An Evaluation of Banking Sector Regulatory Capital in a Multicurrency Economy: A Case for Zimbabwe

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KEYWORDS Minimum Capital. Banks. Reserve Bank of Zimbabwe. Tier 1 Capital

ABSTRACT This paper seeks to evaluate Zimbabwe’s banking sector capital requirements based on existing theory and evidence. Literature surveyed is used to critically evaluate the existing design of bank capital requirements. The study shows that all banks in Zimbabwe had fallen short of minimum capital requirements in 2012, prompting aggressive capital raising strategies in the banking sector. In this study, various implications of the new capital requirements for the banking industry and the economy in general are discussed. The discussion supports the increase in capital requirements in that bank stability and lending would be enhanced as a result of such increase in capital. This however comes at a cost as the weighted average cost of funds increases due to the use of additional equity in capital structure of banks which further adversely impacts on borrowers. Overall, the study shows that benefits of increasing capital requirements outweigh the costs. Further, a set of recommendations for three economic sectors, namely, the banking institutions, the central bank and the government, on ways to respond to the regulatory changes and standard regulatory capital requirements are outlined.

INTRODUCTION

Regulatory capital requirements in Zimbabwe have received great attention over the past decade as the country moved through a period of economic instability between 2000 and 2008 to a multiple currency system in 2009. The major concern regarding regulatory capital arises from the need for banking sector stability in an environment where banks collapse at the start-up phase with an average life of 5.2 years (Sibanda and Mhlanga 2013). The collapse of a banking institution has destabilizing effects on the financial sector due to contagion and systemic risk (Miles et al. 2012; Schaeck and Cihák 2012; Baker and Wurgler 2013; Berger and Bouwman 2013; Sibanda and Mhlanga 2013) and therefore designing efficient and effective regulatory minimum capital requirements is important for the regulator, the financial system and the public in general (Borio and Zhu 2012). The introduction of a multiple currency system in Zimbabwe also means that the country’s central bank has no monetary policy power to control money supply in the economy and so the capital requirements remain the only tool that the monetary authorities have in controlling the financial system.

Zimbabwe faced unprecedented hyperinflation between 2003 and 2009, peaking at 231 million percent in 2009 (RBZ 2012). Consequently, the country’s real output plummeted as industrial capacity utilization dwindled. However, prior to the economic challenges, the country witnessed a significant growth in banking and shadow banking institutions as a result of financial liberalization in 1991, although by 2009 nine banks were either placed under curatorship or closed due to insolvency (Sibanda and Mhlanga 2013). Interest rates soared and only short-term lending took place as depositors shunned the banking system for the black and parallel market. The country eventually abandoned its currency (Zimbabwe dollar) and adopted a multiple currency system in March 2009. A multiple currency system allowed trade to be conducted using major currencies, especially the United States Dollar (US$).

After the introduction of the multiple currency system, the economy stabilized with inflation dropping to single digit levels. Banks resumed their lending functions despite a low deposit base. The Reserve Bank of Zimbabwe (RBZ), as the country’s banking regulatory authority pegged the minimum capital requirement for banks at US$12.5 million in 2009. However,
RBZ increased the minimum capital requirements for banks by 700 percent from US$12.5 million to US$100 million in July 2012. Table 1 shows new aggregate capital requirements for the banking industry, assuming no bank failures, consolidations and new entrants. This increase came amid thin bank profit margins, liquidity constraints, lack of public confidence in the banks, and low manufacturing capacity utilization in the country.

The banking industry held assets of US$5.6 billion as of June 2012, representing 56 percent of the country’s GDP of US$10 billion (RBZ 2012). Furthermore, US$2 billion (20 percent) of the economy’s money supply (M3) circulated outside the banking system as the public struggled to gain confidence in the sector, which was undermined by bank failures and economic policy uncertainties.

