

MIDLANDS STATE UNIVERSITY



FACULTY OF COMMERCE

DEPARTMENT OF BANKING AND FINANCE

THE EFFECTS OF REGULATIONS AND SUPERVISION ON THE ACTIVITIES OF COMMERCIAL BANKS IN ZIMBABWE

BY

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DEDICATION

To my darling mother and all my family members for their encouragement and support.

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I would firstly want to thank the Almighty God whose grace helped me through the completion of my degree.

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ABSTRACT

Banking regulations and supervision is an essential aspect of modern financial systems, seeking crucially to monitor risk-taking by banks so as to protect depositors and the economy as a whole against systemic risk and bank failure. The research involves an investigation on the effects on the activities of commercial banks in Zimbabwe during the dollarization period of (2009-2013). All research findings were obtained from 16 commercial banks and the Reserve Bank of Zimbabwe. The researcher found out that most of the investors are aware of the activity of the RBZ of regulations and supervision on the activities of commercial banks. However, the regulations and supervision had both negative and positive effects on the activities of commercial banks. The negative effect outweighs the positive effects. The researcher found out that supervisory and the regulatory functions of the RBZ have not been effective in curtailing distress in the commercial banks. The results also show that majority of the respondents believed that urgent attention towards verification; processing and settlement of claims filed by depositors of failed banks would help in boosting confidence of the banks' customers. Therefore, in order for commercial banks to improve profitability it was recommended that commercial banks need to invest in supply side of their macroeconomics through capital expansion and deposit layering activities both at individual bank level and industrial level at large as the demand for bank loans continues to escalate. Therefore, effective bank supervision is important in protecting depositors' funds, avoiding bank failures and installing discipline in the financial sector.

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CHAPTER 1: INTRODUCTION

1.1 Introduction

The increasing complexity emanating from liberalisation of markets, globalization and regional integration among other development in the financial sector of economies worldwide has raised a great need for effective and coordinated regulation and supervision of banks if stability is to be achieved in the financial sector of each economy. Hence this study is mainly focused on the effects of bank regulation and supervision on the activities of commercial banks in Zimbabwe. This chapter will look at the background to the study, statement of the problem, objective of the study, research questions, and significance of the study, assumption, scope and limitations together with the organization of the study.

1.2 Background to the Study

At independence (1980), Zimbabwe had a complicated banking and financial market experiencing neither nationalisation of foreign banks nor restrictive legislative interferences (Maimbo; 2002). The oligopolistic nature in banking experienced by that time, and lack of competition deprived the sector of choice, quality service, innovation and efficiency. For the first post independence decade, the Banking Act (1965) was the main legislative framework. There were no directions on prudential lending, insider loans, definition of risky assets and provision for bank inspection (Foot, 2003). However, in 1994 the central bank's annual report indicated the desire for greater competition and efficiency in the banking sector, leading to banking reforms and new legislation.

The new legislation allowed for the conduct of prudential supervision of banks along international best practices (Maimbo; 2002). In September 1999 the Banking Act (24:01) came into effect as well as the Reserve Bank Act (22:15) which was the culmination of the Reserve Bank's desire to liberalise and deregulate the financial services. Entry barriers were removed leading to increased competition resulting in the introduction of new products and services such as e-banking and in-store banking. The Banking Act was then further revised in August 2000 and re-issued as chapter 24:20. This allowed the Reserve Bank of Zimbabwe (RBZ) to assume its official role as regulator and supervisor of registered banking institutions. It was given the authority to conduct on-site and off-site supervision, participate

in licensing decisions, set prudential standards within which banking institutions should operate and to take supervisory action on unsafe and unsound banking institutions.

The Reserve Bank recognises financial stability as a critical pre-requisite for sustained economic growth, thus the bank has joined the rest of the progressive world, through the Basel Committee on Banking Supervision in promoting financial stability. Therefore, the bank undertook to implement the 25 Core Principles for Bank Supervision(Maimbo, 2002). The period 2000 -2003 saw the licensing of commercial banks, discount houses as well as Merchant banks. These include Intermarket Banking Corporation, Renaissance Merchant Bank, Royal Bank of Zimbabwe, Barbican Ltd and Premier Discount House among others (RBZ ;2003) However, since the late 1990s Zimbabwe started to experience intermittent turmoil in its financial sector but mostly after the year 2000. These problems were in the form of financial distress, lapses in corporate governance and illegal activities by banking executives. Taking cases of the Commercial Bank of Zimbabwe, Zimbank, United Merchant bank and Universal Merchant Bank in 1997, the case of CFX Bank, National Merchant Bank in 2004 as well as the Renaissance Merchant Bank case of 2011.

These and other banking crises in the sector caused increased questions as to what could be the real cause of the incessant banking sector problems in Zimbabwe. What are the elements of the Zimbabwean banking sector that makes it vulnerable to illegal activities, problems and weaknesses, causing it to lurch from one crisis to another? A closer look on the problems that are experienced by the Zimbabwean banking sector raises questions on regulatory and supervisory matters. From the period 2000 to-2011, banks in Zimbabwe have been closed, placed under curatorship and some have ceased operations. Some banks were found engaging in non-core activities or holding non-core assets and others involved in illegal activities.

The failure of a bank is an indicative of a bigger underlying structural problem emanating from beyond the bank, which is only the work of regulatory and supervisory authorities to find those problems, most importantly in a proactive manner. For instance, in the case of Renaissance Merchant Bank of January 2011. Shareholders were alleged to have been using illegal debt for equity arrangements, two shareholders of the bank own nearly 70 % of the bank (while the Zimbabwean Banking Act limits an individual shareholder to no more than 10% of issued share capital), the collapse of corporate governance was also unearthed at the bank. Thus, if those and other obvious irregularities are allowed to take place or takes so long to be discovered questions are raised to the general effectiveness of the regulatory and

supervisory body. Now, is it the only bank exposed to such violation, and more importantly, how much rot is entrenched in the banking sector. It gives much work to the regulatory authorities and it shows greater need for effective regulation and supervision.

1.3 Problem Statement

Bank regulation and supervision is implemented to ensure a sound and safe financial system in the economy. Looking at the banking sector of Zimbabwe since the year 2000 up to 2011 some banks have been closed, placed under curatorship and others ceased operations. Previous research on the causes of such instability found the collapse in corporate governance, illegal activities by bank executives and failure to comply with other bank regulations like capital requirements lead to financial distress among other these and other problems continue to raise questions to the research on the effect of regulation and supervision on the activities of commercial banks in Zimbabwe

1.4 Objective of the Study

The primary objective is to determine the effects of bank regulation and supervision on the activities of commercial banks in Zimbabwe.

In vision of the main objective the other aims of the study are:

- To find out the major causes of instability.
- To determine the effects of regulation on the performance of commercial banks
- To determine the effect of regulations on bank lending.
- To investigate the role of bank regulation and supervision towards managing systemic risk.

1.5 Research Questions

- What are the effects of regulation and supervision on the activities of commercial banks
- What are the major causes of bank instability in Zimbabwe?
- How are regulations and supervision affecting commercial banks performance?
- What are the effects of regulation on bank lending?
- How do regulation and supervision affect management of systematic risk?

1.6 Statement of Hypothesis

H0: Regulation and supervision have a positive effect on the activities of commercial banks in Zimbabwe

H1: Regulation and supervision have a negative effect on the activities of commercial banks in Zimbabwe

1.7 Significance of the Study

The health of the economy depends on a sound financial system. Financial institutions in any economy plays a significant role in promoting economic growth and development by recovering the efficiency of resource mobilisation, pooling saving and allocating those savings to investment outlets. However, only a stable economy with a dependable banking system can fulfil its macroeconomic functions which is the cost effective, transformation and provision of financial resources. Bank regulation helps to ensure that this system is efficient and stable through prudential regulations that are designed to remove or lessen the threat of systemic instability. Hence, this study is of importance to the regulatory authorities to realize the effects of their activities on the banking industry, and see areas for improvement and banks in ensuring stability in the financial sector of Zimbabwe.

In the course of a clear recognition and acknowledgement of the importance of bank regulation, bankers will be encouraged to operate within the parameters set by the RBZ. Bankers will understand that regulation and supervision are not coming to them as a threat but as a protective and motivational move set to improve their competitive advantage worldwide and most importantly reduce systemic risk.

1.8 Assumption of the Study

- All respondents will effectively cooperate
- Commercial banks react to RBZ directives and policies uniformly.
- Activities of commercial banks of lending, investment and forex trading are being undertaken

1.9 Scope of the Study

The study shall focus on the effects of regulation and supervision on the activities of commercial banks, although it is the duty of central bank to regulate and supervise all financial institutions, but this study will mainly focus on the regulatory authorities (Reserve Bank of Zimbabwe) and commercial banks only, this is because commercial banks are the major players in the financial sector. The study was carried from 2009 to 2012. This period was chosen as it is perceived and to a larger extent evident that there was a greater level of stability in the economy, hence most of the material used in this study relates to Zimbabwe though there is supporting information from other countries. The research will be conducted at head offices of the commercial banks in Harare, Zimbabwe as the researcher will have access to financial institutions in this area; also most of decisions are made at head offices so the outlying branches will not be considered in this research.

1.10 Limitation of the Study

The following limitations were encountered in the course of the study:

- For confidentiality reasons, it had been very difficult to access information, especially from RBZ and commercial banks. However, the researcher always had to assure the respondent that the information they provided would be used solely for academic purposes. Also the researcher had to contact some relative employed by RBZ and other commercial banks to get some information.
- There were also time and resource constraints. Time limitations existed due to the short academic year and resource constraints emanated from the inadequately funded financial budget. In order to curb the effects of time constraints, the research had to work on weekends. As for financial constraints, the research had to combine tasks and activities to enable once off cash outflows which are cheaper.

1.11 Definition of terms

Bank supervision: is the process of monitoring banks to ensure that they are carrying out their activities in accordance with the rules and regulations, and in a safe and sound manner

Bank regulation: it's a body of specific rules or agreed behaviour either imposed by some government or other external agency, or self imposed by explicit agreement within the

industry that limits the activities and business operations of financial institutions for example the Reserve Bank of Zimbabwe

Stable banking system: A stable banking system means that banks have the ability and capacity to meet maturing obligations as they fall due, and are making adequate profits from authorized banking business to justify their investment while at the same time keeping banking failures at a minimum within the country.

