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Lending in Zimbabwe: Are Banks Using Enough Sources of Information to Make Lending Decisions?

Loverage Chakazamba[1] Norman Marime[2]
Munhumutapa School of Commerce, Great Zimbabwe University, P O Box 1235 , Masvingo, Zimbabwe

Abstract
The Central bank of Zimbabwe governor in his monetary policy statement of January, 2012 lamented that the deterioration in asset quality was of much concern to the monetary authorities. As a consequence of this statement this paper sought to investigate the adequacy of the sources of information used by Zimbabwean banks to make lending decisions. A qualitative research design was employed to enable the researcher to analyse the data using SPSS statistical packages. The data used in the study were collected from small to medium enterprises (SMEs), Commercial banks, and companies. The population sample of the study was 10 Commercial banks in Zimbabwe, 50 SMEs from 5 major cities of Zimbabwe and 10 companies listed on the stock exchange. The study evaluated the sources of information currently used by banks and came up with the following findings: the majority of financial statements the banks use are not audited and most of these unaudited statements are prone to manipulation, the clearance reports from the financial clearing bureau do not show any positive credit history, the bank reports are not adequate. The client may be tempted not to reveal where he/she has a bad name. In view of these shortcomings it is therefore recommended that financial institutions join together to form a credit referencing bureau which keeps all the borrowing records of all customers of the lending institutions. This will motivate the borrowers to perform better as they know that their history is readily available on the market. Even lenders themselves will shorten their turn around period as they will get the client's comprehensive and up to date borrowing history within a short time.
Keywords: Monetary Policy Statement, Non-Performing Loans, Microfinance Institutions, Small to Medium Enterprises, Financial Clearing Bureau.

1. Background

According to Haynes (2012) information is the lifeblood of the modern economies. In many emerging countries, information about a business or an individual's credit track record is simply unavailable resulting in difficulties in accessing bank credits and sometimes higher interest rates to offset the perceived risk.

The Reserve bank of Zimbabwe Governor, Gideon Gono in his Monetary policy statement of January 2012 had this to say about the asset quality in Zimbabwean banks, "The Reserve bank has, however noted with concern the gradual deterioration in asset quality as reflected by the level of nonperforming loans which is now trending towards the watch list category. Asset quality challenges can potentially heighten liquidity risk given the current operating environment where credit is largely financed by volatile short term deposits. In this regard it is imperative that banking institutions enhance their credit management systems with special emphasis on credit assessment, origination, administration, monitoring and control standards."

This deterioration of asset quality appears to be the hallmark of the multiple currency regimes as the Reserve bank also in its 2009 stability report lamented the deterioration of the asset quality of the banking sector. This was reflected in the half year results of Commercial Banks in Zimbabwe which showed an increase in adversely classified loans from an average of 4.8% as at 30 June 2008 to 12.23% as at 30 June 2009. Even the Global Rating Company (2009) indicated that the asset quality of Premier deteriorated by 4.3% within a year. African Banking Corporation (2009) also revealed that asset quality deteriorated for a second consecutive year with the capital value in arrears position increasing from 10% to 14% of gross advances. Minister Biti (2012) lamented that the non-performing loans increased from 7.55% to 9.9% in 2012.

Statistics released by the World Bank on Zimbabwe indicated that non-performing loans in the country increased from about 3.2% in March 2009 to 15.3% in May 2013.

In its first half year results for 2014, NMB Holdings revealed that their non-performing loans figure doubled to 22, 8%. This is against the prudential threshold of 5% as stipulated in Basil II.

The Bankers Association of Zimbabwe President George Guvamatanga in his address to the parliamentary committee in 2014 conceded that the average level of nonperforming loans has further deteriorated to 16%. This is at the backdrop of the non- performing loans figure released by the World Bank in December 2013 of 15%.However a consultant with Jack and Field Corporate Risk Advisory (2014) Mahlomakuru projected the level of nonperforming loans to reach 25% by end of 2014.

