininger (2013) GDP growth is the key driver of non-performing loans, the relationship between NPLs and GDP growth is negative. Decrease in GDP growth from 2012 to 2014 decreases the income for individuals and client firms of POSB who failed to repay their loans thereby increasing the rate of NPLs for POSB for that period. Lata (2014) based on a study on Guyana shows that GDP growth is inversely related to non-performing loans, suggesting that an improvement in the real economy translates into lower non-performing loans.

Gremi (2013) also found a negative relationship between NPLs and GDP and concludes that low GDP growth reduces the level of income and as a result borrowers will have difficulties in paying their loans. This view is supported by Espinonza and Prasad (2010) who also found this relationship to be negative. In the Monetary Policy Statement (MPS) of (2014) the governor of the Reserve Bank of Zimbabwe (RBZ) outlined that the growth in GDP has been slowing down since 2012. Due to low GDP growth the level of income for individuals has been reduced and they are facing difficulties in repaying their loans resulting in NPLs. This can be further supported by the case at POSB, since 2012 when the country started to experience low GDP growth the level of NPLs at POSB have been increasing by a total of 7.9% from 2012 to 2014. This gives practical evidence in support of the view that there is a negative relationship between GDP growth and NPLs.

An opposing view is that of Murumba (2013) who carried out a research on the determinants of NPLs in the Nigerian Banking sector and found out that high GDP growth rate results in a significant increase in NPLs. This view is supported by Fainstein and Nikivov (2011) who argue that there is a positive relationship between GDP growth and NPLs.

Vogiazas and Nikoladiu (2011) as supported by Beck et al (2013) and Bellas et al (2014) also found a positive relationship which implies that growth in GDP increases NPLs. Djioap and Ngomsi (2012) who found that the relationship between GDP and NPLs is insignificant. Their view is supported by Vatansever and Hepsen (2013) who concluded that there is no significant effect between GDP growth and NPLs.

2.2 The effects of non-performing loans on financial performance

Non-performing loans have different effects on the financial performance of the individual banks and the economy as a whole.

2.2.1 Interest income

The large percentage of banks' total assets is made up of loans which generate huge interest income for banks which is a major source of income for banks, which to a large extent determines the financial performance of banks (Jameel 2014). Kofi (2012) outlined that interest on loans is the leading source of income for banks and the overall effect of NPLs on interest income is negative since NPLs eventually cause reduction in the total income of a bank. Saunders and Cornett (2011) go on to say that traditionally 85 percent of banks' income is contributed by interest on loans. However, some of these loans usually fall into non-performing status and adversely affect the performance of banks by reducing their interest income (Bindra 2010).

According to Tanaskovic and Jandric (2013) as supported by Vukovic and Damazet(2013) NPLs has led to reduced interest income for banks and other financial institutions due to increased provisioning for credit losses .

Vukovic and Damazet (2013) goes on to say that high NPLs lead to decrease in credit activity by banks as they will be trying to mitigate the risk of NPLs thereby reducing income from loans. Due to an increase in NPLs from 3.4% in 2012, 5.8% in 2013 and 7.9 % by December 2014 there was a 35% decrease in POSB's interest income from 2012 to 2014. The situation at POSB gives a positive confirmation of what was outlined by European Banking Coordination Initiative (EBCI 2012) that increase in NPLs by 5% or more will lead to decrease in credit supply by 2 % or more which will turn decrease the banks' interest income by more than 2%.

2.2.2 Profitability

Most of the banking literature agrees that a bank's profitability is expected to increase as its portfolio of loans grows in relation to other more secure assets. Bunic and Melecky (2012) found a negative effect between NPLs and the financial performance of banks. According to their research NPLs have a negative effect on the profitability of banks. POSB's profits were reduced due to rise in NPLs during the period 2012 to 2014 this confirms the negative relationship between NPLs and profitability of banks. According to Tanaskovic and Jandric (2014) as supported by the findings of Kofi (2012) increase in NPLs leads to decrease in profitability for both savings and commercial banks. Espinonza and Prasad (2010), De Bock and Demynates (2012) and Klein (2013) are of the view that there is a strong inverse effect between NPLs and banks profitability and financial position thereby giving support evidence to the Bunic and Melecky view. This relation exists because an increase in the unsure assets which do not generate income require banks increase the amount of money set aside for provisions to cover expected credit losses, thus profitability will be lower (Molyneux et al 2011).

Moreso, Jameel (2014) and Negera (2012) agree that NPLs impairs the profits of banks. They go on to say that the evolution of the impairment losses on loans and receivables explains a large part of the profitability of banks. Moreover, higher loan quality typically implies more resources devoted to credit underwriting and loan monitoring, thus increasing bank costs and reducing profitability (Jandric 2014). Non-performing loans are increasing due to lack of risk management which reduces the profitability of banks (Lata 2014). In 2012 to 2014 the profit of POSB decreased by 160%, this was due to increased expenses resulting from high rates of provisioning for credit losses caused by increase in NPLs (POSB AFS 2014). This supports what was outlined by Tanaskovic and Jandric (2014) that high rates of NPLs are associated with high rates of provisioning for credit losses.

However, there are other studies that show a direct relationship between profitability and NPLs and among them Brownless and Engle (2011), Reinhart and Rogoff (2010). Regardless of the high operating costs of holding a large portfolio of loans, bank profitability should increase with a higher ratio of loans to assets as long as interest rates on loans are liberalized and the bank applies mark up pricing. Furthermore, if the economy is stable and lending rates are in line with the risk associated as per requirements of the new banking regulation (Basel III), riskier loans should produce higher interest income with a positive impact on profitability (Asari et al 2010). Fan and Shaffer (2013) concludes that although non-performing loans are negatively related to banks' profit efficiency, it is not statistically significant.

2.2.3 Loanable funds

Non-performing loans have a negative effect on banks' lending ability (Espinonza and Prasad 2010). Vukovic and Damazet (2013) argue that the lending capacity of a bank is adversely affected by rise in NPLs.

They go on to say that NPLs can be mitigated by reducing credit activity therefore by reducing the credit activity as a measure to curb NPLs banks will reduce their lending capacity which results in a significant decrease in the loanable funds. According to POSB loan book (2014) the bank reduced its total loans to clients from 2012 to 2014 this was because many of them were falling into non-performing status. According to Dash and Karba (2010) high loan default leads to lazy banking which decreases the bank's loanable funds. The governor of the Reserve Bank of Zimbabwe pointed out that high rate of NPLs depletes the banks' lending ability due to delays and failure to repay the loans by the borrowers (Mid-term MPS 2013).

Tanaskovic and Jandric (2014) argues that rises in NPLs increases the insecurity of bank capitalisation which reduces the banks' access to finance leading to higher risk on bank's lending. POSB's access to finance from RBZ and CBZ has been limited by 65% from June 2012, this was because the bank was failing to pay back the money due to failure to collect its loans which turned into NPLs (POSB Story Book 2014). Due to the bank's limited access to finance working capital was reduced thereby reducing the amount of money available for lending. This confirms the assertion made by the European Banking Coordination Initiative (EBCI 2012) that a 5% increase in NPLs reduces the loanable funds of bank by more than 2%. According to Kofi (2012) the lending capability of a bank depends on three variables namely deposits, recoveries and disbursement, therefore if a bank give loans and fails to collect the principal and interest its capacity to issue new loans will be reduced. Lata (2014) goes on to say that NPLs above the minimum threshold reduces the bank's lending ability. This view is supported by Tracey (2011) who argues that high NPLs reduce the banks' lending behaviour which will in turn restrain economic activity.

2.2.4 Financial Economic environment's instability

According to Lata (2014) the immediate consequence of high NPLs in the banking system is bank failure as well as economic slowdown. Vatansever and Hepsen (2013) go on to say that non-performing loans are related to bank failure and financial status of a country and if unsolved they can compound into financial crisis causing economic instability. Kofi (2012) in his research on the effects on NPLs in banks in Ghana found empirical evidence that many banks in Ghana collapsed due to NPLs and this led to financial stagnation of the whole economy. Messai and Jouini (2013) provide empirical evidence that NPLs are contributes to the factors that cause economic instability. Their view is supported by Reinhart and Rogoff (2010) who agree that NPLs play a critical role in financial crisis and can be used to mark the beginning of financial crisis. Mancka (2012) carried out a research on a large panel of banks in Albania and also found that non performing loans affect the banking industry's business cycle and the financial stability of the economy as a whole. Furthermore, high NPLs reduce the banks' lending performance and hold back the economic activity (Tracey 2011). The non-performing loans do not only affect the economic growth but also leads towards financial crises (Guy 2011).

According to Jameel (2014) the economy of a nation cannot grow without a strong financial sector, therefore failure of the financial sector due to NPLs will lead to financial crisis. This view is supported by Nkusu (2011) who asserts that rapid growth in NPLs weakens economic performance. Abedi et al (2011) concluded if one bank fails, the effects can be spread to other banks in the industry through the contagious effect thereby affecting the whole banking industry and the economy as a whole. They go on to say that their research found that the US financial crisis started with high level of NPLs in Fannie More and Freddie Mac banks and rapidly spread from Wall Street to the rest of the US economy and the word over.

The increasing rate of NPLs at POSB from 2012-2014 is also contributing to the slowdown in growth of the Zimbabwean economy which is causing economic instability and if left unsolved it can grow into a financial disaster.

2.3 Examining the relationship between NPLs and financial performance of banks.

The relationship between non-performing loans and financial performances of banks can either be positive or negative depending on type of economy in which the bank is operating in. Different views from different scholars are cited in this research.

2.3.0 Relationship between NPLs and Profitability

According to Azeem and Amara (2014) NPLs have a negative impact on profitability. To examine the relationship between non-performing loans and profitability three performance measures namely Return on Assets (ROA) and Return on Equity (ROE) can be used. According to Rasiah (2010) bank performance can be assessed by considering the return on assets (ROA) and return on equity (ROE) of that particular bank.

2.3.1 Non-performing loans and ROA

According to Kaur and Singh (2011) many researchers have presented ROA as an appropriate measure of bank profitability. Among them are Messai and Jouni (2013) who argued that bank profitability is best measured by ROA and that there is a negative relationship between NPLs and ROA. Return on assets (ROA) is the ratio of net income after taxes divided by total assets. ROA signifies efficiency of management, it shows how efficient and effective managers of banks are in transferring assets to earnings. According to POSB AFS (2014) the bank recorded negative ROA during the period 2012-2014 this was due to high NPLs thereby showing that the relationship between NPLs and ROA is negative.

Azeem and Amara (2014) outlined that there is a negative relationship between NPLs and Return on assets. And the higher ratio indicates the higher performance of the banks. Haneef et al (2012) concluded that there is a negative relationship between return on assets and NPLs. This view is supported by Ogboi and Unuafe (2013), Beck et al (2011) and Fan and Shaffer (2013) who agree that there is a strong correlation between NPLs and ROA.