According to the International Monetary Fund (IMF) (2011), the risk of Zimbabwean banks suffering a serious downgrade due to economic slowdown is ranked medium. This emanates from a high credit concentration risk, and the IMF (2001:47) believes, “an outright default of their (banks’) three largest exposures could drive a significant number of banks, including some systematically important banks, to become undercapitalized. An increase in non-performing loans would lower banks’ profitability by lowering interest income and requiring loan provisioning”. This assertion by the IMF highlights the unique structural problems besetting the banking industry in Zimbabwe.

Consequently, the need for prudent minimum capital requirements for Zimbabwean banks became crucial, but the method of determining such capital remains a puzzle. The need for a prudential capital requirements design is important in that the July 2012 capital requirements, ceteris paribus, result in the total bank capital amounting to 25 percent of the country’s GDP. Furthermore, the new minimum capital requirement represents about 50 percent of the banking sector’s assets, and 70 percent of total bank deposits.

The questions that this study seeks to answer relate to how banks could meet capital requirements and the impact of these capital thresholds on the banking sector, the economy and the public in general. This study therefore seeks to evaluate the regulatory capital requirements in respect of the Zimbabwean banking sector after the introduction of the multiple currency system.

**Objectives of the Study**

This study seeks to:

1. Evaluate the regulatory capital requirements in a multicurrency Zimbabwean economy.
2. Provide recommendations to the banking sector regulator, the banks and the government on the best courses of action with regard to regulatory capital design, policy direction and financial strategies.

**Brief Review of Literature**

The 1988 Basel Accord was a landmark benchmark for uniform minimum regulatory capital standards (Basel Committee 1988; Crouhy et al. 2006). The accord was implemented in 1992 with the intention to level the playing field for international banks. Initially, the Basel Committee on Banking Supervision (Basel Committee) comprised senior officials of central banks, supervisory authorities from G-10 member countries and officials from Switzerland and Luxembourg. The committee was established under the Bank of International Settlements (BIS). The Basel Accord I defined two minimum standards

<table>
<thead>
<tr>
<th>Type of bank</th>
<th>Number of banks</th>
<th>Old capital requirements (USD million)</th>
<th>New capital requirement (USD million)</th>
<th>Aggregate capital (USD billion) by June 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td>18</td>
<td>12.5</td>
<td>100</td>
<td>1.8</td>
</tr>
<tr>
<td>Merchant banks</td>
<td>2</td>
<td>10</td>
<td>100</td>
<td>0.2</td>
</tr>
<tr>
<td>Building societies</td>
<td>4</td>
<td>10</td>
<td>80</td>
<td>0.32</td>
</tr>
<tr>
<td>Savings bank</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>25</td>
<td>-</td>
<td>-</td>
<td>2.41</td>
</tr>
</tbody>
</table>

*Source: Various Bank Reports*
for meeting capital adequacy requirements: an assets-to-capital multiple and risk-based capital ratio (Basel Committee 1988). The assets-to-capital multiple is determined by dividing the bank’s total assets (including specified off-balance sheet items) by its total capital with a maximum multiple of 20 being allowed (Crouhy et al. 2006).

Primarily, banks (both commercial and merchant) form the key to economic activity through credit creation and pooling of financial resources. These institutions allow depositors to channel their savings while providing borrowers with a source of funds. Thus the bank’s balance sheet equates total bank assets to total bank liabilities and bank capital. Bank capital (equity) acts as a cushion against a sudden decline in the value of assets or unexpected withdrawal of liabilities (Cecchetti 2008). In preserving capital, banks tend to reduce dividend payouts, engage in mergers and takeover activities, and seek new capital through strategic partnerships and rights issues (Mhlanga and Sibanda 2013).