This is against a situation where the majority of banks were no longer lending during the prevailing hyper inflationary period that existed prior to the introduction of the multiple currency system in 2009.As a result they only started lending in 2009.

The above picture shows that there are high chances that these loans were granted with some inherent weaknesses. As Miller (1996) puts it, credit risk management covers both the decision making process, and the follow up of credit commitments, plus all monitoring and reporting process. The effectiveness of any lending decision is hinged on the information that the decision maker is exposed to. If the decision maker has all the credit information of the borrower, it is more likely that he or she will make a sound lending decision. However if inaccurate or inadequate information is availed, no matter how thorough the lending officer might be in evaluating the loan application a poor lending decision is the likely outcome.

According to Martin Brownbridge in his paper to the United Nations Conference on trade and development in Geneva, “Poor loan quality has its roots in the informational problems which afflict financial markets, and which are at their most acute in developing countries, in particular problems of moral hazard and adverse selection.”

In some developed economies lending decisions are made within some minutes of consumer loan applications as all the pertinent information is readily available. In fact the decision making is computerised as all the required background information like the financial history, current indebtedness to financial institutions and other lenders is readily available on the database. According to the Experian booklet (2010), in the United Kingdom, the establishment of credit bureaus has resulted in a system that gives consumers access to credit at any time of the day or night, every day of the year and consumers can apply for credit over the phone or on the internet and get a decision almost instantly. However in Zimbabwe it takes an average of 7days for banks to make lending decisions for consumer loans and corporate loans take even a longer period of up to 30 days. This is because enough information is not readily available so a thorough evaluation of the available information is needed. In a way this delay in making a lending decision is an indirect admission by Zimbabwean banks of the inadequacy of their information.

In Zimbabwe commercial banks require the customer to provide the following information when applying for business loan; financial statements comprised of the statement of financial position ,statement of comprehensive income, statement of cash flows (projected) together with the customer application and business or project proposal. Apart from the above information provided by the customer the bank then look at internal sources of information like previous loans repayment history, account transaction and conduct history. From the external sources the banks look at trade references given by the customer, report from the Financial clearing Bureau, interview reports with the customer and reports from other banks.

If it is a personal loan application, banks require the applicant’s payslip, confirmation letter of employment from the employer and the loan application letter. The bank will then look at the previous loans repayment history, account activity history, other banks’ reports if any and the Financial Clearing Bureau report.

The above information is what banks analyse to make a lending decision. It is the thrust of this paper to evaluate the adequacy and reliability of this information. Can banks comfortably rely on information provided by their customers to make lending decisions? Is the account history and FCB reports coupled with information given by the customer enough to make a fair, consistent, responsible and profitable lending decision?

According to the Companies and Markets report of September 2012, five local banks, FBC Bank, CBZ Bank, NMB Bank, Metbank and Capital Bank were owed a total of $14 million by a company by the name Lobels Limited and the company defaulted in repaying these loans. These banks later joined hands as creditors and formed an investment vehicle they named Altiwave , to take over full control of Lobels Limited as a workout arrangement in trying to salvage their money. They only joined hands after the customer had defaulted in different loan contracts held with these different banks. It would have been better if these banks were made aware of the indebtedness of the company to each bank before they committed themselves. This is a clear case of information asymmetry which is bedevilling Zimbabwe’s economy. Banks just give customers some loans relying on what the customer discloses as the company’s indebtedness to other banks.

The Companies and Markets report (2012) further state that Rio Zim Limited is also struggling to offset its loan obligations to a number of local banks to the tune of around $50 million. Out of the $50 million debt, $3 million is indebted to Capital Banking Corporation. This was revealed in the agreement registered as a court order by the High court on 5 December 2012 under case number HC12709/11. The fact that the agreement had to be registered with the courts is enough evidence that the company had defaulted to fulfil its loan obligations. Even the Managing Director of Rio Zim Mr Sachikonye indirectly acknowledged the company’s indebtedness to a number of financial institutions when he said in 2011 that, “Rio Zim has not defaulted with any bank and is servicing its debts on terms and conditions agreed with various financial institutions.”