1.12 Organization of the Study

This chapter generally looked at the background to the study and problem statement which views the banking sector since the year 2000 to 2012, some banks have been closed, placed under curatorship and others ceased operations, in the previous studies they stated the causes of this instability which are illegal activities by bank executives, collapse in corporate governance, among other problems. These and other problems have raised the researcher's desires to take the main objective of the study towards assessing the effects of regulation and supervision on the activities of commercial banks in Zimbabwe. The study is designed to benefit bank supervisory authorities, university students and though indirectly, the general public. The scope of the study covers period of 2000 to 2012. The limitation of the study ends up with a list giving definition of key terms used in the chapter. Chapter two will look at the theoretical and empirical literature review on the study topic, followed by chapter three which covers on the research methods used in collecting the data. Chapter four will cover on the presentation and analysis of the data obtained. Chapter five gives a brief summary of the research findings, conclusion, recommendations and suggestions for further research

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

A lot has been written about bank regulation and supervision with different approaches on the subject. This chapter will give an insight into empirical research and theoretical information pertaining the effect, role, comprehensiveness, importance and adequacy of bank regulation and supervision across in finding out how best can effective bank regulation and supervision benefit developing countries such as Zimbabwe. It will give an insight into the effect of bank regulation and supervision towards the activities of commercial banks. The chapter will also give an outline of possible theories of bank regulation and supervision that countries adopt in their pursuit of achieving stability in the banking sector. Moreover the chapter will give detailed information on International authorities on bank regulation and supervision such as the Basel Committee. In addition the chapter will also classify the importance of the banking system that makes it an important sector for concern in any economy.

2.2 Commercial Banks Activities

Commercial banks activities are legal transactions by commercial banks in their daily business such as lending, investment and foreign currency trading depending on the objectives and size of the bank. According to Best (2005) banking activities depend on the economic policies of its sovereign state, ranging from access to central bank funding system to being object to regulatory mandates for sound operating standards.

2.2.1 Aspects of Bank Profitability

Bank profitability is influenced by microeconomic factors (bank specific) and macro factors. Microeconomic factors represents the external influence on the bank such as policies and regulations imposed by the regulatory authority and the government or political and economic stability. The level of bank profitability is influenced by the intensity of its income generation activities such as lending and trading of forex (Ajaya 1995).

It has been proved that in new competitive environment, large banks will survive ,small banks can only survive if they are specialized in a few of their activities (Petreson and Rajan 1995). The named pair also noted that banks enjoy productivity ,but productivity has been said to be higher in small banks.

2.3 Banking Supervision and Regulation

Regulation of banks has been defined by Llewellyn (1986) as a body of specific rules or agreed behaviour either imposed by government or other external, agency or self imposed by explicit or implicit agreement within the industry that limits the activities and business operations of banks. In summary it is the role of public policy towards banks to achieve a defined objective. Bank regulation has two major components

- The rules or agreed behaviour
- The monitoring and analysis to determine safety and soundness and ensure compliance in the banking sector

Supervision; on the other hand is the process of monitoring banks to ensure that they are carrying out their activities in a safe and sound manner and accordance with law, rules and regulation Foot (2003). It is a means of determining the financial condition to ensure compliance with the given rule and regulation at a given time. Bench (1993) asserts that effective supervision of banks leads to a healthy banking industry. They by result in the increase in economic growth of an economy

Vitas (1990) also believes that good regulation and supervision will minimise the negative impact of moral hazard and price shocks on the banking system, thereby leading to a reduction in bank failures and banking system distress. Usually, the role of banks whether in a developed or developing economy, consists of financial intermediation, provision of an efficient payments system and serving as a way for the implementation of monetary policies. It has been postulated that if these functions are efficiently carried out, the economy would be able to increase the level of savings and channel the money in an efficient and effective way to ensure that no viable project is upset due to lack of funds. In view of the importance of the banking sector in economic development and the imperfection of the market mechanism to organize and allocate financial resources to socially attractive economic activities of any nation, governments the world over, do regulate them more than any other sector in the country.

This underscores the need for banking sector regulation. However, in addition, the nature of banking business (being highly geared and conducted with greater privacy when compared with other real sector businesses) provides added reason for strict supervision. This is to

constantly keep an eye on the sector's activities with a view to ensuring that operators play by the rules of the game and take in sound and safe banking practices. Furthermore, such supervision is there to assist supervisory authorities in timely identification of decline in banks' financial conditions before it degenerates to threaten the stability of the banking system or even the economy(Donli,2003).

2.3.1 The need for commercial bank regulation

The experience of many countries shows that capital regulation and supervision are essential for stable and healthy financial system and that the need becomes greater as the number and variety of financial institution increase. The banking sector has always received upper attention on protection due to the vital role it plays in an economy. Minimum capital is one of the three "pillars" of macro prudential regulation. Bank capital serves both as a buffer and as a disincentive to excessive risk taking. When general equilibrium effects are taken into account, however, it is not clear that higher capital requirements will reduce the level of risk in the banking system (Gale, 2010). It has become evident that one of the very completing requirements for the success of any business in any economy is the existence of favourable regulatory environment as evidenced from Schmidt (2002), Thatcher (2002), Thatcher and Stone (2002), and Moran (2002) submitting that regulations can either promote or stifle business performance. Empirical evidence from Kerwer (2005), King (2005) and Quaglia (2005) also suggests that environmental regulations deter entry into industries where the requirements for regulatory compliance activities are high.

Economists have come to disagree on the level of government intervention in economic and financial activities over the world while some believe that many regulations are necessary in order to protect the depositors funds other believe that the banks are overregulated (Short and Driscoll, 1983). For instance the economic theory of regulation postulates that regulation result from the desire of government to eliminate or correct market failure. The public interest theory views that regulation come pressures brought to bear on the government multifarious interest group. Pressure groups in economy such as business, consumers, workers, environmental groups among others lobby government to pass legislation to protect such group. It seems that economy theory of regulation has gained more acceptance among economist as Llewellyn (1986) put it. Regulation is necessary in the case of bank specifically to maintain safe and sound banking system that can meet its obligation without difficulty, hence a high solvency and liquidity level is experience of individual banks than they would

ordinarily maintain. Oloyode (1994) observed that the banking Industry is highly prone to volatility and fragility either arising from exogenous or endogenous shocks and are therefore amenable to regulation and supervision.

Tougher bank regulations may have positive benefits—they may reduce the consequences of market freezes, they may encourage banks to become smaller to avoid “systemic” capital requirements, and they may reduce contagion—but they may not be relied on to reduce the risk of bank failure Gale (2010). This view is in line with Oke (2006) that observed the inconsistency in monetary and regulatory policies as major setback to banks stability.

Mishkin (1997) viewed that forging a strong bank supervision system will be one why out of financial crisis while Ogunleye (2005) summarized the rationale for banks regulation as efficiency, diversity of choice, competition stability of financial system, macroeconomic stability and development and social objective . This view is in line with the World Bank (1986) that good regulation and supervision will minimize the negative impact of moral hazard and price shocks on the financial system there by leading to a reduction in bank distress and failure. Llewellyn (1986) describes presidential regulation as a body of specific rules or agreed behaviour, either imposed by the government or external agency or self imposed by explicit or implied agreement with the industries that constrains the activities in the industry. In terms of policy thrust therefore the banking sectors reforms are expected to build and foster a competitive and healthy financial system to support development and avoid systemic distress. Thus Balogun (2007) averred that banking sector reforms is interpreted to mean embarking on comprehensive process aimed at substantially improving the financial infrastructure, strengthening the regulatory and supervisory framework to address the issue of low capitalization and a structured financing for cheap credit to the real sector and financial accommodation for small and rural credit schemes. Studies have shown that the objectives of financial sector reforms are broadly the same in most countries of sub-Saharan Africa (Balogun, 2007). These are summarized to include market liberalization for promotion of more efficient resource allocation, expansion of savings mobilization base, promotion of investment and growth through market base interest rates.

It also means the improvement of the regulatory and supervision framework, fostering healthy competition in the provision of service and above all laying the basis for inflation control and economic growth Balogun, (2007). Regulation may also, reduce industry risks

through the elimination of weak banks and create better diversification opportunities Berger, (2000). On the other hand, the opponents argue that consolidation could increase banks' propensity toward risk taking through increases in leverage and off balance sheet operations. In addition, scale economies are not unlimited as larger entities are usually more complex and costly to manage (De Nicoló et al, 2003).

2.3.2 The objectives for banking supervision

Banks worldwide are more regulated than any other institutions because of their role of financial intermediation. As the role of financial intermediation banks source funds from the surplus spending units at a cost and then lend it to the deficit spending units at a price both within and outside the country. The difference they get is the margin, (Schumpeter, 1934).

Banks also provide an efficient payment system in the economy. They give a smooth and efficient system for making payment to settle both business and personal transactions, and international financial obligation on behalf of their customers. Thus savings are stimulated for investment in the economy by banks. The mass of the evidence is that banks in the process of intermediation contribute significantly to real economic growth. Schumpeter (1934), banks are necessary condition for economic growth. This proposition has been supported by several scholars including; Goldsmith (1969) and Cameron et al (1972). Practical evidence also suggest that there is a positive correlation between real growth of output, investment and bank assets

.Growth in the financial sector will result in real growth in the economy. But if the financial system is weak, it acts as a magnifier of problems, rather than a shock absorber.

The protection of depositor's funds has come to be generally accepted as the most basic reason for banking regulation and supervision. This objective is hinged on the fact that bank deposits have difficulty protecting their interests when compared to other bank creditors and investors. On his part, Sheng (1990) state the objective of supervision as that of promoting and developing a wide range of financial products to meet the needs of the economy, ensuring efficiency, security and responsiveness of banks to the needs and complaints of customers and ensuring compliance with laid down rules and regulations. Which are relevant to ensuring high standards of banking; and to achieve important developmental and public goals through their compliance with monetary and credit allocation policies. Sinkey (1989) states the goals of:

- The protection of depositors funds
- The protection of the economy from the vagaries of the banking system, and
- The protection of banks customers from the monopolistic power of banks
- The protection of banks from bank failure

Dale (1986) had classified prudential regulation on banks in to three: preventive, protective and supportive. While preventive regulation of banks is designed to limit the risk undertaken, the protective regulation offers protection in the event of failure. The supportive regulation is in form of a lender of last resort.