2.3.2 Non performing loans and ROE

According to Molyneux et al (2011) ROE measures return on equity of the shareholders of a bank. ROE is calculated by dividing net income after taxes by total equity capital which involves surplus, capital reserves, common and preferred stock and undivided profits. An indication of the earnings of a bank is given by this measure (Rasiah 2010). According to the results of the research carried out by Azeem and Amara (2014) as supported by Messai and Jouini (2013) the relationship between non-performing loans and return on equity is negative. This implies that high NPLs results in lower ROE which in turn results in reduced profitability. According to the AFS (2014) for POSB from 2012-2014 as the bank's level of NPLs increased to 7.9% the bank also recorded a reduced ROE by 20% from 2012- 2014. This confirms that NPLs have a negative impact on the ROE which also cause decrease in profits of the bank. Fanstein and Nikivov (2011) also concluded that there is an inverse relationship between ROE and NPLs which also indicates a negative relationship between NPLs and profitability, their view is supported by the research of Kaur and Singh (2011). The ROE ratio for POSB was negative during the period 2012-2014 when the bank recorded the high rates of NPLs.

However, an opposing view is from Vatansever and Hepsen (2013) in their research found that there is a positive relationship between NPLs and ROE.

Their study shows that high rates of NPLs increase the ROE ratio of banks. Bellas et al (2014) as supported by Geza (2010) also concluded that this relationship is positive.

2.3.3 NPLs and Asset Quality

According to Guy (2011) the quantum of non-performing loans measures the asset quality for banks and there is direct relationship between the two. This implies that high NPLs reflect deterioration in value of assets whilst low NPLs indicate high value of assets. POSB recorded total NPLs of \$72 565 in 2012 which rose to \$219 295 in 2013 and \$393 873. As the NPLs increased by a total value of \$321 308 during this period the statement of financial position (SFP 2014) for POSB also recorded a 33% decrease in assets. This shows that as the quantum for NPLs was increasing the asset value for POSB was deteriorating, thereby supporting the view that NPLs have a negative impact on the asset quality for POSB. Negera (2012) also supports this assertion and outlined that main assets of the banks are loans therefore increase in NPLs lead to deterioration in the asset quality. Kofi (2012) as supported by Otasevic (2013) also found that NPLs have a negative impact on the asset quality of banks.

Therefore, according to Jameel (2014) the development of impairment losses on loans and receivables explains a large part of the profitability for banks. Among the studies that show a direct relationship between NPLs and asset quality are Jabukik and Reininger (2013), Bordo and Haubrich (2010). Moreover, De Bock and Demynates (2012) carried out a research to establish factors behind asset quality deterioration and they found that NPLs are the key drivers. High rate of non-performing loans gives a result of a higher ratio and the higher the ratio the poorer the asset quality. Therefore high NPLs devalue the asset quality (Molyneux et al 2011).

The findings of the afore mentioned authors are in line with the situation at POSB during the period 2012-2014 which confirms that the bank's asset quality has also been declining due to high levels of NPLs.

However, if the financial system is well remunerated that is if prices are set in accordance with the risk incurred to the extent recommended in the new banking regulation (Basel II and, more recently Basel III), riskier loans should produce higher interest income with a positive impact on profitability and asset quality. This view is supported by Shehzad et al (2010) who conclude that riskier loans produce high interest loans and improves the asset quality. Beck et al (2013) assert that decrease in asset quality leads to increase in exports value which subsequently improves financial performance and reduces NPLs.

2.3.4 NPLS and Liquidity

According to Kofi (2012) the liquidity position of banks can be undermined by NPLs. Jameel (2014) argues that NPLs reduce the bank's asset quality as well as solvency of a bank. According to the (AFS 2012-2014) for POSB more than 85% of the bank's income comes from interest on loans. Due to the increase in NPLs for the bank during the period 2012-2014 more than 85% of the bank's income is locked up in NPLs thereby reducing the bank's income which in turn reduces its working capital and liquidity. According to Tanaskovic and Jandric (2014) NPLs reduce the liquidity level of banks this view is supported by Brownless and Engle (2011). As the NPLs for POSB were increasing the bank's cash flow decreased by more than 50% due to increased bad debts from 2012 to 2014. Due to decrease in cash flow the bank's liquidity levels decreased which lead to the reduction in maximum withdrawal per day for individuals from \$7500 to \$5000 with effect from May 2012 to December 2014. This shows that NPLs have a negative effect on the liquidity levels of POSB.

Vukovic and Damazet (2013) go on to say that NPLs reduces the ability of banks to create new loans thereby reducing their credit flow as well as their liquidity as supported by Bordo and Haubrich (2010). De Bock and Demynates (2012) confirmed a trade-off relationship between the NPLs and bank liquidity. NPLs lead to insolvency of banks which also reduces their liquidity (Leaven and Valencia 2012).

According to Ozkan (2011) such negative relationship between NPLs and liquidity emanates from the potential conflicts between shareholders and bondholders. The greater the NPLs the lesser the liquid assets of a bank. This is because due to high NPLs more than 85% of the bank's income will be locked in NPLs which will lead to liquidity challenges of the bank. The AFS (2012-2014) for POSB also shows that more than 85% of the bank's income is locked up in NPLs which are unprofitable assets thereby reducing the banks liquidity. Muriithi (2013) concluded that if NPLs are not controlled the income of banks will be tied up in unprofitable resources which reduce the working capital and efficiency of banks which will have an overall adverse impact on the liquidity of the banks.

Nevertheless, NPLs can generate a positive effect in some cases high liquidity eases the availability of debt. When banks have higher non-performing loans in the portfolio, they may be more concerned about the risky, and hence have lower tendency to increase loans (Bellás et al 2014). According to Nkusu (2011) non-performing loans lessen the motivation to boost loans when banks have non-performing loan rate above the threshold level, they will reduce their loans so as to avoid default risk thereby increasing their liquidity levels.

2.4 Evaluating the effects of credit risk management procedures on NPLs

Banks should establish credit risk management procedures to controls their credit operations as it is the most critical risk activity which have the greatest influence on NPLs and if carried out properly it reduces the level of NPLs in banks (Negera 2012).

According to Saba et al (2012) the success of issuing out loans rely on the technique used to assess and to grant the credit hence the credit decision should be based on a cautious evaluation of the customer. Vukovic and Damazet (2013) explained that banks' need to carry out proper credit risk procedure because if not carried properly it causes the rapid spread of NPLs. The risk management procedure runs from client appraisal, credit terms, credit risk control, collection policy and economic cycles.

2.4.1 Client appraisal

According to Abedi (2010) banks evaluates their clients to see if they can be potential borrowers using a model known as the 5Cs model of credit. Moti et al (2012) asserts that the 5Cs model help banks to increase loan performance as they get to know their customers better. In a bid to increase the loan performance as well as reducing NPLs at POSB, the management introduced the 5Cs model. Before issuing a loan the loans officers do an evaluation for the borrowers known as know your customer (KYC) where they will be assessing the ability of the borrower to repay. The POSB management were of the view that if the client appraisal process is carried out properly the rate of NPLs will be reduced. These 5Cs are character, capacity, collateral, capital and condition. Client appraisal is an instrument that allows for weighing of ethics for different characteristics of a borrower and scores obtained by the client are used to estimate credit worthiness (Kolapo et al 2012). Hou et al (2010) as supported by Murumba (2013) and Negera (2012) assert that proper client appraisal has a positive effect on reducing NPLs. Jackson (2011) carried a research in Kenya and found that client appraisal has strong impact on NPLs.

2.4.2 Credit Terms

Credit terms refer to the terms and conditions applied by a bank when issuing loans to its clients (Mancka 2012). The length of credit repayment and the rate of interest will be explained in detail in the credit terms. POSB introduced this policy in December 2013, where the terms and conditions of each loan agreement are presented on paper. The borrower is expected to sign as a way of agreeing to the terms and conditions. This is being done to reduce the level of NPLs as the borrowers will be bound with this agreement and failure to repay will result in legal actions being taken against the borrower. Therefore it may reduce the level of NPLs for POSB since borrowers know that failure to repay results in legal actions. If this procedure is carried out properly it can result in reduction in the level of NPLs for POSB. This is supported by Murumba (2013) who argues that the adverse effects of NPLs can be minimised if this procedure is carried properly. Some scholars have also found that proper credit terms reduce NPLs and among them are Stern and Feldman (2012), Kithinji 2010, and Kargi (2011). Debts are classified into different categories and each debt category has its own rate of interest. The rate of interest charged is the cost of a loan and the loan performance depends on its rate of interest (Abedi et al 2012).

However, Bellas et al (2013) as supported by Guy (2011) have contrasting views and they argued that even if proper credit terms are set the effect on the reduction of NPLs will be very insignificant to a bank. Bofondi and Ropele (2011) go on to say that there is no significant relationship between credit terms and NPLs. Otasevic (2013), Beck et al (2011) and Winiski (2010) concluded that they found empirical evidence that credit terms have no significant effect on the reduction of NPLs for banks.

2.4.3 Credit Risk Control

Fredrick (2010) demonstrated that credit risk control is a risk procedure that has strong impact on reducing the level of NPLs in banks. As a way of implementing what was found by Fredrick, POSB introduced the credit risk control procedure in December 2013. Poudel (2012) goes on to say that credit risk control is a crucial procedure in reducing the risk of banks making losses arising from clients who fail to meet the agreements of their loan contracts such an event is called a default. Many clients for POSB has been failing to repay their loans since 2012 and this led to increase in NPLs, therefore the management introduced this procedure as a way of reducing loan default. According to POSB story bulletin (2014) the credit analysts for POSB pointed out that they were making follow up to ensure that this procedure is followed properly and they said they were certain that if it is carried properly the NPL rate will be reduced by 60% by December 2018. Their view is in line with the findings of Tracey (2011) as supported by Bindra (2010) who outlined that banks usually loose both the principal and interest payment which will result in high NPLs and they suggested that proper credit risk control procedure reduces the level of NPLs in banks. These loan losses may result in reduced working capital for banks. Default risk can be mitigated by carrying the credit risk control procedure properly (Unaefe and Orgboi 2013) as supported by Musyoki and Kabuko (2011).

2.4.4 Collection Policy

According to Asari et al (2011) banks should devise strategies which aim at reducing NPLs through proper credit management. One of the major strategies is a collection policy which is required to ensure that all borrowers pay their loans in time. POSB introduced the collection policy in 2013 where the loans officers will make follow ups to the clients a week before the due date of interest and principal payment so as to ensure that all clients pay in time.

