Credit Risk and Bank Profitability in Zimbabwe: An ARDL Approach

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Abstract

Banks operate in a risky environment, and their performance depends on risk management. Banking systems that are robust and profitable can withstand adversity and contribute more to the expansion of the financial system. Credit risk has the most significant and detrimental impact on a company's viability, systemic stability, and capital allocation efficiency. The literature contains no conclusive evidence of the relationship between credit risk and bank performance. This research aimed to contribute to the ongoing discussion regarding the connection between credit risk and bank performance. It is distinct from other investigations in terms of methodological and contextual perspectives. The research is contextualized in light of the Zimbabwean economic crisis. In contrast to other studies that have used fixed effects, random effects, and generalized methodologies, it utilized an ARDL methodology. The findings indicate that bank profitability is positively affected by capital adequacy, bank size, loan market share, and economic growth, while inflation has a negative impact on profitability. The result indicates that credit risk has a negative and significant impact on banks' short- and long-term profitability. This implies that a rise in credit risk decreases the profitability of banks both in the short and long term. The result implies that instituting policies that reduce credit risk can accelerate bank performance.

Keywords: Banks Operations, Risky Environment, Credit Risk, ARDL