In both developed and developing economies, the banking industry determines the financial products available to the economies. Hence, regulation is necessary to break this monopolistic power and prevent abuse. Moreover, in developing economies, banks play their traditional intermediation roles as well as being as a vehicle for achieving development and public goals. Banks in third world countries have to develop indigenous entrepreneurs by channelling credits for their use. As a result of this, the World Bank (1989) noted that in these economies have to be regulated to ensure that they play their role properly in economic growth.

2.3.3 Basel committee on bank regulation and supervision

The Basel committee on bank regulation and supervision (2001) come up with approaches to bank regulation and standard which are applicable in all jurisdictions although with some variations here and there. A highlight of each of them is given below.

The first approach relates to information disclosure which is of two types. The disclosure to the general public through the announcement of operating results and full disclosure to bank supervisors where public disclosure may not be necessary in order to protect the clients' secrecy. Information disclosure by banks is basically designed to ensure that supervisors, investors and the general public are adequately informed of bank's performance/condition. The enforcement of adequate disclosure is paramount. The level of disclosure and timing of information to the various stakeholders should be articulated for banks to comply as a routine. This is an issue in Pillar III (Market Discipline) of the New Capital Accord.

The second approach is self regulation through the use of internal audit and controls, external audit and board audit committee. Self regulation involves the various independent checks and reviews put in place by the bank itself to ensure that its sound procedures do not deteriorate (Berger (2000)). Self regulation and self discipline are supposed to be more effective than regulation by a government agency because it is based on the conviction of self. It is also developed from industry norms; hence the stigma of non-compliance with peers and competitors are enough to encourage compliance (Besanko and Kanatas, 1996). Basically in all banks, the primary responsibilities for safety and soundness, and prevention and detection of frauds and errors rest with the bank management. Self regulation which is yet to be imbibed in emerging markets works in developed countries where market leaders impose market discipline. Self regulation normally fails due to competition or when market leaders themselves are weak. At such periods, self regulation becomes ineffective; indecision and self interest become a determinant (Herring and Szegö, 1995).

The third approach is through banking supervision which is in two forms. The on-site examination is to ascertain the financial condition of a bank. It also aims at verifying the accuracy of the periodic reports of the banks sent to the Regulatory Authorities, analysing those aspects of a bank that cannot be adequately monitored through off-site surveillance and confirming and ensuring compliance with laid down laws, rules and regulations (Cameron et al (1972)). On-site examiners assess the quality of assets, management, earnings, capital and funds management as well as accounting and internal control systems. The second form is off-site surveillance. The returns of banks to the Regulatory Authorities are analysed by off-site supervisors for completeness, accuracy and consistency as well as compliance with prudential ratios and regulations (James and Charles, (1988)). Regulatory Authorities, mainly in emerging markets, which do not have adequate resources rely more on off-site supervision to monitor the financial condition and performance of banks and to identify those banks that may need closer scrutiny. It is an irony of fate that where on-site examination should be emphasized due to low integrity of information from banks; resource constraints make such Regulatory Authorities to rely on off-site supervision (Llewellyn, (1988)). It is useful to add that on-site examination has been found to be more effective than off-site supervision in many jurisdictions due mainly to unreliable information that many banks do send to the Regulatory Authorities.

Finally, deposit insurance scheme is a financial guarantee scheme which seeks to protect depositors' fund against losses associated with bank failures Mishkin (1997) and Frederic, (1996). The scheme promotes a safe, sound and stable banking system. As a means to curtail moral hazard that deposit insurance could engender, the insured limit is always set at a low amount to ensure adequate protection of small savers for which the scheme is primarily designed. It is therefore, necessary for Regulatory Authorities to set up effective monitoring systems and increase punitive measures against the abuses in the system.

2.3.4 Methods used by regulatory authorities for supervision

Supervisory authorities carry out their functions through bank examinations. Bank examination may be defined as the examination of the books and records of a bank for the purpose of ascertaining that the affairs of the bank are being conducted in a safe and sound manner with respect to: adequacy of capital, asset quality, board and management, earnings, liquidity, adequacy of internal controls, adequacy of accounting system and record keeping as well as compliance with both the individual banks' internal policies and prudential regulations (Davies et al 2008). To accomplish the task of examining banks, bank examiners use both off-site and on-site supervision to carry out their supervisory functions.

2.3.4.1 Onsite supervision

On-site supervision of banks entails physical presence of regulators in the financial institutions to evaluate their internal controls, compliance with the laws and regulations governing their operations with a view to determining their overall risk exposure Ogunleye (2005). Emphasis is placed on their capital, asset quality of management, the strength of earnings and the adequacy of liquidity. On-site supervision is carried out by the Bank Examination Department of the regulatory bodies.

2.3.4.2 Off Site Supervision

The off-site supervision of banks is carried out by the regulatory authority and involves essentially the appraisal of banks returns. Essentially, it serves as an early warning device to detect a bank's emerging financial problem Rime (2001), and Peterson (1995). This is accompanied by analyzing key bank financial ratios and other financial data that are generated from periodic bank financial reports that are submitted to the supervisor.

An off-site supervision system can also contribute to a more efficient use of examiners' resources by giving priority to the examination of banks that are experiencing problems or which appear to be significantly increasing their risk exposure Ajaya (1995). The availability of off-site supervision reports and analyses can help examiners to prepare for on-site bank examination by focusing attention on specific commercial banks' activities that may require close supervision .At the aggregate level, off-site surveillance system can be employed by bank supervision to monitor the financial condition and performance of the entire banking system. Off-site supervision system typically focuses on a variety of key bank financial ratios covering such areas as earnings, asset quality, capital and reserves and liquidity (Crockett et al, 1997).

2.4 Regulations and Commercial Banks Performance

Not all researchers agree that regulation has had significant effects on bank lending. Jackson et al. (1999) review a number of prior studies investigating how capital adequacy regulations influence actual capital ratios; such as Peltzman (1970), Mingo (1975), Dietrich and James (1983), Shrieves and Dahl (1992), Jacques and Nigro (1997), Hancock and Wilcox (1994), Rime (2001), and Wall and Peterson (1987, 1995). Jackson et.al's conclusion is that in the near term banks mainly respond to strict capital requirements by reducing lending and that there is little conclusive evidence that banks regulation has induced banks to maintain higher capital to assets ratios than they otherwise would choose if unregulated.

The regulatory Accord has sparked a debate on the value of its implementation. On the other hand, it has been acknowledged for its contribution to the widespread use of risk-based capital ratios. The Accord has also been praised for the international coverage of regulations standards and for the improvement of these standards in many countries. Its design, however, has been blamed for several distortions to the business of banking. Growing evidence on these distortions and a reduction in its effectiveness has led to proposals to redesign it. There is no consensus on how best to design the regulation of bank, Santos (2002). Restricting bank activities through a higher capital requirements ratio could be negatively associated with bank development, adversely affecting credit expansion and credit growth. Moreover, regulatory restrictions on bank activities may increase net interest margins or overhead costs. The ability of banks to stabilize income flows by diversifying activities may only work in countries with sufficient securities market development (Sheng, 1990).

Earlier studies on the subject employed a static estimation approach which does not account for persistence in the dependent variable and the independent of explanatory variables, including capital adequacy. To address these shortcomings, recent studies have followed a dynamic estimation approach. Athanosoglou, Brissimis, and Delis (2005) investigate, in a single-equation framework, the effect of bank-specific, industry-specific, and macroeconomic determinants on bank profitability. Using dynamic estimation approach, Athanosoglou, Brissis and Delis (2005) investigate, in a single equation framework, the effect of bank regulation and macroeconomic determinants on bank profitability. Using dynamic estimation technique, Goddard, Molyneyx and Wilson (2004) study the determinants of profitability of European banks. They find a significant persistence of abnormal profits from year to year and a positive relationship between regulations and profitability. Showing that they is a positive relationship between bank regulation and commercial bank activities

Another strand of the literature relates regulations to profit efficiency, as measured by frontier techniques. Examples are Kwon and Eisenbeis (1997). Higher leverage or low equity/asset ratio reduces the agency cost of outside equity and increase its value by constraining or encouraging managers to act more in the interest of shareholders. Hence, higher leverage can mitigate conflicts between shareholders and managers concerning the choice of investment. Along these lines, the studies by Besanko and Kanatas (1999) examine the effects of bank regulation on risk taking and bank performance. Technique, Goddard, Molyneyx, and Wilson (2004) study the determinants of profitability of European banks. They find a significant persistence of abnormal profits from year to year and a positive relationship between the capital-asset ratio and profitability.

Another strand of the literature relates capital ratios to bank profit efficiency, as measured by frontier techniques. Examples are Kwon and Eisenbeis (1997), Fare et al. (2004), and Berger and Bonaccarsi Patti (2006). Higher leverage or a low equity/asset ratio reduces the agency costs of outside equity and increases its value by constraining or encouraging managers to act more in the interest of shareholders. Hence, higher leverage can mitigate conflicts between shareholders and managers concerning the choice of investment. Along these lines, the studies by Besanko and Kanatas (1996), Blum (1999), and Calen and Rob (1999) examine the impact of bank regulations on risk taking and bank's performance.

2.5 Banks Capital Adequacy Regulation

The setting by regulators of minimum capital standards on banking institution was one of the vital developments in the 20th century. In most cases banks regulators see capital adequacy regulation as a means of strengthening the safety and soundness of the banking industry (Oladejo and Oladipupo, 2011). Basically, there are three arguments for capital adequacy regulation. The first is that capital adequacy regulation is needed for prudential reasons, but most advocates of this position take the argument no further to explain why prudential “need” is there in the first place (Jackson, et al. 1999). The other argument is that capital adequacy regulation is needed to counter moral hazard problems created by the regulator themselves (Benston and Kaufman, 1996).