This is further strengthened by the findings from Chikoko, Mutambanadzo and Vhimisai (2012) whereby multi borrowing was one of the causes of non-performing loans. In this paper they found out that some individuals were moving pay points from one bank to the other thereby accessing loans from these banks and at the same time evading the monthly repayments required by the lending banks. Capital Bank (2014) in its half year results also cited non-performing loans in the country as being caused by lack of client knowledge and multi borrowing among others causes.

Chikoko et al (2012) in the same paper found out that also high lending rates among others were the major cause of non-performing loans.

If a bank is unable to obtain information on a potential borrower, it is likely to adopt a qualitative approach to evaluating credit risk, which involves using a checklist to take into account factors specific to each borrower, Mishkin (2004). “Since borrowers have private information, banks engage in information acquisition to reduce the presence of this informational asymmetry on the ability to repay the loan.” Allen et al (2012).So banks are only able to confidently risk their customers’ deposits if they have enough information about the loan applicants. As long as they do not have enough information about the credit worthiness of the applicant, they will not take the risk. Mishkin (2004) adds, “To accomplish effective screening lenders must collect reliable information from prospective borrowers and effective screening and information collection together form an important principle of credit risk management.” It is this information that they analyse in order to make a decision whether to grant or decline the loan application.

The study by Odhiambo and Simon (1999) established that loan managers in Zimbabwe used financial statements in their lending decisions although this was not the only source of information. However Wolk et al. (2003) argues that the credibility of financial statement information is enhanced if the statements are audited. This view is further supported by Fight (2004) when he said that unaudited statements can be erroneous or misleading, either by accident or by intent. According to Gomez-Guillamon (2003) credit institutions consider the auditor’s opinion as conveying useful information that is important for both investment and lending as well as for deciding the magnitude of the investment of the loan grant.

Many papers from early studies by Bester, (1985), Henning, (1986), De Meza and Webb, (1987), Besanko and Thakor, (1987) have all pointed to the conclusion that informational asymmetries create an incentive problem inducing banks to ration credit. Banks become hesitant to grant new loans when information about the loan applicants is asymmetric. As a result they become very strict in evaluating the applicants and limit the credit risk they can take. Unlike with adequate information about the potential borrowers, banks would be ready to issue out more loans as they would be comfortable to take the credit risk.

Sena, (2008) is also of the view that information asymmetry lead to lenders demanding collateral security for their loans. He further states that, “Moral hazard is another form by which asymmetric information can manifest itself in the credit market.” This high perceived risk will then force banks to demand collateral security to secure these loans. Since not all customers have security very few customers will then access the loans.

The model by Boot and Thakor, (1994) insinuates that if the bank does not know the quality of the applicant, it is optimal for the bank to charge a high interest rate and have high collateral requirements. These high interest rates and collateral requirements will then mean that the number of customers that will access the loans will be limited.

2. Methodology

The design for this study was descriptive so that the information that is evaluated by banks can be critically evaluated. The research took a form of survey whereby respondents were asked questions pertaining to the information gathered by banks in credit appraisals. The population of the study were all the seventeen Commercial Banks licensed to operate in Zimbabwe, small to medium enterprises operating in Harare, Masvingo, Bulawayo, Gweru and Mutare, and companies listed on the Zimbabwean stock exchange and operating in Zimbabwe. From the Commercial banks the targeted population were the credit risk managers from the respective banks as they deal directly with policy issues relating to credit appraisals. Finance managers of the listed companies and the SMEs were the population targeted.

Non-probability judgemental sampling technique was used. It was the discretion of the researcher based upon judgement that was used to determine the sampling. This sampling was considered because the area of study is specialised and it therefore needs to carefully identify the appropriate respondents and it is cost effective and saves time.