Warue (2012) asserts that some borrowers delay to pay their loans whilst some of them do not pay at all and become bad debts. For those who fail to repay in time the loans officers for POSB will make follow ups in physical and also through phone calls so as to avoid default and reduce NPLs for the bank. Kariuku (2010) asserts that the collection policy is a strategy aimed at speeding up payments from those who delay and reducing credit losses from the non payers.

Kargi (2011) goes on to say that some borrowers fail to pay their loans in time therefore banks should create effective collection procedures and follow them properly so as to reduce the NPLs. Darsh and Karba as supported by Azeem and Amara (2014) postulated that banks should effectively carry the collection policy procedure so as to reduce the high rates of NPLs. Gremi (2012) concluded that if collection policy procedure is carried out properly it will have a positive effect on the reduction of NPLs for banks. POSB's management has to effectively carry this process to reduce NPLS.

2.4.5 Economic Cycles

Economic cycles refer to extensive fluctuations in economic activity over a certain period of time. (Moti et al 2012). According to Unuafe and Ogboi (2013) the fluctuations take place in the long run and normally occur between periods of speedy economic growth and periods of recession. The choice of banks to give loans or not depends on the economic cycles(Negera 2012, Murumba 2013 and Gremi 2013) To reduce the high level of NPLs for POSB, management has implemented this procedure where the loans officers are supposed to study the business cycle for corporate clients before issuing loans. Their choice to issue loans relies on the results of this assessment.

If their assessment shows that there is likely to be a recession on the business cycle of a client they will not issue a loan so as to avoid loan default. Their practise is in line with the findings of Kolapo et al (2012) who concluded that management should study the economic cycle before making choices whether to issue or not issue loans so as to reduce NPLs.

According to Fredrick (2010) as supported by Guy (2011) and Kofi (2012) credit risk management procedure if carried out efficiently and effectively it reduces the non-performing loans of banks. Therefore if the management for POSB continue to practise this procedure and carry it out properly the rate of NPLs for POSB might be reduced to the reasonably acceptable level of below 5% as stipulated by BASEL 111. Musyoki and Kadubo (2011) go on to say that credit risk procedures should be done properly so as to reduce NPLs. This is further supported by Abedi et al (2010) who concluded that proper credit risk procedure is essential for every bank as a control measure to reduce NPLs.

However Unuefe and Ogboi (2013) concluded that credit risk procedure has positive effects on reducing the rate of NPLs but the effects are of doubtful degree and contradictory direction. Kithinji (2010) as supported by the research of Epure and Lafuente (2012) also found that credit risk procedure does not impact positively on the reduction of NPLs. Their view is supported by Boahene et al (2012).

2.5 Measures to reduce NPLs

According to McNulty it is very crucial to reduce non-performing loans for the individual performance of a bank and the whole economy. Banking sector can avoid their non-performing loans by adopting methods suggested by the central bank of that country (Haneef et al 2012).

Banks should control and amend their credit advancement policy with respect to mentioned variables to have lower non-performing loan ratio (Azeem and Amara 2012, Dash and Karba 2010). Richard (2011) concludes that it requires careful appraisal of loan requests and continuous monitoring of customers conditions to overcome the problem of bad debts.

Bindra (2010) pointed out that non-performing loans can be reduced through professional management of the lending department, this requires careful appraisal of loan requests, and continuous monitoring of customer conditions and proper follow up on how the loan has been utilized as there is a possibility that some loans may be utilized for different purposes other than the original motive behind borrowing. Espinonza and Prasad (2010) were of the view that banks should waive part of the interest or suspend interest payment so as to encourage the borrower to pay their debts.

Negera (2012) asserts that loan management is the best way to reduce NPLs, this measure has the benefits of improving the performance of the bank and the whole economy. Kofi (2012) suggest that banks should develop their own measures to reduce non-performing loans, these include the pledging of collateral, use of a third party credit guarantor as well as the use of collection agencies. Banks should avoid giving loans to risky customers, monitor loan repayments and renegotiate loans when customers get into trouble. Tracey (2011) is of the view that proper and adequate appraisal is key element in controlling or minimising non-performing loans.

Unuafe and Ogboi (2013) are of the view that to reduce NPLs credit information bureau should be established so as for banks to gather credit information that exists by tracing the financial record of individuals over a period of time. They go on to say banks should appraise and give awards to personnel involved in the credit department based on their performance.

POSB has been giving awards to the Loans officer with the least number of default loans at the end of each financial year (POSB Story Bulletin 2014). According to the POSB Bulletin (2014) the award for the best loans officer for (2013) was given to Loans Officer of POSB Chiredzi branch in form of a three day holiday to Victoria Falls.

2.6 Summary

In this chapter the researcher examined the concept of non-performing loans. Factors which affects as well as those affected by NPLs were also analysed through citing and referring to the work of previous authors and scholars who carried researches on the effects of non-performing loan on the financial performance of banks.

CHAPTER 3: RESEARCH METHODOLOGY

3.0 Introduction

In this chapter the researcher outlined and explained how the research was going to be carried out, the process and techniques used to collect data, the research design, research tools, target population, sample size and sampling techniques used. The researcher also explained the types of data used in this study and their sources, data analysis and data presentation as well as the research instruments were also highlighted in this chapter.

3.1 Research Design

Saunders and Cornett (2011) describe a research design as a plan in which a research is going to be carried out. The key principle of a research design is to collect significant data which answers the research questions in certain constraints. Yin (2011) explained a research design as the planning of procedures to collect and analyse data in a way that is most relevant to research procedure. The research design helped the researcher to distinguish the population under study into rational magnitude. The research design comprised a set of plan to carry out the different procedures required for the completion of the research and to ensure that selected procedures were sufficient to attain valid and relevant information to answer the research question. The researcher used a case study and descriptive research design in this research.

3.1.2 Descriptive Research Design

Saunders and Cornett (2011) defined descriptive research as a research mainly aimed at producing a true illustration of a person, event or situation. The researcher used a descriptive research design and made use of questionnaires and personal interviews as data collection instruments.

The researcher used the descriptive research design to investigate how non-performing loans are affecting the financial performance of POSB. Furthermore, descriptive research design was used by the researcher because it helps to provide a true and relevant presentation of factors that pertain to the research problem and is also regularly used for quantitative research designs for giving some valuable pointers as to what variables are worth testing quantitatively. According to Jones (2010) descriptive research design allows the researcher to use both qualitative and quantitative data in order to gather concerning a problem that is being researched on.

3.1.3 Case Study

According to Hill (2010) a case study is a research approach, a practical investigation that examines an event within its true life circumstance. It relates to the intensity of a study of certain circumstance rather than a broad statistical analysis and is used to narrow down a broad field of research into one easily researchable study (Jones 2010). When the researcher aims at supporting an argument with a detailed analysis of a certain project it is best to use a case study approach. Moreover, David (2010) goes on to say that the case study approach is not limited it can use both qualitative and quantitative data and it provides an in-depth analysis of a specific problem. Case study was used because it allows a descriptive review of the design factors that impact on non-performing loans and their effects on the financial operations of POSB during the period 2012 to 2014. According to Luck and Rubin (2010), a case study approach gives more information to the researcher as well as an insight of the circumstances on the ground.

They go on to say that a case study approach is cost effective and saves time because it focuses on a particular case rather than to gather data from the whole market while studying every part of the research population especially where there are common factors affecting the whole industry. A case of POSB from 2012 to 2014 was used in this research.

3.1.4 Research gap

Messai and Jouini (2013) Dash and Kabra (2010); Espinoza and Prasad (2010); Louzis et al (2010) , Vatanserver and Hepsen (2013); Bindra (2010); Adebola et al(2011); Nkusu, (2011) used the descriptive research design method of panel data analysis using qualitative methods. Their researches were too broad as they looked at the whole banking industry therefore they could not give recommend to specific banks as their findings could not apply to those banks Negera (2012) used the descriptive research design and case study and established that NPLs have a link with levels of performance of specific banks. However, no current research has been carried on the effects of non-performing loans on financial performance of banks using the descriptive research design and case study approach. Therefore in this study the researcher will use descriptive case study research design to identify the effects of non-performing loans on the financial operations of POSB from 2012 to 2014 so as to contribute to the already scarce research on this area as well as to pay way for future researchers who want to study in this area.

3.2 Population, Sampling and Sample Size

3.2.1 Target Population

According to Luck and Rubin (2010) population is a combination of well defined people from a group in which the researcher is carrying out a study on or a combination of items with similar characteristics. The target population of this study is 15 individuals which consist of loans officers, credit analysts, recovery officers, managers and tellers of POSB which is the case under study.

3.2.2 Sampling technique and sample size

According to Kumar (2011) sampling is a process of taking a small group of individuals from a large group as basis for estimating the occurrence of an anonymous information, condition or result which relates to the bigger group. In this study the researcher used probability and non- probability sampling methods which enabled the researcher to use both statistical and own personal judgment of who to include in the sample in order to gather information pertaining to the effects of non-performing loans on operations of POSB. The researcher used stratified sampling to choose stratum from the sample.

The researcher first recognized the significant stratum and their actual representation in the population. To select the adequate number of respondents the researcher used random sampling method. Stratified random sampling enhanced the maximisation of resources since information was required from those respondents with relevant information on the effects of non-performing loans on the financial performance of POSB. Monoharan (2010) defines a sample as a segment of the total population which selected to represent the target population. Therefore a sample should be a true reflection and true representation of the total population.

The researcher used a sample size of 10 respondents consisting of loans officer, managers, recoveries officers, credit analysts and tellers.

Table 3.1 Population, sample and sample size

Respondent group	Target population	Sample size	% of population	Data collection method
Loans Officers	3	2	66.7 %	Questionnaire and interview
Credit Analysts	2	1	50 %	Questionnaire
Recoveries Officer	4	3	75 %	Questionnaire
Managers	1	1	100 %	Interview
Tellers	5	3	60 %	Questionnaire
Total	15	10	66.7 %	

3.2.3 Justification of the sample size

David (2010) as supported by Jones (2010) outlined that a large and adequate sample size should be more than 50% of the target population. Therefore in accordance with this assertion the researcher used a sample size of 66.7% of the target population. Kumar (2011) goes on to say that a reliable sample is the one which is more than 30% of the target population. This assertion was also supported by Borg and Gall (2012) who pointed that the best way of determining a sample is to use the greatest sample possible.

3.3 Data Sources

The researcher used two sources of data namely primary sources of data and secondary sources of data.

3.3.1 Primary data

According to Borg and Gall (2012) primary data refers to data gathered directly from the respondents. The researcher used questionnaires and interviews to gather data which relates to the effects of non-performing loans on the financial performance of POSB. Blosch et al (2010) explained that the accuracy of primary data is very high since data is relevant to the area of the study. It can include many people and wide area. Furthermore, primary data gives the researcher real a fact about the research area as it is current. Primary data is more reliable because it is collected by the concerned party.