Regulatory capital receives much attention from regulators as the default of a large bank may trigger contagion or systemic risk in the financial sector and subsequently damage the entire sector (Gauthier et al. 2012). To cater for systemic risks, Gauthier et al. recommend that banks implement macro-prudential capital requirements to complement existing capital requirement ratios. Macro-prudential capital requirements refer to a situation where each banking institution has capital requirements that equate to a fixed point corresponding to the bank’s contribution to the risk of the system. Thus instead of bank capital regulation being centered on an individual bank level, there is need for cross-cutting regulation to minimize contagion and systemic risk in the financial sector.

In designing the capital requirements for banks, it is essential for regulators to attain a balance of cost of capital and lending rates to customers (Baker and Wurgler 2013). In doing this, increasing Tier 1 capital tends to increase the weighted average cost of capital and subsequently, lending rates. However, it has also been argued that despite increases in the banks’ cost of funds, banks tend to benefit from increases in charter value and stability of the financial sector by reducing risk-taking incentives (Schleiphake and Kirstein 2013). If indeed the increases in capital requirements prompt increases in the cost of borrowing, then borrowing would adversely impact on the economic activities of the public and government albeit that increases remain desirable when accounting for social and private costs and benefits (Gauthier et al. 2012).

Furthermore, increasing regulatory minimum capital requirements increases the cost of capital, and in a competitive banking environment such regulatory actions are likely to promote collusive practices, which could result in increased profits for a few banks operating in an oligopolistic loan market (Schleiphake and Kirstein 2013). According to Schleiphake and Kirstein, increasing capital requirements could lead to banks further cutting back on lending in a bid to raise equity capital. This possible consequence could have an adverse impact on the desired objective of increasing lending to productive sectors of the economy. However, this notion has been opposed in recent literature where it is argued that equity financing used in propping up regulatory capital bolsters lending activities as equity is used to finance lending activities (Miles et al. 2012). This argument is supported by the fact that regulatory capital is not put aside as reserved capital, but is used for normal banking activities and hence does not shrink funds available in the banking sector and economy in general. Moreover, increasing capital requirements has been observed to increase the probability of survival and market share of small banks during normal times as well as at times of crises (Berger and Bowman 2013). Berger and Bowman further show that increases in bank capital improve the performance of medium-to-large banking institutions during times of banking crisis. Thus the role of regulatory capital has effects on contagion and the stability of the financial sector and the economy in general.

Another important aspect of regulatory capital relates to the behaviour of banks in response to regulatory capital changes. Capital requirements that include firm-specific and time-varying add-ons have an impact on the banks’ desired capital ratios (Francis and Osborne 2012). Consequently, the adjustments to capital and lending are a function of the gap between the actual and target ratios. Thus, according to Francis and Osborne, the bank-specific capital requirements determine the bank’s internal capital targets. The level of a bank’s capitalization relative to an internal target influences the growth of the balance sheet and lending activities (Fran-
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Furthermore, the capital standard affects bank behaviour in the form of the cost related to breaching the minimum threshold and subsequently the actions required to prevent this breach (Borio and Zhu 2012). Borio and Zhu categorize these as the capital threshold effect and the capital framework effect. The capital threshold effect emanates from a failure to meet the capital requirements and is costly to the bank as it triggers restrictive supervisory actions, reputational damage and negative market reactions. The capital framework effect reflects how the banks actually perceive, manage and price risks. In this case, banks have to adjust their portfolios in response to changes in capital requirements, the resultant risk perception and risk assessment.

The banking sector relies heavily on leverage for credit formation, which in turn requires a strong capital base. Capital for banking institutions refers to investments in common and preferred stock that a banking institution has outstanding (Rose and Hudgins 2010). A BIS definition classifies capital into two: Tier I and Tier II capital. Tier I capital refers to the core capital, which relates to the book value of equity and perpetual preference stock contributions, while Tier II is referred to as supplementary capital (Basel Committee 1988). Furthermore, Tier II capital encompasses a broad spectrum of secondary sources of capital, such as loan loss reserves, convertible and subordinated debt securities with minimum caps (Saunders and Corner 2011). Overall, Basel II Pillar I requires minimum capital requirements of 8 percent of the risk-weighted assets, while Tier II should not exceed 50 percent of total regulatory capital.