The final argument is that capital adequacy regulation is needed to protect small depositors (Craig and Hardee, 2007). Capital adequacy by definition is seen as a quantum of fund, which a financial institution should have and plan to maintain in order to conduct its business in a prudent manner (Kishore, 2007). Adequate capital is viewed as the amount of capital that can effectively discharge the primary function of preventing banking industries failure by absorbing losses. It is seen as a way of providing the ultimate protection against insolvency arising from the risk in banking sector. It is the least amount necessary to inspire and sustain confidence in the banks, keep it open and operating so that time and earnings can absorb losses without being forced into costly liquidation and enable banking industry to take full advantage of its profitable growth opportunities (Akintoye and Somoye, 2008).

It is to be expected that commercial bank’s value can be enhanced by sensible use of equity and borrowed capital. Thus, the enhanced capitalization of insurance industry been called for by regulatory authorities provides an opportunities for banks to attain desired optimal structure for the purpose of increasing market value and shareholders wealth (Peek et al 1999). Their efforts are geared towards protecting depositors from banks and insurance industry fragility and failure. It should be borne in mind that the type of recapitalization envisaged should improve banks performance by ensuring solvency and profitability as well as enhancing financial intermediation capacity. The various approaches to recapitalization have been identified to be raising additional capital from existing or new owners i.e. using laundered financial resources (capital market) or raising capital using insurance fund; reduce liabilities (write down certain debt); Book value of an asset; right issues for existing

shareholders and capitalization of profits; public offer through the capital market and or private placement.

Merger, acquisition and a combination of the identified strategies (Adeyemi, 2006). However, it is not known currently whether increases in capital levels will improve profitability of bank and the researcher intends to cover this gap. Despite the many theoretical papers on the subject, the empirical evidence on the value of bank monitoring is quite scant. In a notable exception, Yafeh and Yosha (2003) use firm level data from Japan to examine whether bank monitoring reduces firms' spending on projects with scope for private benefits. They find limited supporting evidence using the share of the largest creditor in a firm's total debt as a proxy for monitoring intensity. The marginal contribution of this paper relative to that literature is to empirically examine the impact of changed monitoring incentives on borrower default and bank performance in a manner that circumvents a difficult reverse causality problem.

2.6 Regulation and Bank Lending

Banks play a major role in lending that's credit creation. This encourages investment and provide the need finance for constrictive purposes that alleviate a country's industrial, financial and economic well being Peterson and Rajan (1994).

According to Goodhart (2005) banks that fail to comply with regulations might be forced to actively manage their assets and reduce loan portfolio to maintain target capital ratio whether it is the regulatory minimum or optimal level that the bank desires to maintain. In a study carried out in Kazakhstan, Krainer (2007) noted that a decrease in loans to meet the targeted regulations depends on the leverage ratio each bank wants to maintain the regulatory or desired level of ratios should be different. Financial regulations in Kazakhstan explained that the main cause of the shrinkage of bank loans in Kazakhstan was the lack of credible borrowers' rather than enhanced regulatory requirements. Groeneveld et al (1990) in another study carried out in Kazakhstan found different results from those of the financial regulations, they come to conclusion that main causes of shrinkages of bank loans in Kazakhstan was due to regulation rather than lack of credible borrowers and other minor factors

Santors (2002) found out that restricting bank activity through higher requirements of regulations could be negatively associated with bank development, adversely affecting crediting expansion and credit growth. Moreover, regulations restrictions on bank activities

may increase net interest margins or overhead cost. The ability of banks to stabilize income flows by diversification activities may only work in countries with sufficient securities market development

Diamond and Rajan (2000) found out that bank's structure affects its liquidity creation and credit creation functions in addition to its stability. They noted that greater regulations reduce the probability of bank's financial distress and also reduce credit creation. Large regulatory requirements increase banks' safety and soundness but these requirements also lead to an increase in banks' effective cost by reducing the amount the bank can lend. Regulations may pose a credit crunch for the cash poor and potentially increase the debt burden of the cash rich

In a study that concentrated on banks in developed countries Gonzalez and Pereira da Silva (2010) analyzed the cyclical effects of bank regulations buffers using an international sample of 2361 banks from 92 countries over the period of 1990-2007. Their findings showed that regulation reduces the banks' credit supply, but also has an expansionary effect on economic activities by reducing the spread between lending and deposits rates.

Goodhart, Hofmann and Segoviano (2004) analyzed United States, Mexico and Norway banks. Their findings showed that banks increased their capital levels by partially shifting to low risk weighted assets. Consequently they come to a conclusion that this may have caused a reduction in the credit supply in the economy of these countries. According to Hancock and Wilcox (1998), Chiuri, Ferri and Majnoni (2001) regulatory requirements and the adoption of risk sensitive regulatory policies reduce banks' credit creation

Peek and Rosengren (1997) in a related study looked at the effects of declines in the Japanese stock market on the lending by subsidiaries and branches of Japanese banks in the US. The pair concluded that regulations squeeze due to equity declines in the Japanese market to influence lending in the US especially by branches. It must however be noted that during the period of the study, US banks were under liquidity constraints rather than regulations consequently the results are less convincing

2.7 Regulation and Supervision Towards Managing Systemic Risk

Banking Supervision refers to the process of monitoring the control systems, activities and financial condition of banks in order to ensure these are always within the parameters of

prudent banking practises as set out in the regulations King and Levine(1993). Its main objective is to safe guard the viability and stability of the financial sector, which is an irreplaceable sector to the development of each economy. Banking supervision has been generally set to prevent the occurrence of systemic risk to the banking sector, as well as to increase the transparency and effectiveness of the banking sector and contribute to the protection of small depositors(Kasiak, 2000).

Following the work of the International Monetary Fund and the Bank of International Settlements for the G20. Systemic risk can be defined as a risk of disruption to financial services and is caused by an impairment of all or parts of the financial system and has the potential to have serious negative cost for the real economy. If a bank loses money from a risky investment that is not systemic that's operational risk (Kwon and Eisenbeis1997).However, it takes the form of institutional failure, market capture, infrastructure breakdown or even a sharp rise in the cost of financial services. This can have serious adverse implications for many other market participants. It is such negative externalities and the significant spill over to the real economy that are the essence of systemic risk and which make a case for policy intervention.

Karuana (2010) asserted that the failure an individual bank introduces the possibility of system-wide failures or systemic risk. This perception is widespread. It appears to exist in almost every country at almost every point in time regardless of the existing economic or political structure. As a result, bank failures have been or continue to be a major area for public policy concern in all countries and a major reason that banks are regulated more carefully than other firms.

Systemic risk has two dimensions. The first one is the cross-sectional dimension which reiterates that the structure of the financial system influences how it responds to shocks. Shocks can arise from common exposures across institutions or from network interconnections. The policy problem is how to anticipate and as well address such exposures and inter linkages among financial institutions. The second one is the Time dimension which spells out that the build-up of risk over time interacts with the macro-economic cycle. It poses policy problem of how to address the problem of the financial system, (Maimbo, 2002)

In view of the dangers posed to the economy by systemic risk and the understanding that it mostly emanates from banks, banking supervisors have anticipated the need for rigorous bank supervision practises to ensure proper adherence to bank regulations which are meant to sustain stability in financial sectors and the economy as a whole(Chant et al 2003). Hence, financial regulators are an important part of the solution, but they alone will not suffice to address systemic risk in all its complexity. Other policies, especially monetary and fiscal, also have a role to play.

2.8 Empirical Research on Commercial Bank Regulations and Supervision

Barth et al (2006) sought to empirically address the issue of what works best with bank regulation and supervision. They examined the impact of the approaches to bank supervision on a variety of empirical indicators for bank development, bank stability, bank fragility, bank efficiency, bank performance and integrity in bank lending. Using data for bank supervision from their own dataset on regulation and supervision around the world for 2001. They carried out preliminary cross - country correlation exercises between the supervision variables and bank development. The correlation results showed that greater government ownership of banks is positively related to regulations that reduce competition and restrict international financialintegration. This is because foreign ownership of domestic banks is restricted and is also negatively associated with regulations that promote transparency and private sector monitoringof banks.

Barth et al (2006) also investigated the effects of bank supervision on systemic banking crises. They utilize data on episodes of banking crises from Lindergreen et al (1996) and Caprio et al (1999) for the period from 1988 to 1999. Using a logit probability model regression with banking crisis as the dependent variable, they find that restricting bank activities and strongofficial supervision are associated with an increased probability of suffering a major crisis even in the presence of a very generous deposit insurance scheme.

Soludo (2004) discovered that low bank regulation has made commercial banks to be less able to finance the economy and more prone to unethical and unprofessional practices. These include poor loan quality of up to 21 % of shareholders' funds compared with 1–2 percent in Europe and America; overtrading, abandoning the true function of banking to focus on quick profit ventures such as trading in foreign currency and tilting their funding support in favour of import-export trade instead of manufacturing; reliance on unstable public sector funds for

their deposit base; forcing their female marketing staff in unwholesome conduct to meet unjustifiable targets in deposit mobilization; and high cost of funds. Aminu and Kola (2004) maintained that increasing the capital base of banks in Nigeria would strengthen them and, in the process, deepen activities within the industry. “Growing the Nigerian economy is about the number of banks that have the capacity to operate in all the states of the federation, fund agriculture and manufacturing concerns, and in the process generate employment for Nigerians.” (Ologbondiya and Aminu, 2005),

2.9 Summary

This chapter looked at the need for commercial banks to be regulated and supervised due to the important role they play in economic development, it also gave an insight on the activities of commercial banks, bank regulation and supervision and the objectives for bank supervision among other factors. This work was done so as to see the effect of bank regulation and supervision on the activities of commercial bank. The chapter also looked on the implications of bank regulations in relation with commercial bank performance and also the effect of capital adequacy on the activities of commercial banks such as regulation on lending. The part also introduces how regulation and supervision have an effect towards managing systemic risk .Some empirical studies and researches on the effectiveness of bank supervision have also been highlighted in the chapter. With different researchers producing different results on given phenomena for bank supervision. This and other information pertaining bank regulation and supervision have prompted the researcher to look into the effects of bank regulation and supervision on the activities of commercial banks in Zimbabwe. This was done utilising the research methodology that is to be outlined in the next chapter.

CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides an insight into the methodology adopted in the collection, analysis and interpretation of the data for the study. It attempts to provide a detailed analysis of the research plan and tools utilized in the actualization of this study. It will also give details of the research population and sample. Data collection methods used in the study as well as the techniques employed in collecting each type of data will be outlined. The chapter will also focus on the data validation, evaluation of the reliability of the data and a data presentation and analysis plan.

3.2 Research Design

The descriptive survey method has been adopted for the purpose of this study. This type of research design was chosen as it enables the assessment and analysis of certain behaviour and information. The primary objective of the study is to assess the effects of regulation and supervision on the activities of commercial banks. Therefore, the adoption of this survey method is important to ensure a detailed account of the factors contributing to achieving financial stability in the economy through effective bank regulation and supervision in the country. Although this method takes a lot of time, frequently cost and depends a great deal on the willingness, honest and ability of the respondents. With a descriptive research design the researcher could reveal data and perform analysis and perform analysis and assessment that often lie on the blind side of regulation and policy formulation. The research design was also chosen as it aids enhancing a deeper understanding of phenomena and deemed to produce a strong descriptive result

3.3 Research Population

The study population is made up of the Reserve Bank of Zimbabwe (RBZ) which is the one responsible for making regulations. It also includes commercial banks which are affected with the regulations on their activities. The respondents include the head regulatory and supervision department, bank managers and other representative of the department. These respondents will provide the researcher with the right information to answer the research questions

3.4 Research Sample

The researcher used stratified random sampling method, by using questionnaires and also conducting personal interviews from the entire population. The stratified random sampling of respondents was carried out from the strata's, thus 16 RBZ staff members, 48 commercial bank's employees randomly selected from 16 commercial banks to makeup a total sample size of 64 respondents. This was done considering the structural design of the Zimbabwean banking sector and the specific banking activities that the sector encountered within the research period.

The advantages are the ability to capture key population characteristics, it often requires a smaller sample which gives a greater precision, hence minimising costs, and mainly it ensures that particular groups in a population are adequately represented in the sample and improves efficiency by gaining greater control on the composition of the sample.

Table 3.1 Research Sample

Respondents	Distribution	Weight of respondents
Commercial bank's staff	48	75%
RBZ's staff	16	25%
Total	64	100

A total of 64 questionnaires were distributed 75% of the targeted respondents were commercial bank's staff and 25% were RBZ staff. The sum of their weights represents the grant total of dispatched questionnaires

3.5 Data Collection Methods and Instruments

To ensure reliability and relevance of the information resulting from the research and also for in-depth knowledge about the subject matter, the researcher employed qualitative and quantitative approaches which were derived from primary and secondary sources.

3.5.1 Primary Data

One of the main advantages of collecting primary data is the greater amount of control that the researcher have in determining the methods used, and time period to collect the data. This enables the researcher to focus on specific aspects of the research. In addition, by using primary data the researcher is most likely to collect original, upto date and unbiased data. The main disadvantage of primary data is that it consumes a lot of time, hence the researcher have to manage time effectively.

3.5.1.1 Questionnaires

The questionnaire were composed of both structured questions which were simple and relatively easy to administer and unstructured questions, which assessed the views of the respondents without guiding them. Carefully chosen questions were enlisted to aid respondents to answer only questions which were related to the topic under study. The researcher prepared 16 questions, which is definitely not a small number. The questions seek to dig deeply into the practices inside the bank and were very flexible. Respondents were people who were busy, thus giving them questionnaires gave them sufficient time to respond to questions hence giving accurate answers and deliver well thought answers

3.5.1.2 Interviews

The researcher conducted interviews to reinforce the questionnaires disbursed and also gather other data. Two types of interviews were used which are telephone and personal interviews. The interviews brought about information regarding individual experiences, knowledge and opinions an in-depth or face-to-face interview was conducted on one to one basis to reveal the underlying motives of the interviewee's attitudes, behaviour, and perceptions and allowed much interaction between the interviewer and interviewee .Interviews were important because they allowed the researcher to get an in-depth knowledge on the subject as contrasted to questionnaires and they allowed the respondents to help the researcher in areas where they had total knowledge.

3.5.2 Secondary Data

Secondary data is data that have been already collected by and readily available from other sources. Secondary data helps to make primary data more specific and improves the understanding of the problem. It also provides a basis for comparison for the data that is

collected by the researcher. However, it is very difficult to align secondary data to the current research problem.

For the purpose of this study secondary data was sourced from the banks' financial and nonfinancial performance data sent to the RBZ quarterly, the published financial statements, banks' annual reports, RBZ's monetary policy statements and other financial journal. It was necessary to use the secondary data because already existing data is efficient and less costly to use. In addition, secondary data allowed the researcher to foster an extension of the scope of data analysis thereby improve the quality of findings.

3.6 Data Validation and Reliability

The aim of assessing validity is to see how accurate the relationship between the measure and the underlying trait it is trying to measure, (Gaur et al, 2006). In this instance, face validity were used where the questionnaire's usability were tested. This will enable the researcher to prepare meaningful and easily understood questions. The questionnaires will also be given to the supervisor to test the validity before being distributed to the respondents to assess the effects of bank regulation and supervision on the activities of commercial banks. The questionnaires will be coded to facilitate the researcher to effectively assess the effects bank regulation and supervision on the activities of commercial banks

A pilot test was done on both the interviews and questionnaires techniques in order to evaluate the impact of the questions, and assess the quality of the responses with a view of adjusting questions so that they work towards, achieving the objectives of this research. Pilot testing aims to assess the validity of the questions and reliability of data collected. Fellow students who have knowledge on the research were used for the pilot test.

3.7 Data Presentation and Analysis Plan

Data presentation and analysis will involve coding of questionnaires, editing, classification, and tabulation of collected data so that an analysis could be made, deviations, averages, variances, dispersions, relationships and other statistical measures which are used to interpret data calculated. Editing involved examining the raw data to detect errors and omissions. Coding involved the process of assigning numerals and symbols to answers so that responses can be put into a limited number of categories and classes. Classification involved putting data in groups or classes each class having similar characteristics and finally these were

tabulated and graphs and pie charts were derived. Statistical tools such as Chi-square test in order to make comparison test the hypotheses and draw conclusions; Percentages is a statistical tool that uses too as its base. It will be much easy for the research to make comparison using percentages in describing the relationship. Chi-square test provides a means of comparing a set of observed frequencies with a set of expected frequencies.

The test statistic for testing hypothesis is based on the quantity

$$X^2 = \frac{(O_i - E_i)^2}{E_i}$$

Where: O_i = the observed frequency
 E_i = the expected frequency
 X^2 = the value of the random variables

3.8 Summary

The chapter is a layout of the research methods that the researcher employed for the purpose of this study. This chapter defines the research design used as descriptive research design. It also gave an insight into the research population, research sample and data collection methods. The research population is characterised by commercial banks, depositors of the banks and the Reserve Bank of Zimbabwean. This is because the research is mainly focused on assessing the effects of regulation and supervision on the activities of commercial banks. Data collection methods take the form of primary and secondary research with the RBZ publications constituting much of secondary research. Finally data validation, presentation and analysis plan was well described in the chapter. This will be done before moving on to the next chapter which will diagrammatically present and analyse data from research findings.

CHAPTER 4: DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter involves the presentation and analysis of data gathered from the questionnaires which were administered on the sample selected. For the analysis, tables, bar charts, pie charts and simple percentage will be used to present data while the test of hypothesis shall be carried out using chi-square (X^2) statistics. The statistical tool adopted was opted for because it allows for effective understanding and interpretation of results. Furthermore, in order to reduce the bulkiness of data, the data presented and analysed are those that are considered relevant to the problems, Objectives and hypotheses of this research work.

4.2 Analysis of the Response Rates

A summary of how questionnaires were distributed and the response rate in give in table 4.1 below

Table 4.1 Percentage Distribution of Returned Questionnaires by Respondents

	Administered	Returned/completed	Response rate (%)
Commercial banks Staff	48	44	92
RBZ Staff	16	14	89
Total	64	58	91

Source: Raw data

From table 4.1, it can be seen that a total 48 questionnaires we administered to commercial banks staff but only 44 (92%) was completed and returned, also 16 questionnaires was administered RBZ but only 14 (89%) was completed and returned. In total of 64 questionnaires which were administered a total 58 (91%) was completed and returned. This shows that the total responses were significant to investigate on the effects of regulations and supervision on the activities of commercial banks

4.3 Awareness to RBZ Regulations

In order to assess the effects of regulation and supervision on commercial banks, through assessing if the investors are aware of the RBZ regulations and supervision on the activities of commercial banks, the degree of respondents' opinion was sought using a two-point.

Table 4.2Awareness of the RBZ regulation

Response	Number of response	Percentage (%)
Yes	49	84.5
No	9	15.5
Total	58	100

Source: Raw data

In relation to whether investors are aware of the RBZ regulation and supervision on the activities of commercial banks, table 4.2 show that 49 (84.5%) of the investors are aware and 9 (15.5%) of the investors are not aware. This implies that most of the investors are aware of the activity of the RBZ of regulation on the activities of commercial banks .This agrees with Sheng (1990) he stated that this will make commercial banks to develop in a wide range of financial products to meet the needs of the economy. So as to ensure efficiency, security and responsiveness of banks to the needs and complaints of customers and ensuring compliance with laid down rules and regulations.

4.4 Supervision and Public confidence

A summary of whether regulation and supervision has facilitated public confidence in the banking sector in give in table 4.3.

Table 4.3 Supervision and Public Confidence

Response	Number of response	Percentage (%)
Agree	29	50
Disagree	23	39.7
Undecided	6	10.3
Total	58	100

Source: Raw data

Table 4.3 shows that 29 (50%) of the respondents agreed that regulation and supervision of banks facilitate public confidence in the banking sector, however 23 (39.7%) disagree, while 6 (10.3%) respondents were indifferent. Based on this analysis, we can surmise that most respondents consider that regulation and supervision of banks facilitate public confidence in the banking sector. This is because banking supervision has been generally set to prevent the occurrence of systemic risk to the banking sector, as well as to increase the transparency and effectiveness of the banking sector and contribute to the protection of depositors. (Kasiak, 2000). There by increasing their confidence in the banking sector. The researcher also carries out some technical test so as to further examine data as under discussion.