3.3.2 Secondary data

According to Saunders and Cornett (2011) secondary data refers to the collection of data formerly gathered for another purpose. The researcher made use secondary includes newspapers, journals, POSB news and story bulletins and loan book as well as published financial statements of POSB. The secondary data helped the researcher to formulate objectives, the problem and best measures to reduce the effects of non-performing loans on the financial performance of POSB. Koziol and Arthur (2010) outlined that secondary data is mainly used before data collection and helps the researcher in explaining the research question.

3.4 Research Instruments

According to Yin (2011) research instruments are methods used to gather information concerning a particular research. The suitability of the instruments used will determines the validity and reliability of the research.

3.4.1 Questionnaires

According to Saunders and Cornett (2011) a questionnaire comprises of all methods used to collect data in which the respondents are supposed to reply to similar questions in a preset way. Questionnaires were sent to selected sample of POSB staff to complete under the supervision of the researcher or during their own time. The researcher delivered the questionnaires in person to the POSB staff and made use of closed questionnaires or structured questions in the process of collecting data. Kumar (2011) postulated that the possible answers are given in a questionnaire and the respondent ticks the category that best describes the respondent's answer in accord with the parameters given.

3.4.2 Interviews

Interviews were used as a technique to gather primary data for the research on the effects of non-performing loans on the financial performance of POSB. Questions were properly structured in order to obtain sufficient results for the research. Blosch et al (2011) outlined that interviews allows for explanation of compound questions to the interviewee. Interviews gives the room to ask open questions since the interviewees do have to put their views on paper and the interviewer can select non-verbal clues which shows what is significant to the respondents and how questions are being answered.

3.4.3 The Likert Scale

A likert scale is psychometric scale which was named after its discoverer Rensis Likert and is used often in studies that make use of questionnaire.

Basing on likert questionnaire items respondents show their degree of disagreement or agreement on a scale that ranges from strongly agree to disagree. The researcher structured the questionnaires using the likert scale in which the respondents will tick in the box which they think represents their view. Therefore, according to Hill (2010) the series reveals the strength of how the respondents feel for a specified item. Likert scale was used for this research because it is easier for respondents to understand and the rating scale used is shown in table 3.2 below.

Table 3.2 Likert Scale Rating

Strongly Agree	5
Agree	4
Uncertain	3
Strongly Disagree	2
Disagree	1

3.5 Data Presentation and Analysis

According to Blosch et al (2011) data presentation refers to the translation of into a significant form which is simple to interpret and understand. Tables, charts and graphs were used by the researcher to present quantitative data to ensure easier data interpretation on the effects of non-performing loans on the financial operations of POSB. Charts and graphs were mostly used since they provide a clear pattern of collected data to obtain meaningful conclusions. Data is analysed in order to make it clear to enhance easy understanding for the provision of answers to the research problems (Jones 2011).

3.6 Reliability and Validity

According to Best and Khan (2003) reliability means the extent to which autonomous scholars carrying out research on similar topics in the field may bring about the same findings. Hence reliability refers to the measure of consistence confirmed by the processes engaged in research resulting in relevant results. Interviews and questionnaires were adjusted and piloted before they were distributed to the POSB staff so as to guarantee their reliability. Validity refers to the value of data collected that is appropriate to a certain area of study. It is based on the principle that the research technique used helps the researcher to obtain the results and findings intended by the research. The researcher ensured the validity of collected data from POSB staff by analysing it and relate to the objectives of the study.

3.7 Summary

In this chapter the researcher explained how the research was going to be carried out and the data collection techniques were also discussed. Stratified random sampling technique was used to select the sample of respondents from POSB. Descriptive case study research design was used and both primary and secondary data sources were used in this research

CHAPTER 4: DATA PRESENTATION AND ANALYSIS

4.0 Introduction

This chapter focused on the discussion, presentation and analysis of data collected from POSB Chiredzi branch on the effects of NPLs on financial operations of POSB through the use of interviews and questionnaires. Data was presented and analysed through the use of graphs, charts and tables congruent with the research questions and objectives. However, in some cases data could not be presented statistical descriptive summaries were used.

4.1 Response Rate

Table 4.1 Questionnaire and Interviews response rate

	Distribution	Response	Response Rate
Questionnaire	10	9	90 %
Interviews	3	3	100 %

Source Primary data

4.1.1 Questionnaires

The researcher distributed 10 questionnaires to POSB staff at Chiredzi branch. From a total of 10 questionnaires distributed 9 were filled and returned thereby representing a 90% rate of response from the respondents. Only 1 questionnaire was not returned representing 10% failure to return the questionnaire was ascribed to limited time and many commitments on the part of the respondent. However the 90 % response rate reflects a fair representation of the views of POSB staff which is satisfactory to draw up conclusions from it.

4.2 Presentation and Analysis of Data from questionnaires

The researcher presented data in form of graphs, charts and tables. The presented data was analysed and explained through the use of descriptive summaries which are found below the presented data for each research question.

4.2.1 Question 1: What are the causes of NPLs at POSB?

Figure 4.1: Causes of NPLs at POSB

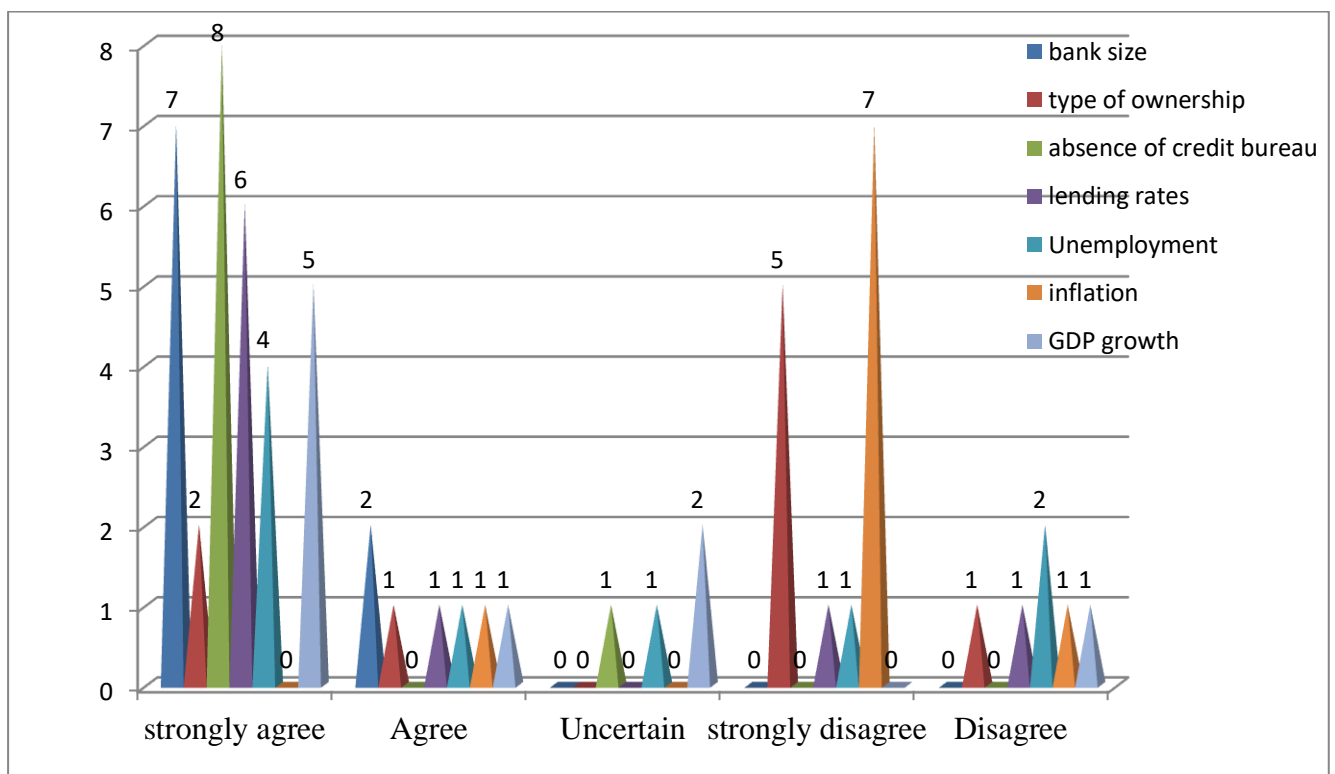


Figure 4.1 above shows the different causes of NPLs at POSB. The analysis and conclusions made from the presented statistics are explained below.

4.2.1.1 Bank Size

Figure 4.1 above shows that 78 % of the respondents that is 7 out of 9 respondents strongly agree that bank size is the main cause of NPLs at POSB whilst 2 respondents representing 22 % agree to this cause.

This is in line with the findings of made by Bellas et al (2014) that large banks are associated with high NPLs. None of the respondents were uncertain, strongly disagreed as well as disagreed. As a whole 100% of the respondents agreed that bank size causes NPLs whilst 0% of the respondents disagreed. The mode shows the agreement that bank size cause NPLs. The research findings confirms the agreement that bank size cause NPLs and agrees with the available literature from Vazquez et al (2012), Louizis et al (2011) and Stern and Fieldman (2012) who agreed that bank size cause NPLs.

4.2.1.2 Type of ownership

The graph above shows that 2 people representing 22% strongly agree that government owned banks have high NPLs whilst 1 person representing 11% also agree to this cause. Thereby giving support to Klein (2013) who argued that state owned banks have high rate of default. None of the respondents were uncertain of this cause and 5 people representing 56% strongly disagreed that government ownership is the cause of NPLs at POSB, whereas 1 person also disagreed with this cause. As a whole 3/9 (33%) of the respondents agreed whilst 6/9 (67%) disagreed. The mode showed the disagreement that type of ownership cause NPLs for POSB. The findings of the research confirm the disagreement that type of ownership causes NPLs. This agrees with the available literature from Negera (2012), Azofra and Santamaria (2011), Marco and Fernandez (2012) and Louizis et al (2011) who ascertained that government owned banks have the lowest rates of NPLs.

4.2.1.3 Lending rates

From a total of 9 respondents 6 of them representing 67% of the respondents strongly agreed that high lending rates causes NPLs at POSB and 1 respondent (11%) also agreed to this cause. Their response is in support of Louizis et al (2011) who agree that high lending rates cause NPLs in banks.

Furthermore, none of the respondents were uncertain of this cause whilst 1 respondent strongly disagreed to this cause and 1 respondent disagree that high interest rates causes NPLs at POSB. As a result a total of 78% of the respondents agree that high interest rates cause NPLs at POSB whilst 22% of the respondents disagreed to the cause. Therefore basis on these results the researcher concluded on the finding that high interest rates cause NPLs at POSB since the mode of the respondents agreed to this cause. The responses of the mode are also in line with the loan book of POSB (2014) which shows that the lending rate increased from 15% in 2012 to 18% in 2014 and as this rate was increased the rate of NPLs also increased to 7.9%. Therefore the findings of this research agree with the available literature from Adebola et al (2011) and Espinonza and Prasad (2010) who agree that lending rates causes NPLs in banks.