Several measures have been adopted internationally to avert bank crises and issues of undercapitalization. For instance, the Deposit Insurance Scheme has been mooted and implemented in most countries, including Zimbabwe (Chikoko and LeRoux 2013). These schemes, however, have a problem in that they are subject to flat insurance premiums, which may lead to banks assuming excessive risk behind the back of uninformed depositors. Other studies found that despite regulatory pressure to increase bank capital, banks assume the same level of risk (Rime 2001). Further, increases in capital tend to raise costs and reduce access to external financing, especially in developing countries where capital flows are volatile (Claessens et al. 2003). To the best of the researchers’ knowledge, no research has been conducted on banking sector regulatory capitalism in a multiple currency economy. However, the reviewed literature contributes to the evaluation of standard capital requirements that could thus be dovetailed into a multiple currency situation.

**METHODOLOGY**

The study evaluates capital requirements for banks in Zimbabwe based on existing literature. The data are obtained from various banking reports and the RBZ database for the period ending 30 June 2012. This period coincides with the announcement of higher capital thresholds on 31 July 2013.

RBZ argues that the minimum capital requirements should bolster economic activity through increased lending to both the private and public sectors (RBZ 2012). This assertion comes in the context of an environment where the central bank uses minimum capital requirements as a tool to drive monetary policy in the absence of other mechanisms, such as open market operations. Consequently, the RBZ has resorted to this tool to achieve financial market stability in the country. However, if abused and frequently used, raising bank capital thresholds could be detrimental to the banking sector as economic agents may perceive the sector as unstable and risky. The increase in regulatory capital came at a time when the majority of banks in the country struggled to recapitalize. Bank capitalization levels vary across banks as depicted in Table 2.

**Table 2: Bank Capitalization Levels – June 2012**

<table>
<thead>
<tr>
<th>Capital levels</th>
<th>&lt; $25m</th>
<th>$26m–$50m</th>
<th>$51m–$75m</th>
<th>&gt; $75m</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign owned</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>Local owned</td>
<td>8</td>
<td>5</td>
<td>1</td>
<td>1</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>10</td>
<td>7</td>
<td>2</td>
<td>1</td>
<td>20</td>
</tr>
</tbody>
</table>

*Source: Various Bank Reports*
Of the 20 banks, which include one stand-alone building society, 10 (50 percent) had capital levels less than US$25 million, while only one bank had capital levels above US$75 million. The median share capital was US$26.7 million with a minimum of US$11.8 million and a maximum of US$83.4 million. Total share capital of the banks was US$662 million compared to the new minimum of US$2.42 billion if all banks complied, ceteris paribus.

Since one of the sources of Tier 1 capital, according to the Banking Act Chapter 24:20, are retained earnings, we find that three banks reported losses up to June 2012. Table 3 shows the profitability levels of banks in the country.

Of interest are the 11 banks (3 foreign and 8 local) that posted a profit of more than US$2 million for the half-year to June 2012. Such profits help banks boost capital adequacy levels to ensure regulatory compliance and a sufficient buffer for adverse shocks in profitability. Capital adequacy ratios for banks also vary considerably as shown by Table 4.

Fifty percent of the banks have capital adequacy ratios of between 8.1 and 14 while only 20 percent are within the 8 percent range. The rest have ratios above 14 percent. Thus, based on capital adequacy ratios, banks in Zimbabwe are well capitalized as they fall within the regulatory international standards of 8 percent. The research design employed for this study is mainly interpretive and analytical in nature.

**OBSERVATIONS AND DISCUSSION**

Since all the banks had capital levels below the minimum thresholds in July 2012, this means that they have to embark on a variety of strategies to raise additional equity capital amid illiquidity in the market. These strategies have serious consequences on the public confidence in banks, the structure of the banking sector, the regulatory mechanisms and policy formulation. These consequences are discussed as implications of new capital requirements to the banking sector and to the economy below.