The sample sizes were 10 credit managers from the 10 banks randomly selected. One hundred SMEs were randomly selected and distributed as follows: 35 SMEs randomly selected from Harare, 20 SMEs from Bulawayo, 20 from Masvingo, 15 from Gweru and 10 from Mutare. These were considered to give a fair representation of all SMEs operating in Zimbabwe. The finance manager of each SME was targeted as the respondent.

The sample size of the companies listed on the ZSE was 10 companies and these were all taken from Harare. This was mainly because the majority of the companies that are listed on the ZSE are headquartered in Harare which is the capital city. The finance managers of these companies were targeted as respondents.

Questionnaires and interviews were used to gather data from these respondents. This was done so as to extract as much necessary information as possible. Questionnaires were used on SMEs to enable respondents to have enough time to respond to the questions given. Interviews were also used to gather data from the finance managers and credit managers. The interviews were preferred for this group because the researcher wanted to ensure that all the issues are thoroughly thrashed as they are a critical component of the research.

3. Results

The research established that all the companies that are listed on the Zimbabwe Stock Exchange provide financial statements that are audited by reputable audit firms. These audited statements are 6months old and beyond. Banks said that they require these financial statements for the past 5 years.

Sixty out of one hundred SMEs agreed that they provide financial statements that are not audited to financial institutions for loan applications. The other forty provided financial statements that were audited but however the auditors that handle their books are small and emerging firms some of which are not registered. They all justified choosing such auditors by citing that they are affordable whilst reputable ones are beyond their reach. This concurs with the banks' view that audited financial statements of most SMEs are audited by obscure audit firms. The banks further stated that most SMEs find it difficult to furnish them with audited financial statements. Eighty percent of the credit managers conceded that most financial statements furnished by SMEs whether audited or not raises a lot of questions and they are no longer paying much attention to them when doing credit evaluations.

The majority of the SMEs were of the same voice that they only engage accountants when they want to borrow from the bank or for tax purposes only.

Seventy three percent of the SMEs confirmed that they sometimes borrow from micro finance companies and registered money lenders. They argued that banks are reluctant to offer them with loans. All the SMEs and listed companies concurred that banks take a period ranging from one month to two months to process a business loan application and make a lending decision. They also take an average of one week to process a personal loan application. However banks were arguing that their turnaround time for their business loans range from 3 weeks to 6 weeks and concurred that personal loans take a week on average.

All the banks were in unison in stating that they only get positive feedback from their internal sources and that the Financial Clearing Bureau (FCB) only provide banks with history of clients which is negative. They all were of the view that there should be a customer information bank that provides both positive and negative information.

Banks were of the view that they find it difficult to evaluate loan applications from individuals and SMEs that do not have an account history with them. They also noted that they over rely on information provided by the customers. One hundred percent of the banks agreed that if a customer is on a borrowing spree from all banks, banks cannot easily detect that unless he or she has defaulted with one bank and a default judgement has been passed by the courts.

Banks also revealed that they use bank reports as part of their customer information search. If the loan applicant discloses his current or previous bankers then the bank which is handling the loan application will request a report about the applicant. This report will be entirely based on the account conduct of that customer.

The study also revealed that it is difficult for banks to know if their customer has another loan with a micro finance institution, credit store or those companies that advance inputs to farmers.

4. Discussion

The results of the study shows that banks rely on audited financial statements when making lending decisions to corporates that are listed on the stock exchange. However, even if some SMEs produce audited financial statements, they are not readily acceptable to banks because the audit firms used are obscure and some are not credible. The other challenge is that most of the financials are more than 6months old and this cannot be called current information. There is a risk that if circumstances change at the company and it is now facing challenges the bank may issue out a loan to a company that is folding. There is need to find ways to get up to date information on the performance of the company.