4.2.1.4 Absence of credit bureau

Figure 4.1 above shows that 8 out of 9 respondents representing 89% of the total respondents strongly agree that absence of credit reference bureau is a cause of NPLs at POSB and none of the respondents agree to this cause. This is supported by the findings of Unaefe and Ogboi (2013) who found out that absence of credit reference bureau causes NPLs. However 1 of the respondents was uncertain if absence of credit bureau is a cause of NPLs at POSB, whilst none of the respondents neither strongly disagreed nor disagreed to this cause. As a result a total 89% of the respondents strongly agreed that absence of credit reference bureau is a cause of NPLs at POSB whilst 11% was uncertain. Therefore, the mode showed the agreement that absence of credit reference bureau causes NPLs. The finding of the results confirmed that absence of credit reference bureau causes NPLs and agrees with available literature from scholars like Bofondi and Ropele (2011) who concluded that absence of credit reference bureau is one of the major causes of NPLs.

However the results also showed a new finding of those who neither disagreed nor agreed with the available literature. New findings confirmed that absence of credit bureau is neutral to NPLs.

4.2.1.5 GDP growth

5 respondents from a total of 9 representing 56% of the total respondents strongly agreed that decrease in GDP growth of the Zimbabwean economy causes NPLs at POSB. Moreover 1 more respondent also agreed to this cause. This supports the view of Louizis et al (2011) who pointed out that slow GDP growth triggers the growth of NPLs. However 2 respondents representing 22% were uncertain if slow GDP growth causes NPLs at POSB, neither of the respondents strongly disagreed nor disagreed to this cause. The above statistics show that 67% of the respondents agree that slow GDP growth in the Zimbabwean economy causes NPLs at POSB and none of the respondents disagreed to this cause. Therefore the research finding is that slow growth in GDP of the Zimbabwean economy causes NPLs at POSB. The findings are in line with the available literature which supports that slow GDP growth causes NPLs. (Jabukik and Reininger 2013, Tanaskovic and Jandric 2014)

4.2.1.6 Inflation

None of the respondents strongly agree that inflation causes NPLs at POSB whereas 1 respondent agree to this cause. Furthermore, none of the respondents were uncertain of this cause, whilst 7 respondents representing 78% of the total respondents strongly disagreed that inflation causes NPLs at POSB. 1 respondent also disagreed to this cause thereby giving a total of 89% of the respondents who disagree that inflation causes NPLs at POSB. This gives a practical confirmation to the argument of Djiogap and Ngomsisi (2012) that inflation is insignificant in explaining causes of NPLs in banks.

Based on this data the researcher draw up a conclusion that, though some respondents agreed that inflation causes NPLs at POSB their value is insignificant, therefore to a greater extent inflation is not a cause of NPLs at POSB as supported by the majority of the respondents.

4.2.1.7 Unemployment

The statistics presented in figure 4.1 show that 4 of 9 respondents strongly agree that unemployment cause NPLs at POSB whilst 1 respondent also agree to this cause. According to Nkusu (2011) there is a positive relationship between unemployment and NPLs which is in line of what was outlined by POSB respondents. However 11% of the respondent is uncertain if unemployment causes NPLs at POSB. Moreover, 1 respondent strongly disagree that unemployment cause NPLs at POSB whilst 2 respondents also disagree to this cause. As a result the researcher concluded that unemployment causes NPLs at POSB though this cause is not very significant.

4.2.2 Question 2: What effect does NPLs have on the financial operations of POSB?

4.2.2.1 Effects of NPLs on Interest income

Figure 4.2: Effects of NPLs on interest income

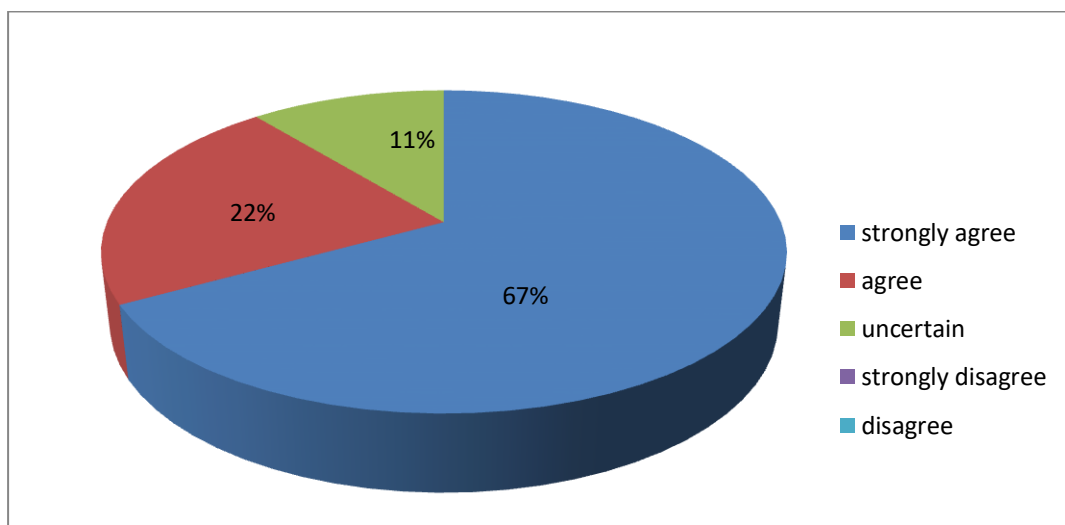


Figure 4.2 above shows that 67 % of the respondents strongly agreed that NPLs have a negative effect on interest income. Furthermore 22% of the respondents agree that NPLs reduces interest income of POSB. This is in line with the view of Tanaskovic and Jandric (2013) who argue that NPLs reduce interest income for banks. 11% were uncertain of this effect. In addition none of the respondents neither strongly disagreed nor disagreed that NPLs reduces interest income for POSB. Basing on this information a total of 89% of the respondents agreed that NPLs reduces interest income whilst 11% were uncertain. The mode shows the agreement that researcher reached a conclusion that NPLs reduces interest income of POSB. Therefore the finding is that NPLs have a very significant effect on the reduction of interest income for POSB. The findings are also in line with the AFS of POSB which shows a 35% decrease in interest income from 2012 to 2014 as NPLs were increasing.

4.2.2.2 Effects of NPLs on Profitability

Figure 4.3: Effects of NPLs on profitability

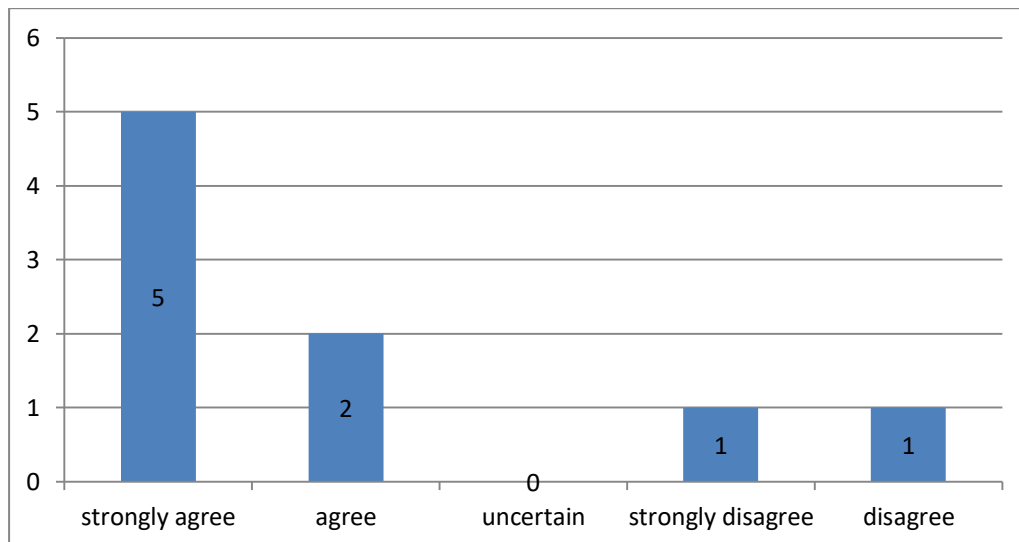
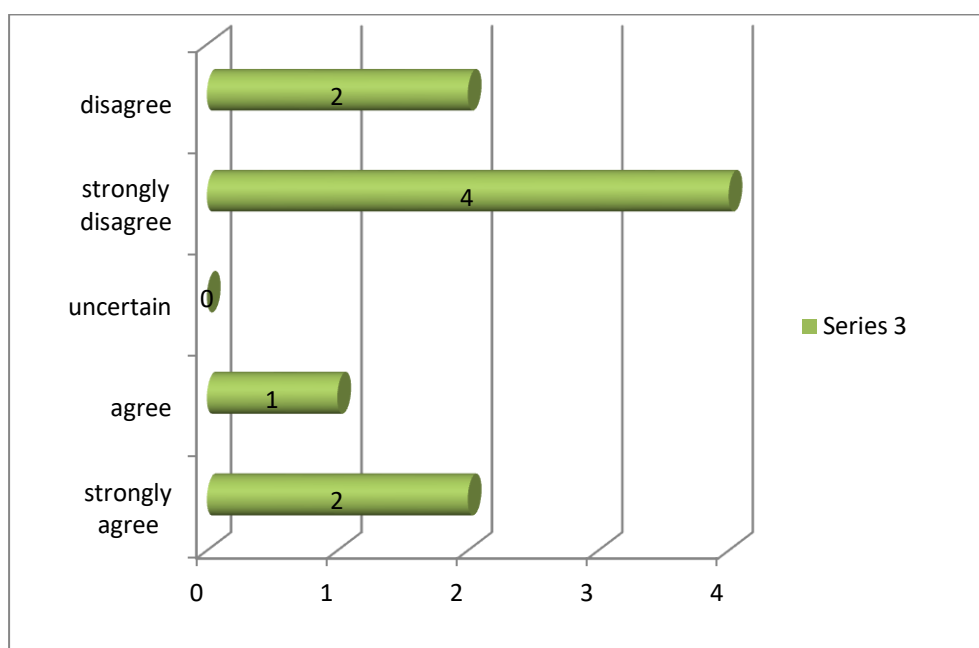


Figure 4.3 above shows responses from different respondents on whether NPLs had effects on the profitability of POSB.