**Implications of New Capital Requirements for the Banking Industry**

**Downgrade of Bank Status**

The Reserve Bank of Zimbabwe proposed that banks which fail to meet minimum capital requirements would be downgraded to micro-banks. Micro-banks, unlike micro-finance institutions, would be allowed to take deposits from the public but would have limited banking activities. Given that the country is primarily driven by small-medium enterprises, micro-banks are likely to take an active role in the financing of this sector. However, these banks could suffer from lack of depositor confidence or even bank-runs in the short to medium term as investors become risk-averse due to the banks’ failure to raise the minimum capital. This downgrade would also promote an oligopolistic market structure in the banking industry, primarily constituted by foreign-owned banks. Further to this, the oligopolistic structure could lead to cannibalism in the banking industry as big banks detect market practices and prices. As suggested by Schliephake and Kirstein (2013), categorizing
banks according to size could create an oligopolistic banking structure, which could further promote collusive practices and increased profits for a few banks. This will be undesirable if the economy requires a competitive banking sector.

**Corporate Finance**

To meet new capital levels, banking institutions could engage in corporate finance activities, such as rights issues, seasoned offerings, and joint ventures. However, rights issues are unlikely to yield desired capital levels for most small banks due to the inactive capital markets in the country. Consequently, corporate finance activities may raise part, but not the entire capital required by banks. As such, a combination of corporate financing instruments, including initial public offerings and offshore listings, may yield the desired outcomes. Although raising bank capital this way could increase the weighted average cost of capital for banks (Gauthier et al. 2012; Schliephake and Kirstein 2013), this could have desirable consequences in that it increases the banks’ charter value and stability in the financial sector (Schliephake and Kirstein 2013). The corporate finance instruments mentioned here have a great shareholder dilution effect in cases where existing shareholders have inadequate funds to take up their pre-emptive rights.

**Constrained Distribution Policy**

One major source of cash outflow is distribution of cash in the form of dividends to shareholders. Since past and current retained earnings would be considered in calculating capital for banks, it is prudent that banks stop dividend payments until new capital thresholds are met. As observed by Francis and Osborne (2012), banks are likely to adjust their desired capital ratios when faced with changes in regulatory capital and therefore more capital would need to be retained. In the same way, restricting dividend payments could be a cost related to the foregone breaching of the minimum threshold, as suggested by Borio and Zhu (2012). This would, however, pose a challenge for bank investors who prefer immediate cash to capital gains. Nevertheless, as stated by the dividend clientele theory, such shareholders can always create their own dividends by selling their stock or investing in other sectors that pay dividends.

**Market for Corporate Control**

Mergers and acquisitions are imminent in the wake of new capital requirements for banks. Banks with inadequate capital, but with attractive offerings and potential, are likely to be acquired by more capitalized banks. However, a precondition for such acquisitions would be synergies and takeover discount. Takeover discounts would be difficult, especially for listed banks, as existing shareholders are better-off offloading their stake in the market than accepting a lower bid. Alternatively, undercapitalized banking institutions are likely to court each other for possible consolidations. Such horizontal mergers are, however, problematic in that there are cultural differences and other potential post-merger conflicts. Moreover, banks may be acquired by foreign investors who are optimistic about the country’s economic and financial outlook. Banks with sister companies or under a conglomerate set-up are likely to spin-off or divest some of their operations in a bid to raise more Tier 1 capital. As discussed by Mhlanga and Sibanda (2013), banks are likely to engage in these activities in a bid to preserve capital and enhance shareholder value. The biggest challenge would be the availability of funds in the capital markets to execute such transactions.