The researcher adopted the Chi-Square goodness-of-fit test to test if regulation and supervision have facilitated public confidence in the banking sector. The Chi-Square statistics formula is given as

$$X^2 = \text{Summation of } (O_i - E_i)^2 / E_i$$

Where O_i = Observed frequency

E_i = expected frequency

The degree of freedom $n = 3$, $V = 3 - 1 = 2$

Level of significance = 5% or 0.05

Note: E_i = total frequency 58 divided by 3 = 20

H₀: Regulations and supervision have facilitate public confidence in the banking sector

H₁: Regulations and supervision have not facilitate public confidence in the banking sector

Decision Rule:

If the Chi-square calculated value is greater than the Chi-square table value, we accept the alternative hypothesis, but if otherwise, reject the alternative and accept the null hypothesis.

Table 4.3.1 Chi-square calculated value

O_i	E_i	O_i-E_i	(O_i-E_i)²	(O_i-E_i)²/E_i
29	20	9	81	4.05
23	20	3	9	0.45
6	20	-14	196	9.8
			Total	14.3

Degree of freedom (n-1) = 2
 Level of significance = 5%
 Critical value X^2 0.05 at 2 degree of freedom = 5.99
 Chi-square calculated = 14.3

Analysis of the test result (14.3 > 5.99). The null hypothesis (H₀) is rejected while the alternative (H₁) is accepted. By this analysis, the Regulatory and Supervisory activities of the RBZ have contributed negatively in boosting depositors' confidence in commercial banks. This shows that most of the depositors in the country have no confidence in the banking sector. There by regulations and supervisions have a negative effect on boosting depositor's confidence.

4.5 The Effectiveness of RBZ's Regulation and Supervision

The table 4.4 below gives a summary on whether regulations and supervision carried by the RBZ were effective or not.

Table 4.4 the effectiveness of RBZ's regulation and supervision

Response	Number of response	Percentage (%)
Effective	35	60.3
Ineffective	20	34.5
Undecided	3	5.2
Total	58	100

Source: Raw data

Table 4.4 shows that about 35 (60.3%) of the respondents described regulations and supervision carried by RBZ as effective respectively, while 20 (34.5%) respectively described it as ineffective. 3 (5.2%) respondents were indifferent. Based on this analysis it shows that majority of the respondent described RBZ's regulations and supervision as effective. This has resulted in an increase in economic growth as sited by Bench (1993) that effective supervision of banks leads to a healthy banking industry. They by result in the increase in economic growth of an economy

The researcher also carries out some technical test so as to further examine data.

The researcher adopted the Chi-Square goodness-of-fit test to test the effectiveness of regulation and supervision.

H₀: RBZ's regulations and supervision are effective

H₁: RBZ's regulations and supervision are not effective

Decision Rule:

If the Chi-square calculated value is greater than the Chi-square table value, we accept the alternative hypothesis, but if otherwise, reject the alternative and accept the null hypothesis.

Table 4.4.1 Chi-square calculated value

O_i	E_i	O_i-E_i	(O_i-E_i)²	(O_i-E_i)²/E_i
35	20	15	225	11.25
20	20	0	0	0
3	20	-17	289	14.45
			Total	25.7

Degree of freedom (n-1)	= 2
Level of significance	= 5%
Critical value X^2 0.05 at 2 degree of freedom	= 5.99
Chi-square calculated	= 25.7

Interpreting the test result ($25.7 > 5.99$), the null hypothesis (H_0) is rejected while the alternative (H_1) is accepted. By this, it shows that the Regulatory and Supervisory functions of the RBZ are not effective. This may result in failing of banks as cited by Dimitri Vitas (1990) that ineffective regulation and supervision will cause negative impact of moral hazard and price shocks on the banking system, thereby leading to an increase in bank failures and banking system distress

4.6 Prudential Management of Bank Assets and Guarantees the Safety of Depositors Funds

Table 4.5 below will give a brief summary on whether effective supervision of commercial banks would ensure prudential management of bank assets and guarantees the safety of depositor's funds

Table 4.5 Prudentialmanagement of bank assets and guarantees the safety of depositors' funds

Response	Number of response	Percentage (%)
Yes	35	60
No	23	40
Total	58	100

Source: Raw data

Table 4.5 show that 35 (60%) of the respondents agreed that effective supervision of commercial banks ensures prudent management of bank assets and guarantee the safety of depositors funds and 23 (40%) of the respondents did not agree to that. Based on this analysis, it shows that effective supervision of banks would ensure prudent management of bank assets and guarantee the safety of depositors' funds.

This proposition has been supported by several scholars including; Goldsmith (1969) and Cameron et al (1972). Practical evidence also suggest that effective bank supervision would result in a positive correlation between real growth of output, investment and bank assets there by guarantee the safety of depositors funds.

4.7 The introduction of prudential guidelines and banking stability

The table 4.6 below give a summary on whether the introduction of prudential guidelines has promoted stability in the banking sector

Table 4.6 The introduction of prudential guideline and banking stability

Response	Number of response	Percentage (%)
Yes	30	52
No	28	48
Total	58	100

Source: Raw data

Table 4.6 in response to whether the introduction of prudential guidelines has promoted the nation's banking stability indicates that 30 (52%) of the respondents agreed that the introduction of prudential guideline promoted the nation's banking stability and 28 (48%) of the respondents disagreed. Based on this analysis, it shows that most respondents uphold the statement. This is because prudential guidelines would require framework for early warning signals (EWS) and a holistic engagement of their thrusts. Onno Ruding, (2002) was of the view that strictness requires the setting of high standard of prudential guidelines to reduce the risks of individual banks or the entire banking system in a country from becoming illiquid or insolvent.

4.8 Regulation and Supervision Function of the RBZ.

The table below shows the response rate on whether the stability in the banking sector was as a result of sound regulations and supervision of the central bank

Table 4.7 Regulation and Supervision function of the RBZ

Response	Number of response	Percentage (%)
Agree	23	39.7
Disagree	32	55.2
Undecided	3	5.1
Total	58	100

Source: Raw data

Table 4.7 tries to affirm whether the stability in the banking system was as a result of sound regulatory and supervisory functions of the RBZ in commercial banks. From the responses, 10 (17.2%) of the respondents strongly agreed, 23 (39.7%) agreed, 32 (55.2%) disagreed while those that were indifferent are 3 representing (5.1%) The break down indicates that most respondents believe that the stability in the banking system was not as a result of sound regulatory and supervision functions of the RBZ. This shows that the regulatory authorities are not carrying out their duties so as to maintain stability in the banking sector. Since supervision is there to assist supervisory authorities in timely identification of decline in banks' financial conditions before it degenerates to threaten the stability of the banking system or even the economy. Donli (2003). The researcher in addition carries out some statistical examination so as to further examine the statistics.

The researcher adopted the Chi-Square goodness-of-fit test to test the weather the stability in the banking system was as a result of sound regulatory and supervision function of the RBZ

H₀: the stability in the banking system is as a result of sound regulation and supervision function of the RBZ.

H₁: the stability in the banking system is not as a result of sound regulation and supervision function of the RBZ.

Decision Rule:

If the Chi-square calculated value is greater than the Chi-square table value, we accept the alternative hypothesis, but if otherwise, reject the alternative and accept the null hypothesis.

Table 4.7.1 Chi-square calculated value

O_i	E_i	O_i-E_i	(O_i-E_i)²	(O_i-E_i)²/E_i
23	20	3	9	0.45
32	20	12	144	7.2
3	20	-17	289	14.45
			Total	22.1

Degree of freedom (n-1)	= 2
Level of significance	= 5%
Critical value X^2 0.05 at 2 degree of freedom	= 5.99
Chi-square calculated	= 22.1

Interpreting the test result ($22.1 > 5.99$), the null hypothesis (H_0) is rejected while the alternative (H_1) is accepted. By this, it shows that the stability in the banking system is not as a result of sound regulation and supervision function of the RBZ. This shows that the RBZ is not doing its duties as the regulatory authority. Dale (1986) had classified prudential regulation on banks into three: preventive, protective and supportive. While preventive regulation of banks is designed to limit the risk undertaken, the protective regulation offers protection in the event of failure. The supportive regulation is in form of a lender of last resort.

4.9 Onsite Supervision and Unethical Conducted in the Businesses of Banking

The table below will give an analysis on whether onsite supervision has helped in reducing unprofessional and unethical conduct in the banking sector so as to enhance stability in the banking sector

Table 4.8 Onsite supervision and unethical conducted in the businesses of banking