In figure 4.3 above it is shown that 5/9 (56%) of the respondents strongly agreed that NPLs have a negative effect on the profitability of POSB whilst 2/9 (22%) of the respondents agreed to this. None of the respondents were uncertain whether NPLs. The graph depicts that 1/9 (11%) of the respondent strongly disagreed and 1/9 (11%) of the respondents disagreed that NPLs reduces the profitability of POSB. This gives empirical evidence to the findings of Kofi (2012) who argues that NPLs reduce profitability for banks. In total it can be noted that 78% of the respondents agreed that NPLs reduces the bank's profitability against 22% of the respondents who disagreed to this. The respondents who agreed to the cause confirms that NPLs have a negative effect on the profitability for POSB, this is in agreement with the available literature from Jameel (2014) and Negera (2012) who agree that NPLs impairs profits for banks. The AFS for POSB (2014) also shows that profits for POSB decreased by 160% from 2012 to 2014 due to increase in NPLs. The research finding is that NPLs reduces profits for POSB

4.2.2.3 Effects of NPLs on Loanable funds

Figure 4.4: Effects of NPLs on loanable funds



The figure above presents different views from respondents regarding the effects of NPLs on the loanable funds for POSB. 2/9(22%) of the respondents strongly agreed whilst 1/9 (11%) of the respondents agreed that NPLs reduces the loanable funds for POSB. Out of the 9 respondents none of them were uncertain if NPLs reduces the loanable funds for POSB or not. The number of the respondents who strongly disagreed that NPLs reduces loanable funds for POSB was 4 whilst 2 other respondents disagreed with the fact that NPLs reduce the loanable funds for POSB. The research finding confirmed that NPLs does not reduce the loanable funds for POSB. And this finding disagrees with available literature which supports that NPLs reduce loanable funds for banks. The finding also disagrees with the AFS of POSB which shows that the money available for lending at POSB decreased by 65% from 2012-2014. Therefore the finding here is a new finding.

4.2.2.4 Effects of NPLs on Economic stability

Table 4.2 Effects of NPLs on economic stability

Opinion	Number of Respondents	Percentage
Strongly agree	0	0 %
Agree	0	0 %
Uncertain	1	11 %
Strongly disagree	7	78 %
Disagree	1	11 %
Total	9	100 %

Table 4.2 above shows different responses from 9 respondents on the effects of NPLs of POSB on the economic stability of the country.

Out of 9 respondents none of them neither strongly agreed nor agreed to the fact that NPLs have a negative effect on the economic stability of the Zimbabwean economy. 1 respondent was uncertain if NPLs of POSB have negative effect on the economic stability of the country or not. A total of 7 respondents out of 9 strongly disagreed that NPLs have a negative effect on the economic stability and 1 other respondent also disagreed to this cause. This is with the findings of In conclusion it can be noted that NPLs does not have a negative effect on the economic stability since none of the respondents agreed to the fact that NPLs have a negative effect economic stability.

4.2.3 Question 3: What is the relationship between NPLs and the financial operations of POSB?

Figure 4.5 Negative relationship between NPLs and financial operations

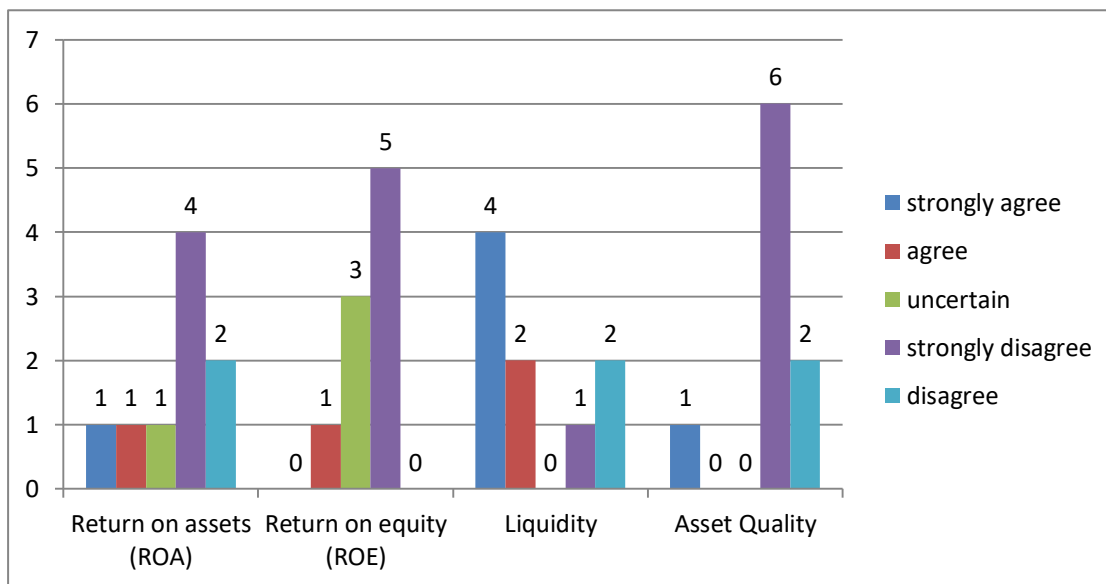


Figure 4.5 above depicts views from respondents on the relationship between NPLs and financial operations. These views are explained below

4.2.3.1 NPLs and ROA

In figure 4.5 above 1/9(11%) of the respondents strongly agreed that NPLs and ROA have a negative relationship whilst another 1/9(11%) of the respondent also agreed to this relationship. Their responses were in line with the view of Azeem and Amara (2014) who outlined that there is a negative relationship between NPLs and ROA. 1 respondent was uncertain if NPLs reduces the ROA of POSB or not. However, 4/9(44%) of the respondents strongly disagreed whilst other 2/9(22%) of the respondents disagreed with the fact that NPLs and ROA are negatively related. As a whole a total of 6/9(67%) of the respondents disagreed that NPLs reduces ROA for POSB. The finding of the research confirms a disagreement that NPLs reduces ROA. This finding disagrees with the available literature from Messai and Jouini (2013) as supported by Azeem and Amara (2014) who argues that NPLs reduces ROA. Based on these statistics the researcher made a conclusion that the relationship between NPLs and ROA at POSB is insignificant.

4.2.3.2 NPLs and ROE

None (0/9) of the respondents strongly agreed with the fact that NPLs of POSB have a negative effect towards the bank's ROE and 1/9 (11%) of the respondent agreed to that fact. 3/9 of respondents were uncertain if there is a negative relationship between NPLs and ROE of POSB. A total of 5/9(56%) of the respondents strongly disagreed with the fact that NPLs and ROE are negatively related while none of the respondents disagreed to that fact. As a whole the mode confirms the disagreement that NPLs does not have a negative effect on ROE, Conclusively the finding of the research confirms a disagreement that NPLs reduce ROE. The finding is in disagreement with the available literature which states that there is a negative relationship between NPLs and ROE (Rasiah 2010, Kaur and Singh 2011).

Therefore it can be pointed out that NPLs and ROE of POSB are not negatively related since majority of the respondents disagreed to it.

4.2.3.3 NPLs and Liquidity

As presented in figure 4.5 above 4 respondents out of 9 strongly agreed that NPLs and liquidity are negatively related. In addition 2 other respondents agreed that increase in NPLs lead to reduction in the liquidity level of POSB. According to Jameel (2014) NPLs reduces the solvency of a bank which is in line of the responses made by the respondents for POSB. None of the respondents were uncertain if this relationship existed or not. 1 respondent strongly disagreed that NPLs reduces the liquidity of POSB whilst 2 respondents also disagreed to this fact. From this information a conclusion can be drawn that NPLs and liquidity are negatively related as supported by 67 % of the respondents.

4.2.3.4 NPLs and Asset Quality

According to figure 4.5 above 1 respondent out of 9 strongly agreed that NPLs and Asset Quality of POSB are negatively related and none of the respondents agreed to this relationship. None of the respondents were uncertain if there was a negative relationship between NPLs and the quality of assets of POSB. 6 out of 9 respondents disagreed with the fact that NPLs and asset quality are negatively related while 2 respondents disagreed with this fact. According to the above statistics it can be concluded that the majority of the respondents disagreed with the fact that NPLs and asset quality of POSB are negatively related. Therefore there is no significant relationship between NPLs and Asset Quality of POSB.

Question 4: What are the effects of credit risk procedure on NPLs

Figure 4.6 Effects of credit risk management procedure on NPLs

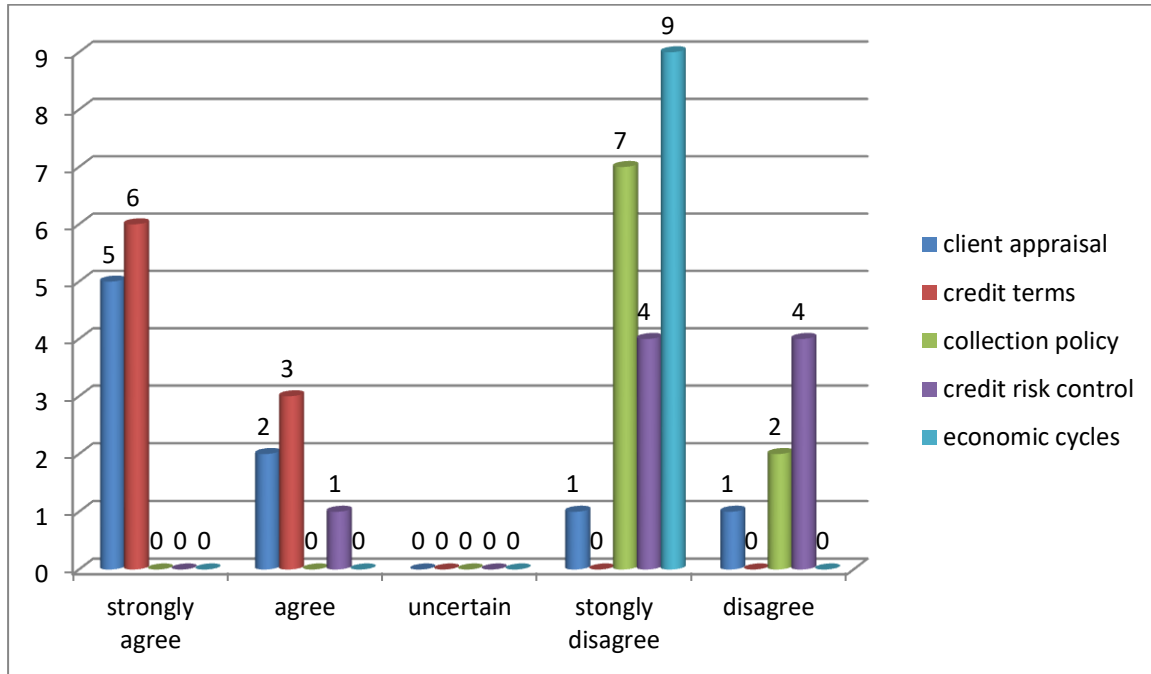


Figure 4.6 above depicts the responses from different respondents on the effects of credit risk procedure on NPLs. The responses are explained in detail below.