**Bank Failures**

Zimbabwe experienced unprecedented bank failures between 1998 and 2012. The new capital requirement, coupled with a low savings culture and increased loan impairments in the economy, is likely to exacerbate bank failures. As in 2003, banks are likely to become more aggressive to bolster earnings, which when retained constitute part of a bank’s core capital. The increased need for new capital will propel risk taking, artificial accounting, and a propensity for non-interest income streams amid the constrained regulatory and supervisory capacity of the Reserve Bank of Zimbabwe. This has been witnessed in the past as banks collapsed due to imprudent lending practices and concealing of losses and non-performing loans (Sibanda and Mhlanga 2013). Thus, the new capital requirements are likely to force both micro and large banks into liquidation further leading to a new banking crisis should banks fail to raise new capital. However, if banks are able to raise capital, then they
will be able to survive crises, as asserted by Berger and Bouwman (2013).

**Artificial Capital**

Related to bank failures as mentioned above and in particular the constrained supervisory capacity of the central bank, banks in Zimbabwe are likely to engage in more innovative activities that create artificial bank capital. The central bank has stipulated that capital to be considered would be paid-up share capital, share premium, audited retained earnings, and current year earnings verified by the banking institution’s external auditors (RBZ 2012). It has been recorded in the history of the country’s banking industry that banks have reported increased audited profits, despite them being in a loss position and with negative share capital positions, as noted by Sibanda and Mhlanga (2013). This scenario, together with losses and the impairment of loans, is likely to present a put option to the owners of the bank, whereby these owners will have the right to surrender the institution license to the central bank at no cost, despite executives pocketing handsome remuneration packages during the tenure of the business.

**Cost of Supervision and Regulation**

The collapse and creation of artificial capital by banks will put pressure on the regulator to tightly monitor banking institutions. However, this comes at a cost to the reserve bank. The RBZ is undercapitalized and too understaffed to effectively monitor the activities of all the banks. It is therefore prudent for the government to capitalize the central bank, or invite private investors to buy stakes from the government shareholding. Such cases are common; for example the South African Reserve Bank is owned partly by the private sector. However, such a move should be well documented such that shareholders only have a right to elect a given number of board members with the rest appointed by the State, and have a right to dividends among other rights. Further, decisions of the central bank should remain autonomous and independent of the shareholders as stipulated by the principal-agent theory.

**Lack of Public Confidence**

Any bank failures or failure to meet capital requirements would lead to a contagion effect in the banking industry (Chikoko and LeRoux 2013). Systemic risk will be evident and as a result the investing public would lose confidence in the entire banking industry. Given that the Zimbabwean population lost life savings in the hyperinflationary environment between 2000 and 2008 due to the financial system at the time, they are likely to shy away from banks. In 2012, an estimated US$2 billion (25 percent of GDP) circulated outside the banking system, showing lack of public confidence in banks. If the objective of the central bank is to retain only well capitalized banks, allowing small banks to collapse, public confidence may be restored.

**Alternative Banking Channels**

Uncertainties in the banking industry will spur the use of mobile (technology) channels such as mobile money. Although registered as money transfer agents, mobile money agents allow individuals to hold, transfer cash and transact in shops through cellphones across the country. The systems are efficient and available beyond banking hours, with a cross-country branch network through the use of agents. Despite its money creation ability, mobile money poses a great threat to the deposit base of banking institutions thus depriving banks of loanable funds.

**Implications of New Capital Requirements for the Economy**

**Foreign Direct Investment (FDI)**

Liquidity constraints in the country mean that domestic corporate finance strategies may not yield adequate funding for banks. Thus most banks would be forced to approach external investors for capital. This means that additional funding from external sources would propel foreign direct investment, which could further boost economic activity and investor confidence in the country. However, foreign direct investment comes at a cost in that new banking funding would dilute existing shareholding and may come with several pre-conditions and prescriptions which may prove difficult to meet.

