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FACULTY OF COMMERCE

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effects of political risk on the performance of commercial banks in zimbabwe.

BY

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DEDICATIONS

This project is dedicated to my grandmother and my family for their unwavering support, prayers, sacrifices, encouragement, and guidance throughout my academic journey.

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I express my deepest gratitude to the Almighty God for the gift of life and the opportunity to pursue this research. I am eternally grateful to my academic supervisor for their invaluable guidance, patience, and expertise in guiding me through this project.I also extend my sincere thanks to all the respondents of this study for generously sharing their time and valuable insights, making this research possible. My heartfelt appreciation goes to my family, particularly my grandmother Mrs. Annie Chiunda, my aunt Mrs. M Poshiwa and Mrs. N Dera for their unwavering prayers, moral and financial support, and unconditional love.Special thanks to my friend Mr. B Mungate, for his camaraderie, encouragement, and unwavering belief in me. May the Almighty God bless you all.

ABSTRACT

Affected by political instability and policy uncertainty, political risk determines the inter-temporal expectations and decisions of economic units, and affects microeconomic, mesoeconomic and macroeconomic fields. Thereby, impacts of political risks that occur frequently in Zimbabwe over bank profitability are specified in this study. At first, the reasons of political risk and political instability in Turkey are analyzed. Secondly, the mechanisms that transfer the impacts of political risk to bank profitability are specified. Then, panel ARDL method is used to determine the effects of political instability on bank profitability in Zimbabwe . In addition to the variable of political risk index, some endogenous, macroeconomic and financial variables that affect bank profitability are also included and these variables are found to have a significant effect on bank profitability in accordance with the literature. In the context of the aim of the study, we find negative effect of the political risk on the bank profitability. Also, by separating banks as public and private banks, this effect is examined and the negative effect of political risk on public banks is found stronger. According to these results, it can be argued that implementations towards political stability should be worked as soon as possible for steady economic growth, in terms of the financing of real sector more favourably and the requirement of financial stability.

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LIST OF ACRONYMS

RBZ : Reserve Bank of Zimbabwe

CBZ : Commercial Bank of Zimbabwe

ZB Bank : ZB Bank

USD : United States Dollar

ZWL : Zimbabwean Dollar

ROE : Return on Equity

ROA : Return on Assets

NIM : Net Interest Margin

CRR : Cash Reserve Ratio

CPI : Consumer Price Index

IMF : International Monetary Fund

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CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

Political risk is the chance that political upheaval or changes in government will have a detrimental effect on the returns on an investment. Political risk is a subset of nation risk and is defined as the exposure that a bank or corporation has to political developments that could have an impact on its bottom line. Mokatsanyane, (2016) The banking sector `s performance is significantly essential for economic growth (Seyed 2020). Political risk is the risk an investment`s returns could suffer as a result of political changes or instability in a country Chen (2020). Legislative bodies, the administration, other foreign policy makers, military control, or other factors could cause instability that affects investment returns. Chen (2020). A stable banking sector is a sign of an economy`s resilience to shocks from both the internal and external environments and it plays a significant role in promoting economic growth and strengthening the health of the financial system in all countries A Hadood, et al. (2023). Commercial banks have a direct impact on the economy's stability, effectiveness, and growth. As they act as a middleman between depositors and investors, they allocate resources, and in order to do this, they must ultimately make enough money to pay for their operating expenses. Political risk has led to a noteworthy impact on bank profits due to its negative impact on commercial banks in Zimbabwe. According to (Keefer 2007), a country's political history or antecedents determine its financial development, however (Roe, 2006) contended that the political country's organizational structure plays a crucial role in creating a sophisticated financial institution. This viewpoint's proponents stated that a country with stable political systems typically has developed economies (Siegel & Roe). Thus, research (Bordo & Rousseau, 2006, has demonstrated that stable political tenure, political office holders' responsibility, and a nation's democratic features all influence financial development.

The political climate of every country now attracts investments and various forms of financial

activity, which in any event can happen through financial markets and organizations. As we move closer to the fourth industrial revolution and the globalization of financial markets, the idea of "political risk" is becoming more and more prevalent. While certain investors and company management have realized how important it is to comprehend political risk Mawanza, (2015), others have remained fearful of it since it jeopardizes the terms and conditions of investments. The money markets that are used for investments and short-term financing are centered on the banking industry. As a result, the industry is vital to the financial system and essential to the advancement and expansion of countries. Obalade A et al (2020). Nations, regardless of their economic standing, require a stable social and political climate in order to advance and enhance the standard of living within their communities. Some authors imply political risk as government interference, while others depict political risk in terms of events (Sithembile et al ,2022). Overall, the results show that political unpredictability is linked to a notable decline in bank performance. Kouze, (2023). An excessive number of shortcomings, high levels of corruption, and bad governance have been blamed for the failure of many African banks. A recent example of this is the collapse of numerous locally owned banks in Zimbabwe (2012–2015), which was brought on by politicians and large corporations with ties to the political system refusing to repay loans Kouki I. and Damette . (2022). But little research has been done on how political ties affect banks, particularly in African nations.