4.2.4.1 Client appraisal

The graph above depicts that out of the 9 respondents 5 strongly agreed that if client appraisal is carried out properly it reduces the level of NPLs at POSB and 2 other respondents also agreed to it. This gives support to the findings of Abedi (2010) who asserts that proper client appraisal reduces NPLs in banks. None of the respondents were uncertain if proper client appraisal procedure reduces the level of NPLs at POSB or not. Only 1 respondent out of 9 strongly disagreed with the fact that proper client appraisal reduces NPLs, whilst 1 other respondent disagreed with it.

The analysis of data in figure 4.6 brings a conclusion that proper client appraisal reduces the level of POSB's NPLs since the majority of the respondents agreed to this fact.

4.2.4.2 Credit terms

Basing on the data presented in figure 4.6 above it is shown that from a total of 9 respondents 6 of them strongly agreed that good credit terms have a positive effect towards reducing NPLs at POSB. 3 other respondents agreed that good credit terms reduce NPLs at POSB. However none of the respondents were uncertain if good credit terms reduces NPLs at POSB or not. Furthermore none of the respondents neither strongly disagreed nor disagreed to this cause. Analysis of these findings shows that all respondents agreed that good credit terms reduce NPLs at POSB. Therefore basing on these finding the researcher made a conclusion that good credit terms reduces the risk of high NPLs since none of the respondents disagreed with this fact.

4.2.4.3 Collection Policy

Findings from the respondents as presented in figure 4.6 above shows that out of 9 respondents none of them neither strongly agreed nor agreed with the fact that proper collection policy reduces NPLs at POSB. Out of the total respondents none of them were uncertain if proper collection policy reduces NPLs or not. Respondents who strongly disagreed that proper collection policy reduces NPLs for POSB were 7 and 2 other respondents also agreed to this. To sum it up, 9 out of 9 respondents disagreed with the fact that proper collection policy reduces NPLs at POSB. These finding made the researcher to conclude that proper collection policy does not reduce NPLs at POSB because none of the respondents agreed with it.

4.2.4.4 Credit risk control

As shown in figure 4.6 above none of the respondents strongly agreed with the fact that credit risk control reduces NPLs at POSB whereas 1 respondent agreed that credit risk control reduces NPLs at POSB. None of the respondents were uncertain whether credit risk control reduces NPLs or not. 4 respondents out of 9 strongly disagreed that credit control reduces NPLs at POSB whilst the other 4 respondents disagreed that credit risk control reduces NPLs at POSB. After analysing these findings the researcher found out that a total of 8 respondents disagreed with the view that credit risk control reduces NPLs for POSB. Due to these findings the researcher reached a conclusion that credit risk control does not reduce NPLs at POSB because this was what majority of the respondents showed.

4.2.2.5 Economic cycles

None of the respondents neither strongly agreed nor agreed that studying of the economic cycles reduces NPLs for POSB. There were no respondents who were uncertain whether study of the economic cycles reduces NPLs at POSB or not. According to the data presented in figure 4.6 all (9/9) respondents strongly disagreed with the view that studying of the economic cycles by the bank reduces NPLs at POSB and none of the respondents disagreed with that fact. This is in line with the findings of Kithinji (2010) and Epure and Lafuente (2012) who also disagreed that study of economic cycles reduces NPLs. The researcher concluded that studying of economic cycles does not reduce NPLs at POSB since all respondents disagreed.

Question 5: What measures can be put in place to reduce NPLs at POSB?

Respondents have their different responses on the measures that can be put in place to reduce NPLs at POSB. The findings from these different respondents are presented in table 4.2 below.

Table 4.3 Measures which can reduce NPLs at POSB

	Strongly agree	Agree	Uncertain	Strongly disagree	Disagree
Establishing credit reference bureau	9	0	0	0	0
Careful client appraisal	4	3	0	1	1
Continuous client monitoring	2	1	0	4	2
Waive part of interest/ defer interest payment	0	0	0	8	1

4.2.5.1 Establishing credit reference bureau

Table 4.3 above shows that out of 9 respondents all of them strongly agreed that establishment of a credit reference bureau will reduce the high level of NPLs for POSB. This is supported by what was postulated by Unaefe and Ogboi (2013) that establishment of a credit reference bureau will reduce the level of NPLs. None of the respondents were uncertain if establishment of a credit reference bureau will reduce NPLs at POSB or not. None of the respondents neither strongly disagreed nor disagreed to this fact.

Analysis of these findings shows that all the respondents agreed that establishment of a credit reference bureau will reduce NPLs for POSB. Basing on these findings the researcher made a conclusion that establishment of credit reference bureau in Zimbabwe will reduce the level of NPLs for POSB.

4.2.5.2 Careful and adequate client appraisal

The statistics presented in table 4.2 show that 4 out of 9 respondents strongly agreed with the fact that careful and adequate client appraisal can reduce the level of NPLs for POSB while 3 other respondents agreed to this fact. None of the respondents were uncertain whether careful client appraisal reduces NPLs or not. From a total of 9 respondents 1 of them strongly disagreed with the view that adequate client appraisal reduces NPLs for POSB and one other respondent also agreed to it. A total of 7 out of 9 respondents agreed that careful and adequate client appraisal reduces NPLs for POSB, whilst only 2 respondents disagreed to it. The value of respondents who disagreed is insignificant as compared to those who agreed therefore a conclusion was made that NPLs for POSB can be reduced by adequate client appraisal.

4.2.5.3 Continuous client monitoring

2 respondents strongly agreed continuous client monitoring can reduce the NPLs for POSB and 1 other respondent also agreed with this. This is in support of what was said by Bindra (2010) that continuous monitoring of clients may reduce NPLs. None of the respondents were uncertain whether this measure can reduce NPLs for POSB or not. Out of 9 respondents 4 of them strongly disagreed that POSB's NPLs can be reduced by continuous client monitoring, 2 other respondents from 9 disagreed that this measure can reduce NPLs for POSB.

The researcher found out that though 3 respondents agreed that NPLs for POSB can be reduced by continuous client monitoring, their value is insignificant as it is outweighed by the value of those who disagreed. Therefore NPLs for POSB cannot be reduced by continuous client monitoring.

4.2.5.4 Waive part of interest or defer its payment

Results from table 42 above show that none of the respondents neither strongly agreed nor agreed that waiving part of interest or deferring its payment can reduce the level of NPLs for POSB. Of all the 9 respondents none of them were uncertain if this measure can reduce NPLs for POSB. Respondents who strongly disagreed that this measure can reduce NPLs for POSB were 8 and 1 other respondent also disagreed. All in all, all the respondents disagreed with the fact that NPLs for POSB can be reduced by waiving part of the interest or deferring its payment. This made the researcher to draw conclusions that NPLs for POSB cannot be reduced with this measure.

4.3 INTERVIEWS ANALYSIS

Interviews were conducted with 2 loans officers and 1 branch manager and there was a 100% response rate as all of them were interviewed. The results from these interviews are explained below under each interview question.

4.3.1 Question 1: What are the causes of NPLs at POSB?

All the 3 respondents identified high lending rates as the major cause of NPLs at POSB. They were of the view that due to very high interest rates the amount of interest will be also high therefore many clients will fail to repay. Their opinion was in line of the findings of the research done by Bofondi and Ropele (2011) that increased lending rates increases bad debts which will lead to high levels of NPLs.

Respondent 1 and 3 went on to say that the rising rate of unemployment is also another factor contributing to NPLs. They pointed out that most of their bad debts resulted from failure to repay by borrowers due to loss of their sources of income as a result of retrenchment. Their view is related to what was found by Bellas et al (2014), Nkusu (2011) as well as Vatanserver and Hepsen (2013). Absence of credit reference bureau was also identified as a cause of NPLs for POSB by respondent 2 thereby giving support to the view of Richard (2011) who outlined that NPLs arises due to the absence of a credit reference bureau. Based on these findings it can be concluded that high lending rates have a very significant effect on causing NPLs.

Question 2: What effects does NPLs have on the financial operations of POSB?

The 3 respondents were of the view that NPLs are adversely affecting the profitability of POSB due to increased provisions for credit losses related to those NPLs. Their view is supported by the findings of Lata (2014) who postulated that NPLs reduces the profitability of banks. Respondent 2 and 3 also stressed on the point that NPLs reduces the income for POSB since most of the bank's income comes from interest on loans. This is in line with the view of Saunders and Cornett (2011) who argues that about 85% of the bank's income is contributed by interest on loans. All the 3 respondents also confirmed that NPLs are reducing the liquidity level for POSB since its income is locked up in non-performing loans. From their opinion a conclusion can be drawn up that NPLs reduces the profitability and liquidity for POSB because all the interviewees pointed it out. Furthermore it can be noted that NPLs have a significant effect on interest income since it was identified in 2 out of the 3 interviews that were conducted.

Question 3: What is the relationship between NPLs and financial operations of POSB?

Only one of the 3 interviewees said that there is a positive relationship between NPLs and ROA of POSB. The other 2 interviewees identified this relationship as a negative one. All the 3 people who were interviewed confirmed that there is a negative relationship between NPLs and liquidity levels for POSB. They further supported their point saying that the bank's working capital is tied up in NPLs and that is the main reason why the bank's liquidity is decreasing as NPLs are increasing. Therefore based on these findings the researcher concluded that there is a negative relationship between NPLs and liquidity level for POSB. It can also be concluded that there is a negative relationship between NPLs and ROA since majority of the interviewees for POSB confirmed that.

Question 4: What effects does the credit risk procedure have on NPLs?

The two loans officers who were interviewed by the researcher mentioned that if the procedures of credit risk management process are properly followed and executed, the level of NPLs can be reduced by a very significant amount. One of them further explained that this procedure is very crucial in reducing NPLs and every bank should implement it to reduce NPLs. Their responses support what was said by Moti et al (2012) that credit risk procedure may reduce NPLs if properly carried out. One of the interviewees was not sure whether of the effects that this procedure have on NPLs of POSB. In conclusion the researcher found out that credit risk procedure reduces NPLs for POSB in accordance with the information obtained from the interviews.

Question 5: What measures can be put in place to effectively address the problem of NPLs for POSB?

From the 3 interviews that the researcher conducted, all the respondents pointed out that creation of a credit reference bureau can reduce the problem of NPLs at POSB. They all attributed that NPLs are increasing at POSB because the bank does not have a credit record for everyone so they are giving loans to some clients who are overburdened with debt and will fail to repay. This is in line with the view of Unaefe and Ogboi (2013) who argues that establishment of a credit reference bureau may reduce the level of NPLs for banks as they will gather credit record of the applicants from the credit reference bureau. According to Bindra (2010) NPLs can be reduced by continuous monitoring of clients. Interviewee 1 was of the idea that continuous monitoring of clients after disbursement can also help reduce NPLs for POSB thereby giving support to Bindra's view.