Response	Number of response	Percentage (%)
Yes	38	65.5
No	20	34.5
Total	58	100

Source: Raw data

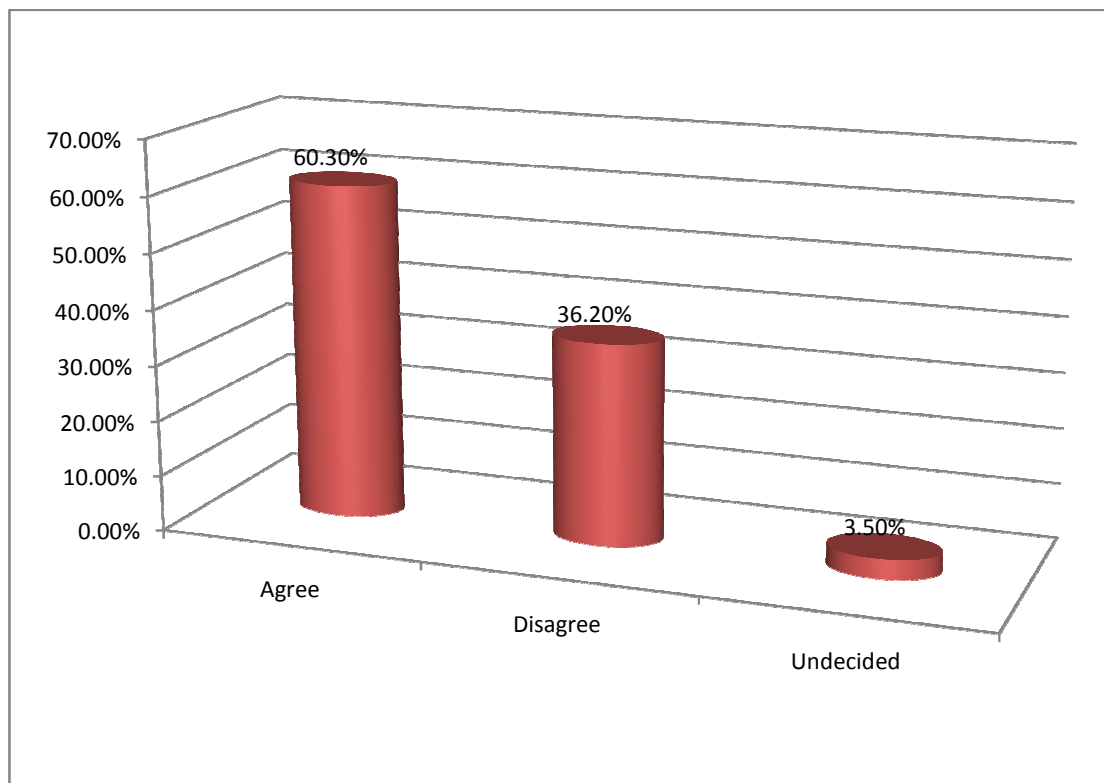
Table 4.8 it was discovered that a total of 38 (65.5%) of the respondents have agreed that onsite supervision has helped in reducing unprofessional and unethical conduct in the business of banking and 20 (34.5%) respondents have disagreed. Based on this analysis, most respondents were of the view that onsite supervision of commercial banks has helped in reducing unprofessional and unethical conduct in banks. This is for the reason that the central bank is not fully carrying out its duty of supervising banks.

Soludo (2004) discovered that low bank regulation has made commercial banks to be less able to finance the economy and more prone to unethical and unprofessional practices. These include poor loan quality of up to 21 % of shareholders' funds compared with 1–2 percent in Europe and America; overtrading, abandoning the true function of banking to focus on quick profit ventures

4.10 Disclosure of Bank Financial Statement and the Soundness of Banks

The summary of the responses shows weather the disclosure of financial statements will help investors in determining the soundness of a bank

Figure 4.1 Disclosure of financial statements helping in determines the soundness of a bank.



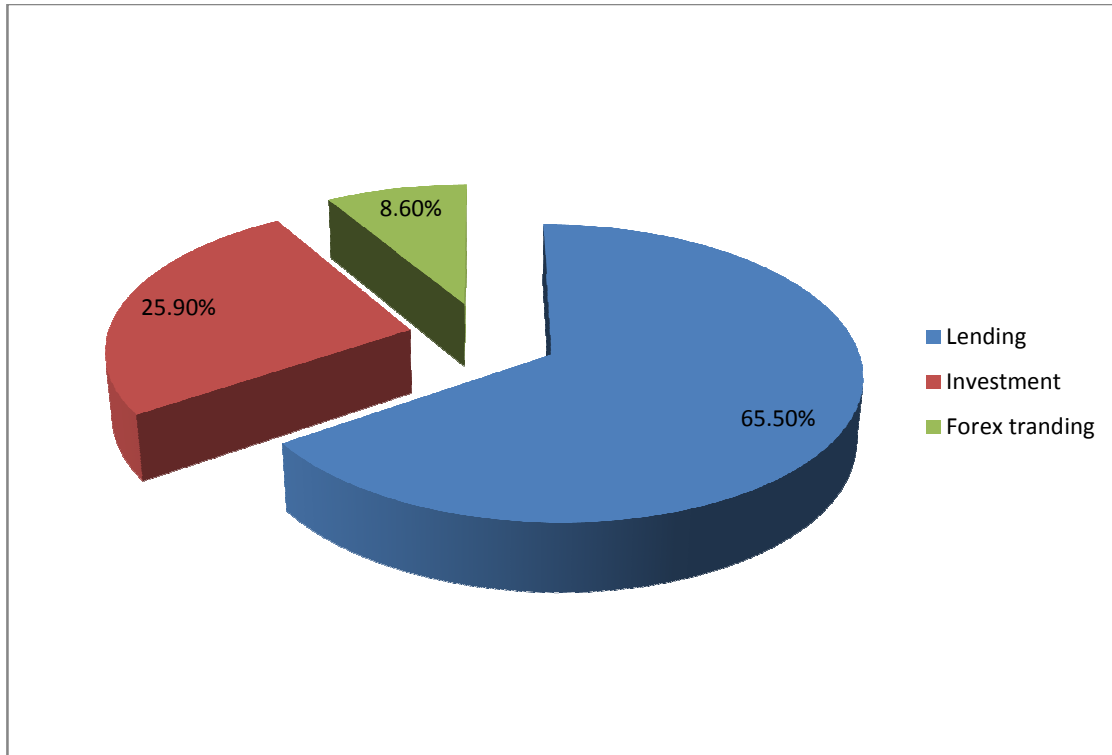
Source: Raw data

Figure 4.1 shows that 60.3% of the respondents agreed that the disclosure of bank's annual financial statements to investors would help in determining the fitness of the bank, while 36.2% of the respondents disagreed and 3.5% of the respondents were indifferent. Based on this report only, the researcher concluded that, disclosure of bank's annual financial statements to investors would help in determining the fitness of commercial banks

4.11 Commercial Banks Activities

The summary of the response rate of the activities of commercial banks which are being affected mostly with regulations and supervision are shown in figure 4.2 below

Figure 4.2 Commercial banks activities



Source: Raw data

Figure 4.2, shows the response rate of commercial activities banks which have been affected by supervision and regulations of the central bank. 65.5% of the respondents said that lending has been affected mostly, 25.9% of the respondents said investment has also affected and 8.6% of the respondents agreed that forex trading has been affected with the activities of the RBZ of regulation and supervision. Basing on this analysis we conclude that lending is the most commercial banks activity which has been affected most by regulation and supervision in a negative way.

This was supported in a study that was carried out on banks in developed countries by Gonzalez and Pereira da Silva (2010) analyzed the cyclical effects of bank regulations buffers using an international sample of 2361 banks from 92 countries over the period of 1990-2007. Their findings showed that regulation reduces the banks credit supply, but also has an

expansionary effect on economic activities by reducing the spread between lending and deposits rates.

4.12 Insider Lending and other Abuses by Bank Staff

The summary of response in table 4.9 show if regulation and supervision helped in guarding against insider lending and other abuses by bank directors, managers and officers of banks

Table 4.9 Insider lending and other abuses by bank directors, managers and officers of banks

Response	Number of response	Percentage (%)
Agree	38	65.5
Disagree	17	29.3
Undecided	3	5.2
Total	58	100

Source: Raw data

In Table 4.9 shows that 38 (65.5%) of the respondents respectively, agreed that bank regulation and supervision have helped in guarding against insider lending and other abuses by bank directors, managers and officers of banks; 17 (29.3%) respectively, disagreed to the statement while 3 (5.2%) of the respondents were indifferent. The break down indicates that most respondents believe that bank regulations and supervision have helped in guarding against insider lending and other abuses by bank directors, managers and officers of banks.

This is done so as to curtail moral hazard that deposit insurance could engender, the insured limit is always set at a low amount to ensure adequate protection of small savers for which the scheme is primarily designed. It is therefore, necessary for Regulatory Authorities to set up effective monitoring systems and increase punitive measures against the abuses in the system Dietrich and James (1983). The researcher in addition carries out some statistical examination so as to further examine the statistics.

H₀: bank regulation and supervision have helped in guarding against insider lending and other abuses by bank directors, managers and officers of banks

H₁: bank regulation and supervision have not helped in guarding against insider lending and other abuses by bank directors, managers and officers of banks

Decision Rule:

If the Chi-square calculated value is greater than the Chi-square table value, we accept the alternative hypothesis, but if otherwise, reject the alternative and accept the null hypothesis.

Table 4.9.1 Chi-square calculated value

O_i	E_i	O_i-E_i	(O_i-E_i)²	(O_i-E_i)²/E_i
38	20	18	324	16.2
17	20	-3	9	0.45
3	20	-17	289	14.45
			Total	31.1

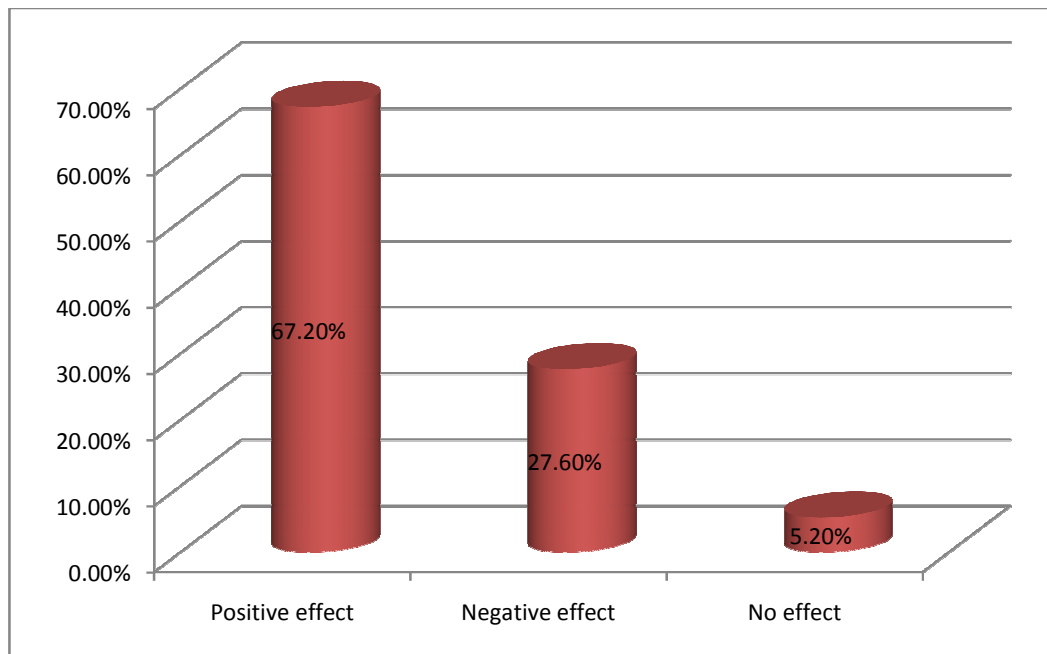
Degree of freedom (n-1) = 2
 Level of significance = 5%
 Critical value X^2 0.05 at 2 degree of freedom = 5.99
 Chi-square calculated = 31.1

Interpreting the test result (31.1 > 5.99), the null hypothesis (H₀) is rejected while the alternative (H₁) is accepted. By this, it shows that bank regulation and supervision have not helped in guarding against insider lending and other abuses by bank directors, managers and officers of banks

4.13 Effects of Regulations and Supervision on Systemic Risk

The summary in figure 4.3 below shows the results on whether regulations and supervision has a positive or negative effect on the management of systemic risk

Figure 4.3 Effects of regulations and supervision on systemic risk



Source: Raw data

Bar chart above show that 67.2% of the respondents were of the view that regulations and supervision have a positive effects on systematic risk management function. However 27.6% of the respondents held that systematic risk function has a negative effect on the management of systemic risk, small proportion equal to 5.2% of the respondents was of the opinion that regulations and supervision have no effect on the systemic risk management function. Using these research results, regulations and supervision have a positive effect on systemic risk management function of commercial banks.