Damette and Kouki (2022) In light of the discussions surrounding the role of political and proprietary ideology in banking operations, researchers have examined the function of government through political engagement in banking, focusing on the effects of election years and the political cycle on banking performances. Profitability of financial institutions specifically banks is affected by both firm-specific and macroeconomic variables. Bank profitability is commonly measured by proxy return on assets and returns on equity it is expressed as a function of firm-specific and macroeconomic determinants Ademe (2023) Commercial banks with better financial performance are better able to withstand negative shocks and contribute to financial sector stability Ademe, (2023).

Political stability or instability is one of the determinants of profitability in the banking sector. The effects of political instability in economic studies have been witnessed intensely since the 1990s. This is a result of the lack of the knowledge of the effects of the democracy variable on macroeconomic performance in a clear manner, although democracy is taken as the political variable in the search for variables aside from economic variables to determine the economic performance differences between the developed and developing countries. Political instability stemming from different sources in different countries prevented the consensus on the conceptual definition of this instability type. However, based on the viewpoints of Sanlisoy (2017), regarding the political instability, it can be argued that two facts are at the forefront; constitutional or non-constitutional government changes as well as social unrest and political violence. The increasing political instability in a country firstly increases the political risks, and then increases the risk in economy, which stems from political field, in other words the political risk. The increasing political risk influences on the one hand the financial variables and on the other hand the real economic variables, and affects the microeconomic and macroeconomic performance of the country in a negative manner. Based on this point, the banking sector, which is the basic element of financial sector, is exposed to these influences both in terms of supply and demand. Increasing risk premium due to the rise of political risks and so increasing interest rates are influential in the supply side by increasing the costs of banks Sanlisoy (2017).

Diverse causes of political instability in various nations hindered the agreement on the conceptual definition of this kind of instability. However, it may be stated that two facts constitutional or non-constitutional government transitions, as well as popular unrest and political violence are at the forefront of the political instability based on Alesina and Perot's points of view. As a nation's political instability rises, so do the political risks and the economic risks that flow from the political sphere Sanlisay et al (2017). The country's microeconomic and macroeconomic performance is negatively impacted by the rising political risk, which also has an impact on financial and real economic indicators. This means that these effects affect both supply and demand in the banking sector, which is the foundation of the financial industry. Growing interest rates and a rising risk premium brought on by an increase in political risks have an impact on the supply side by raising bank expenses. Conversely, rising interest rates impact the banking industry from the demand side by raising the cost of lending and lowering the demand for credit from economic actors Selim Sanlisay et al (2017). This study is associated with various independent variables which include political stability, trade openness, financial crime and military spending. The stated variables have an influence on bank performance and their impacts are going to be evidenced in the empirical Review in chapter 2.

1.2 BACKGROUND

Given the prevalence of today's politically unstable environments, the financial channel of political instability is understudied despite its critical importance. The recent global financial crisis has resulted in a wave of bank collapses and scandals, which has intensified calls for better corporate governance. Notably, many collapses have been attributed to poor corporate government practices that failed to manage bank risk-taking Marie et Al (2023). A bank's exposure to political events that could have an impact on its profitability is known as political risk, which is a component of nation risk Motsakanyane, 2016). Evidence from throughout history indicates that nations all around the world bear a heavy price for acts of aggression. Political risk comes at a higher cost, particularly in developing nations The global financial crisis that erupted in 2007–2008 caused large banks and other financial institutions that were deemed too big to fail to fail Mokatsanyane (2016).African nations are known for their political unpredictability and volatile exchange rates. In addition to being susceptible to political risks, other African banks are also characterized by their fragility and susceptibility to failures brought on by insufficient capital, non-performing loans, lax banking regulations, high inflation, insecurities, a lack of infrastructure, and slow economic growth (Oyetade and Muzunditsi 2023). The banking sector in Nigeria functions in a politically unstable context that is impacted by pervasive corruption, a lack of transparency, and subpar infrastructure Obalade et al. (2021). It was implied that a significant portion of national risk in the Nigerian banking sector is comprised of political risk. In this context, moral hazard resulting from political involvement was attributed by Obalade et al. (2021) to banking crisis in African countries like Nigeria, Kenya, Uganda, and Zambia. A nation's political risks—that is, the political risk—increase initially due to growing political instability in the political sphere and subsequently due to increased economic risk. The country's microeconomic and macroeconomic performance is negatively impacted by the rising political risk, which also has an impact on financial and real economic variables Sanlisoy et Al (2017). Accordingly, these factors affect supply and demand in the banking sector, which is the foundation of the financial sector Sanlisoy et al. (2017). Growing interest rates and a rising risk premium brought on by an increase in political risks have an impact on the supply side by driving up bank expenses. Conversely, rising interest rates impact the banking industry from the demand side by raising credit costs and lowering economic agents' credit requests Sanlisoy et al (2017).