4.4 Summary

In this chapter data was presented and analysed through the use of charts, graphs, table and descriptive summaries. The research findings under each objective were also stated. The researcher is of the view statistics given in this chapter are in line with the existing literature enclosed in chapter two which results in recommendations which are practical in curbing NPLs at POSB.

CHAPTER 5: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter summarised the whole research project. In this chapter the researcher outlined the summary of chapters, the major research findings and conclusions obtained from the data presented and analysed in the previous chapters. Basing on the findings of the research recommendations were given to POSB on the best measures to reduce NPLs and suggestion on the areas for further study were also given.

5.1 Summary of Chapters

Chapter one introduced the research problem which highlighted that POSB faced rising non-performing loans from 2012 to 2014. The trend for non-performing loans was increasing from 3.4% in 2012 to 7.9% by December 2014. The chapter also covered the main research question which is the effects on non-performing loans on financial operation of Zimbabwean banks: A case study of POSB from 2012 to 2014. The main research objectives which were to find the causes of NPLs at POSB, to examine the effect of credit risk management on NPLs, evaluating the effects of NPLs on the financial operations of POSB, to evaluate the relationship between NPLs and financial operations and to establish measures that can effectively address the problem of NPLs at POSB.

Chapter two outlined a review of the available literature from different authors and scholars who wrote on the effects of NPLs on the financial operations of banks. In this chapter the researcher examined what other scholars have established pertaining to NPLs to obtain an insight of gaps in the previous researches and a basis for future research. Some of the authors who were cited in this chapter include Messai and Jouini (2013), Louizis et al (2011), Nkusu (2011) and Saunders and Cornett (2011).

In chapter three the researcher looked at the research methodology which was used for data collection. The researcher used a descriptive research design and a case study for POSB focusing on the effects of NPLs on POSB. The researcher selected the sample from POSB staff which consisted of loans officers, credit analysts, recoveries officers, branch manager and tellers. 10 questionnaires were distributed and 3 interviews were conducted to obtain information from the selected sample. Secondary data was also used and these sources include scholarly journals, company bulletins, news papers and e-books.

Chapter four looked at the presentation and analysis of data obtained from the respondents through the use of questionnaires and interviews. A total of 10 questionnaires were distributed and 9 were returned giving a response rate of 90% and for interviews there was a 100% response rate since all interviews were successful. The research findings were presented under sub questions using graphs, pie charts and tables.

5.2 Major Research Findings

The findings of this research give empirical evidence that non-performing loans are one of the crucial and ever rising problems that POSB is facing. The main objective of the research was to establish the major effects of NPLs on the financial operations of POSB during the period 2012 to 2014. It was found that NPLs have a negative impact on the profitability and interest income of the bank. The research findings also showed that NPLs have an insignificant effect on the loanable funds of POSB as well as an insignificant effect on the stability of the economy of Zimbabwe as a whole.

Finding the causes of NPLs at POSB was one of the research objectives. It was noted that the major causes of NPLs at POSB include the size of the bank as well as very high lending rates applied by the bank. The absence of a credit reference bureau in Zimbabwe was also among the major causes of ever rising NPLs at POSB.

Other factors which were also noted to have been causing NPLs are slow GDP growth and the high rate of unemployment in Zimbabwe. However, high rates of inflation in the country and the type of the bank ownership were found to be of very insignificant effect towards NPLs of POSB.

The relationship between NPLs and performance measures of POSB was also established. According to the findings of this research there is a negative relationship between NPLs and liquidity of POSB. These findings are in line with what was discovered by Tanaskovic and Jandric (2014) that there is a negative relationship between NPLs and a bank's liquidity. The findings of the research also showed that NPLs do not reduce the ROA, ROE as well as the asset quality of POSB. Thereby, indicating that the relationship between NPLs and these three variables is positive.

Another objective of the study was to find if credit risk procedure which runs from client appraisal through credit terms, credit risk control, and collection policy to economic cycles can reduce the level of NPLs for POSB. It was discovered that proper client appraisal and favourable credit terms can reduce the NPLs of POSB. The findings also showed that studying economic cycles and monitoring of the collection policy will not reduce the bank's NPLs in any way. Proper credit risk control can reduce the level of NPLs but with a very insignificant amount.

An underlying objective of this research was to establish the effective measures to reduce the problem of NPLs at POSB. Establishment of a national credit reference bureau by the government of Zimbabwe was found to be one of the most effective methods of reducing NPLs for POSB. The credit reference bureau will be containing consolidated information of all borrowers in different banks and other finance lenders so that banks will refer to them on information concerning loan applicant so as to avoid giving loans to bad borrowers.

Careful client appraisal was also found to be one of the best measures to address the NPPLs at POSB to a reasonably accepted level of below 5% as stipulated by BASEL 11.

5.3 Conclusions

The findings of this research give a practical confirmation that the problem of ever rising rate of NPLs prevailed at POSB during the period 2012 to 2014. The findings of the research also confirmed that NPLs have a negative effect on the profitability and interest income of POSB as well as the liquidity level. This research was successful as the researcher was able to address the main research objectives as well as the main research question through the findings made and gave recommendations to POSB which was the unit of study in question.

5.4 Recommendations

After analysing the findings of this research as well as the conclusions made the researcher came up with some recommendations which may be of help in reducing the level of NPLs for POSB to the minimum threshold of not more than 5% as stipulated by BASEL 11. To reduce NPLs a credit reference bureau should be created. The findings of this study shows that due to absence of a credit reference bureau the banks was issuing loans to bad borrowers who are overburdened with debt. Therefore if a credit reference bureau is established the bank will refer to it and get credit record by tracing the financial record of individuals and as a result good borrowers who are able to repay are selected which will in turn reduce NPLs for POSB. This is supported by Unaefe and Ogboi (2013) who outlined that NPLs in banks can be reduced through the establishment of a credit reference bureau.

The bank should implement a policy whereby the clients have to pledge assets for collateral security which can be sold to recover the amount in cases where the clients fail to repay their loans.

The bank should also make use of a third part credit guarantor who may pay on behalf of the borrower should the borrower fail to do so. Collection agencies should also be used to make follow ups of all bad debts by way of debt factoring. Avoiding issuing of loans to overburdened clients should also be implemented by the bank. Kofi (2012) suggests that to reduce the level of NPLs banks should devise methods such as pledging of collateral, third party credit guarantee as well as use of collection agencies and avoiding risky clients.

The loans officers together with the whole credit department team members should ensure that there is careful client appraisal before issuing loans to clients to avoid giving loans to defaulters thereby minimising NPLs. Sheila (2011) says that proper client appraisal can reduce NPLs. The findings of this research showed that most respondents agreed that high lending rates are the major causes of high rates of NPLs. Therefore the bank should frequently review and revise its lending rates to make sure that they are not too high from those prevailing in the banking industry so as to reduce the level of NPLs. To support this Jabukit and Reininger (2013) outlined that high lending rates increase the default thereby causing NPLs in banks.

5.5 Suggested areas for further research

The researcher suggest that future researches should focus on the effectiveness of measures put in place by the banks to reduce non-performing loans as well as the role played by the central bank in reducing NPLs of the economy as a whole. This will help in contributing to the already scarce research in these suggested areas.

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APPENDIX A: QUESTIONNAIRE COVER LETTER



Midlands State University

P Bag 9055

GWERU

04 April 2015

To whom it may concern

REF: QUESTIONNAIRE TO SOLICIT FOR INFORMATION

My name is Rumbidzai R. Njaravani a final year student at the Midlands State University, doing a Bachelor of Commerce in Accounting Honours Degree.

In partial fulfilment of the programme we are required to carry out a research project. The title of my project is: **The effects of Non-Performing Loans on the financial performance of banks.**

All information obtained will be treated with strict privacy and confidentiality and will be used for academic purposes only. Anonymity shall be maintained at all levels. Please assist by answering the questions below. There is no wrong or correct answer.

Your positive response is greatly appreciated.

Yours faithfully

Rumbidzai .R Njaravani

Registration number R114025F



Company Stamp

APPENDIX B: QUESTIONNAIRE

Instructions

1. Do not write your name on the questionnaire.
2. Show your response by ticking in the respective box provided.

Questions

1. The following are the causes on non-performing loans at POSB

	Strongly Agree	Agree	Uncertain	Strongly Disagree	Disagree
Bank size					
Type of ownership					
Lending rates					
Absence of credit reference bureau					
Unemployment					
Inflation					
GDP growth					

2. The following performance measures are affected by non-performing loans at POSB

	Strongly Agree	Agree	Uncertain	Strongly Disagree	Disagree
Interest Income					
Profitability					
Loanable Funds					
Economic Instability					

3. The following performance measures are positively related to non-performing loans

	Strongly Agree	Agree	Uncertain	Strongly Disagree	Disagree
Return on Asset(ROA)					
Return on Equity(ROE)					
Liquidity					
Asset Quality					

4. The following credit risk management procedure have effects on non-performing loans

	Strongly Agree	Agree	Uncertain	Strongly Disagree	Disagree
Client appraisal					
Credit terms					
Credit Risk Control					
Collection Policy					
Economic Cycles					

5. The following are measures can reduce non-performing loans at POSB

	Strongly Agree	Agree	Uncertain	Strongly Disagree	Disagree
Establishing a Credit Reference Bureau by the government					
Careful and adequate appraisal of clients					
Continuous monitoring of the client					
Waive part of the interest or defer interest payment					

APPENDIX C: INTERVIEW GUIDE COVER LETTER



Midlands State University

P Bag 9055

GWERU

04 April 2015

To whom it may concern

REF: INTERVIEW TO SOLICIT FOR INFORMATION

My name is Rumbidzai R. Njaravani a final year student at the Midlands State University, doing a Bachelor of Commerce in Accounting Honours Degree.

In partial fulfilment of the programme we are required to carry out a research project. The title of my project is: **The effects of Non-Performing Loans on the financial performance of banks.**

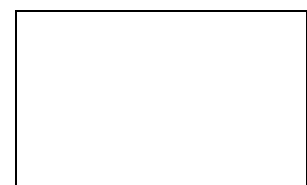
All information obtained will be treated with strict privacy and confidentiality and will be used for academic purposes only. Anonymity shall be maintained at all levels. Please assist by answering the questions below. There is no wrong or correct answer.

Your positive response is greatly appreciated.

Yours faithfully

Rumbidzai .R Njaravani

Registration number R114025F



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APPENDIX D

Research project interview guide

Interview questions

1. What are the causes of non-performing loans at POSB?
2. What effects does non-performing loans have on the financial performance of POSB?
3. What is the relationship between non-performing loans and the financial operations of POSB?
4. What are the effects of credit risk management procedure on non-performing loans?
5. What measures can be put in place to effectively address the problem of non-performing loans at POSB?

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