**Increased Loanable Funds**

Increasing minimum capital thresholds implies that banks would have increased loanable
funds, which could boost economic activity in line with the assertions of Miles et al. (2012). This increase in loanable funds is independent of whether equity capital is sourced from domestic or foreign markets. Loanable funds would lead to credit creation and hence boost money supply in the economy.

Indigenization Efforts

The government of Zimbabwe passed legislation in 2011 that requires all companies to have a 51 percent local shareholding. If this legislation is upheld, it could prove difficult for local banks to raise new capital from both domestic and foreign sources. This means that the new minimum capital levels could undermine indigenization efforts in the country, which may create political risk in bank funding.

CONCLUSION

The study employed a comparative analysis approach supported by a descriptive research design to evaluate bank capital requirements in Zimbabwe. The researchers note that bank capital is not free; it costs money to raise and to hold. Since 1988, capital adequacy has been based on the size, riskiness of the institution’s assets, and off-balance sheet exposures. Despite this, regulators in Zimbabwe implemented it differently with a one size fits all approach. Imposing relatively high capital requirements could bolster bank lending and promote economic activity in line with the existing theory and evidence. However, failing to meet the minimum capital requirements increases the danger of financial sector instability through contagion and systemic risk. A number of implications for policy require both the central bank as the regulator and the government to harness resources and efforts to stabilize the banking industry. The study also identifies some financial management implications for the banking institutions regarding alternative measures for minimum capital compliance. Subsequently, the study provides recommendations that entail overhauling strategies to stabilize the banking industry in the face of the new capital thresholds.

RECOMMENDATIONS

Given the challenges facing the Zimbabwean economy and the banking sector, it is paramount that banks, the regulator and the government adopt some strategies to ensure a smooth transition to the new capital thresholds required by the Reserve Bank of Zimbabwe. The following recommendations are therefore made:

To the Banks, Available Options Include One or a Combination of Some Following Strategies

- Consider spin-offs of non-core business units to obtain additional capital.
- Seek external equity partners.
- Embark on right issues where existing shareholders are given the right to purchase additional shares in the bank at a predetermined price.
- Sell the bank to other investors or external investors. This will allow owners to exit profitably.
- Do nothing and allow the central bank to convert the institution’s license to that of a microfinance bank.
- Delist and seek private equity investors to boost bank capital.
- Embark on massive cost-cutting measures, such as reducing executive management allowances and incentives, reducing research and development expenses, and deferring capital expenditure related to information communication technology, to boost profits.

To the Central Bank (Regulator)

- Continue to build supervisory and regulatory capacity to monitor the activities of banks in the country.
- Consolidate the activities of banks and building societies into one function. At present there is only one standalone building society in the country and the other three are subsidiary to commercial banks. Legislation to phase out building societies by gradually transforming them into commercial banks would ensure the number of banks is reduced in the country. Already three building societies out of four are under the flagship of commercial banks. Banks would thus be allowed to offer mortgage-related instruments. Consolidating these would enable banks to aggregate their capital levels, which would subsequently increase their capital base. Establishing a universal banking act which phases out finance
houses and discount houses could ensure focus in the banking industry and less strain on the supervisory function of the central bank.

To the Government

- Consider amending the indigenization act to enable banks to access external finance. The economy may not have the capacity to capitalize banks without outside assistance.
- Shed part of the government shareholding in the central bank to allow private sector participation in the shareholding of the bank. This will inject new capital into the bank to allow it to objectively regulate and supervise banks through capacity building in both personnel and infrastructure. Further, new capital injection would ease pressure on government to finance the operations of the central bank, while creating financial capacity for the bank to play the function of the lender of last resort.
- Allow independence of the central bank decision making, in particular with regard to monetary policy formulation. However, a close relationship between the Ministry of Finance and the central bank should be encouraged to align government (fiscal) policy with monetary policy.

ACKNOWLEDGMENTS

The researchers would like to express sincere gratitude to the reviewers who have contributed immensely in shaping this article.

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