Regarding the SMEs, the study found out that a significant proportion of the customers are being given loans against an appraisal of unaudited financial statements or financial statements audited by obscure audit firms. This has the potential risk of these financials being manipulated. As the study revealed most of these financial statements are prepared for specific purposes of either tax or for loan application. There is therefore a temptation on the part of those who prepare these financials to try and help the company to secure the loan and they therefore manipulate the figures to be assured of future business from their customers. This therefore shows that there are high chances that these financials do not reflect the true picture on the ground. This tallies with Fight, (2004), when he says, "Unaudited statements can be erroneous or misleading, either by accident or by intent."

Also the questionable audit firms have no reputation to protect and are therefore not concerned with the protection of their integrity unlike well reputable companies who have a name to protect.

The majority of the SMEs confirmed that they also borrow from Microfinance and money lending institutions. This therefore poses a great risk to banks of advancing loans to customers who are heavily indebted to these companies. It is important that banks should have access to the information that pertains to the indebtedness of these SMEs. The loans from Micro finance institutions are also very expensive and the customers who borrow from these are in most cases likely to default.

Results from both banks and their customers shows that banks are taking too long to approve loan applications. This can also be traced to information asymmetry. Banks take long in making decisions because they have to scrounge for information from various sources.

The bank reports that banks give each other depend only on condition that the applicant has voluntarily disclosed his previous or current bankers. If the applicant is aware that he has a negative history he will not even mention his previous relationship. If the applicant deliberately omits his or her previous or other relationships it is difficult for the bank to find out information about this relationship. Also banks may be tempted to give a very lukewarm report on the customers they would not want to lose to competitors. Also at the same time they may be tempted to give a favourable report for the customer whom they want to secure some loan to repay their outstanding commitments.

It was also revealed that banks are finding it difficult to get positive credit information about their customers. They only get negative credit information from the FCB. If they could access all the information from the credit bureaus they would easily make lending decisions but the current information asymmetry makes it difficult for them to make lending decisions. Banks only get positive information about the loan applicant from their internal sources only. So if the applicant has no account history with that particular bank, banks find it difficult to access adequate information to analyse so as to make lending decisions.

Even banks conceded that if information was easily available, the turnaround time would be greatly reduced.

5. Conclusion

It is the finding of this study that the bulk of the information that is used by banks in Zimbabwe is not enough and also not water tight. This is because the financial statements do not show the current position of the company. Those financials audited by obscure audit firms are as good as unaudited financials and unaudited financials are prone to manipulation by the customers. The time taken by banks to process a loan application is enough evidence that there is a challenge of getting enough information that aids in lending decisions.

Banks are at the risk of giving loans to customers who are heavily indebted to other banks and micro finance institutions. This is because if the customer does not voluntarily disclose that he or she has a running credit facility with another bank; it is not easy for the bank to pick that out. This then makes clear the origins of the challenge that local banks that gave loans to Lobels Ltd faced before they formed a company called Altiwave to run this defaulting company. It shows that they were not aware of the indebtedness of each other. Even those banks that issued loans to Rio Zim could probably have faced the same problem.

The credit information banks are getting from the FCB is not enough to aid in decision making on lending issues. There is need for all the credit information both positive and negative to be centralised at one point. This will speed up the decision making process by banks.

6. Recommendations

Given all the informational challenges that are bedevilling the credit market of Zimbabwe, banks should join hands and establish a credit bureau that maintains all the credit transactions that are done in Zimbabwe. These should include even loans issued by microfinance institutions and money lenders, and even by credit stores. This credit bureau should be linked to all institutions that give out credit and all players should have access to this data bank. This data bank should even be showing the repayment pattern of these loans. This would prevent the problem of multi borrowing from different lenders by customers and also even customers would be motivated to repay their obligations as they know that any default or repayment arrears would smear their credit worthiness. All players should be part of this project as this would enhance its chances of success. The government should put in place legislation that addresses the issue of information sharing by lending institutions and put in place legislation that forces all lenders to be part of this system.

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