This shows that the regulatory authority work so as to protect the financial sector as a whole. Karuana (2010) asserted that the failure an individual bank introduces the possibility of system-wide failures or systemic risk. This perception is widespread. It appears to exist in almost every country at almost every point in time regardless of the existing economic or political structure.

4.14 Summary

Overall, research findings on the effects of bank regulations and supervision above clearly confirmed that there are a lot of areas which regulators and supervisors of banks have to closely look at in order to maintain stability in the financial sector. As deduced by the research findings, banking regulations and supervision components such as guarding against insider lending and other abuses of power by bank directors, managers and officers of banks are being affected negatively by these regulations and supervision of the central bank. These components affect the overall performance and activities of most of the commercial banks. This will result in a greater risk and loss of depositors to the economy as a whole. It also results in poor financial statements which are being disclosed by commercial banks. This enhances the need and importance of effective bank regulations and supervision to minimize systemic risk. The next chapter summarizes the research findings and gives conclusion and recommendations on the research topic of the effects of regulation and supervision on the activities of commercial banks

CHAPTER 5: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS.

5.1 Introduction

In this chapter, the researcher will provide a summary of the study and make conclusions on the results obtained for each research objectives. The research will also include a brief comparative narration of the conclusions that were reached by other authors. Recommendations and suggestions for future research will also be provided in this chapter.

5.2 Summary of the Study

The primary objective of this study was to determine the effects of regulations and supervision on the activities of commercial banks. Different authors and scholars on the field of study reviewed suggested theories that were given by the researcher. Observations and statements renowned authorities and legends on the subject also found their way in the review. This was provided as literature review to support the study. The research used descriptive research design to achieve this objective as well as the secondary objectives. In the study the research used a population of 16 commercial banks and the RBZ, from which a sample of 48 commercial banks staff and 16 RBZ staff was drawn. The sample was drawn using the stratified random sampling technique.

From the findings it was observed that regulations and supervision has a negative effect mostly on bank lending .Also that regulations and supervision have a positive effect in facilitating public confidence in the banking sector. The researcher also found that most of the investors are aware of the regulations on the activities of commercial banks .The Regulatory and Supervisory activities of the RBZ have contributed negatively in boosting depositors' confidence in commercial banks. The Researcher also observed that the Regulatory and Supervisory functions of the RBZ are not effective. The results of the findings also reflect that,the stability in the banking system is not as a result of sound regulation and supervision function of the RBZ. On the subject of the disclosure of bank's financial statements, it has been observed that they have a positive effect on determining the soundness of a bank. This observation is with regards to the intensity of the activities that the bank undertakes to drive income. However regarding systematic risk management regulations and supervision have a positive effect.

5.3 Conclusions

From the investigation carried out by the researcher, the study draws the following conclusions:

- The supervisory and the regulatory functions of the RBZ have not been effective in curtailing distress in the commercial banks.
- Depositors' confidence in the banking system needs to be improved through an integrated process involving all stakeholders.
- Effective regulations and supervisions by the RBZ would boost the volume and the value of transactions
- Effective bank supervision is important in protecting depositors' funds, avoiding bank failures and installing discipline in the financial sector.
- The Reserve Bank of Zimbabwe's loss of the lender of last resort function since dollarization has posed difficulties in the operations of banks especially with regards to liquidity challenges, leading to reduction in profit levels
- Capital adequacy and asset quality were found to be major causes of bank failures in Zimbabwe.

5.4 Recommendations

In order for commercial banks and the RBZ to achieve stability in the financial sector. The following recommendations may be put in place.

5.4.1 Investing in supply side

In order to improve the lending function in the event of any negative effect, commercial banks are recommended to invest in supply side of their macroeconomics through capital expansion and deposit layering activities both at individual bank level and industrial level at large as the demand for bank loans continues to escalate. However caution need to be taken of risks replete in such advances. A good example was maintaining minimum balances affordable for different classes of individuals at different socio economic classes and employment fraternities

5.4.2 Compliance with Regulations

Generally the risk management function was improved by regulation and supervision. As such commercial banks are recommended to be in compliance with regulations so as to safeguard their individual banks and financial system as a whole from the inherent risks in banking activities. The risk management function is also improved through frequently reviewing operations procedures, improving information management systems and enacting early warning systems on risk

In order to compliment the risk management function a cautious exploration of the asset and liability management theory as a tool for prudential risk management results is recommended for commercial banks. Through banks still had at their disposal, activities such as selling of certificates of deposits, securities under purchase agreements and others as supplements to liquidity, these still were not without risk as noted by Reed and Grill (1989). Therefore incorporation of prudential risk management into banks liability management system was here considered of paramount importance if banks were to successful withstand the raging banking demands of this multicurrency environment

5.4.3 On-site Supervision

It is also imperative that, regular on-site supervision must be conducted by skilled people, following rigorous procedures, so as to try and detect red flags that tell if a bank is solvent and in compliance with applicable rules and regulations. This is very important because some of the elements of banking risk cannot be easily revealed by looking at disclosures and other mandatory paper filings. Often, banks' financial reporting can be biased and vested interests can disguise problems or mask fraud, hence the supervisory authorities must be vigilant in their examination and surveillance processes.

5.4.4 Formulation of strategies by the Government

Commercial banks activities have a serious implication to the overall growth of the economy. From the findings, regulations have a negative impact on the lending, forex trading and investment activities of commercial banks. Hence there is need for proper formulation of strategies that promotes these banking activities in the economy. While concurring with the RBZ that there is need for regulations to ensure the financial sectors stability, it is wise to note that the economy has faced decline levels of economic growth owing to, among other things, dwindling levels of aggregate investment due to failure by commercial banks to lend

and invest especially in this multi currency era. Thus there should be a framework that strikes a balance between the need to maintain financial sector stability and economic growth. This calls for implementation of regulations and supervision.

5.5 Suggestions for Future Research

In future research work, further research is needed to assess the adherence of banking institutions to banking regulations to have an in-depth picture of commercial banks adherence and compliance to regulations and supervision.

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APPENDIX A: COVER LETTER

**MIDLANDS STATE UNIVERSITY
FACULTY OF COMMERCE
DEPARTMENT OF BANKING AND FINANCE**



.....September 2013

The General Manager

Dear Sir/Madam

Reff: Application for assistance through completion of questionnaire forwarded to your bank for academic research purposes.

I am a 4th year student in Banking and Finance at the Midlands State University, am carrying out a research on the topic, the effects of regulations and supervision on the activities of commercial banks. I therefore kindly ask for assistance through the completion of questionnaires accompanying this letter as per your understanding. You are strongly assured that this information will be treated with confidentiality and its use will be limited to academic purposes only. Your cooperation is kindly appreciated.

Yours faithfully.

Murandu Clayton.

APPENDIX B QUESTIONNAIRE ON THE EFFECTS OF REGULATION AND SUPERVISION

Please tick in the appropriate box

SECTION A: Background information

1. Ownership: locally owned foreign owned
2. When was incorporated.....years
3. Position held.....

SECTION B: Effects of regulations and supervision

- 4 Are the investors and depositors aware of the central bank’s regulation and supervision in the activities of commercial banks?
Yes No
- 5 Does the regulation and supervision of banks facilitate public confidence in banking sector?
Yes
- 6 How can you describe the effectiveness of the RBZ’s regulation and supervision function?
Effective Ineffective
Undecided
- 7 Does effective supervision of banks ensure prudent management of bank assets and guarantee the safety of depositors’ funds?
Yes No
- 8 Has the introduction of prudential guidelines promoted the nation’s banking stability?
Yes No

9 Do you agree that the stability in the banking system is a result of sound regulation and supervision function of the RBZ, do you agree?

Agree Disagree Undecided

10 Is the Central Bank carrying out the on-site supervision, has it helped in reducing unprofessional and unethical conducted in the business of banking?

Yes No

11 Does disclosure of bank financial statements help in determining the soundness of the banks?

Agree Disagree Undecided

12 Which of the following commercial bank activities have been affected by central bank's supervision and regulation?

Lending Investment Forex trading

13 Has regulation and supervision have an effect on systematic risk function?

Yes No

14 Bank regulation and supervision have helped in guarding against insider lending and other businesses by directors, managers and other officers of the bank

Yes No Undecided

15 As a bank, are you complying with the central bank regulation and supervision

Yes No

16 What is your overall assessment of the effects of regulation and supervision on the activities of your bank?

.....
.....
.....

THANK YOU

APPENDIX C: INTERVIEW GUIDE FOR BANK GENERAL MANAGERS

These are some of the questions that will guide the researcher to carryout interview.

- What are the objectives of bank supervision?
- What are the challenges faced by banks in trying to adhere with set regulations?
- What are the challenges faced by bank supervisory authorities in doing their work?
- How often are banks supervised in Zimbabwe?
- How do you ensure best lending practises for your bank?
- What do you think are the major concerns of bank supervision