Since the year 2000, the Zimbabwean banking sector continues to experience unprecedented bank closures (Shingirai ,2015). Zimbabwe has a number of political concerns, such as hyperinflation and economic sanctions. Zimbabwe's sanctions situation has drawn a lot of attention from both domestic and foreign sources. Most notably, the United States of America (USA), United Kingdom (UK), European Union (EU), Australia, and Canada have imposed sanctions on Zimbabwe since 2000. Chingono, (2010) notes that the main justifications given by these western states for enforcing the penalties include political intolerance, violations of property ownership rights, abuses of human rights, and disdain for the rule of law. Financial sanctions prevent both short- and long-term loans from flowing freely, which lowers a nation's inflow of foreign currency Njanike et al (2011). From 2008 until 2023, Zimbabwe was subject to economic limitations that had a substantial effect on bank profits. Among the main problems impeding banks' profitability were restricted access to foreign financial markets, a decline in trade and economic activity, a decline in foreign investment, currency devaluation, and increased operating costs. According to Cagan's definition, Zimbabwe is experiencing hyperinflation, which started in February 2007 and is still ongoing. Because the Zimbabwean government ceased to submit official inflation numbers, it was challenging to gauge the country's hyperinflation during the 2008–2009 inflation peak.

Patrick (2015) Zimbabwe declared in the middle of 2015 that it would fully convert to the US currency by the end of the year. Announcing in June 2019 that all foreign currency was no longer legal tender, the Zimbabwean government reinstated the Real Time Gross Settlement dollar (RTGS), which will henceforth be referred to as the Zimbabwe dollar. According to Abel and Leroux (2016) and Anthony (2015), the hyperinflation severely lowered real banking savings and depleted the bank's assets and liabilities. As a result, there was a decline in public confidence in the banking industry. Political risk discouraged investment and consequently the demand for loans and credit in the economy, the dampened demand compelled a balancing adjustment on the financing side of the bank`s balance sheet Arthur (2020). Okika et al (2018) said that currency rates have a direct impact on profitability, pricing, and resource allocation. They also noted that unstable exchange rates make business challenging since they force businesses to make difficult decisions. Due to the unstable currency, inflationary pressures, and high interest rates, many firms in Zimbabwe collapsed, and some are currently experiencing financial distress. A rise of non-performing Loans has been identified. As at December 2013, RBZ monetary policy statement noted that the total level of insider loans in the bank was $175.3 million. This was quite a large percentage which showed the existing problem of higher NPLs Mahaso (2016).

One country that has been impacted by political risks since 2000 is Zimbabwe, and in the framework of the study's goal, we discover that political risk has a detrimental impact on bank performance. Political instability, according to Abeyasinghe (2004) and Siegel (2011), hinders financial development and overall economic progress. Political instability, according to Mbaku (2016), deters foreign direct investment as well as capital flight, including brain drain. Government decisions are distorted by corruption, which also undervalues public service obligations. Zimbabwe, a nation rich in culture and history, has long struggled with political and economic issues. These difficulties have not spared the nation's commercial banks, and political risk has significantly impacted their earnings Abe Yasinghe, (2004). The researcher gave a thorough overview of the background information on the variables that have affected how political risk has affected the profits of Zimbabwean commercial banks in this response. Furthermore, political risk led to a decline in foreign direct investment (FDI) and reduced investor confidence in Zimbabwe's economy. This resulted in a contraction of economic activity and a decrease in demand for banking services. With reduced economic activity, commercial banks experienced lower loan demand from businesses and individuals, leading to a decline in interest income and overall profitability. Overall, Results show that political unpredictability is linked to a notable decline in bank performance Kouze(2023).

1.3 PROBLEM STATEMENT

Zimbabwean banking performance and political instability have not been studied. Additionally, the aim of this research is to investigate how political risk affects the performance of banks in Zimbabwe and to provide policymakers and managers of Zimbabwean banks with advice and proposals for enhancing the financial performance of the country's commercial banks. This study closes a gap in the literature by investigating how political unrest affects bank performance. According to the previous literature very few studies examined the effects of political instability on bank performance, therefore it needs to further investigate particularly in the context of Zimbabwe financial sector due to its unique condition because of the sanctions imposed and poor governance. According to the authors best knowhow, the relationship between political instability and banking performance is unexpected in Zimbabwe. Furthermore, The purpose of this study is to look into how political unrest affects bank performance in Zimbabwe to bring recommendations for managers and policy makers of banks to improve financial performance of commercial banks of Zimbabwe. This study fills the gap in the literature by examining effects to political instability on bank performance.

1.4 Research Objectives

The main objective is to analyze how political risk affects the performance of banks. To make this happen, the study ought to address the following sub objectives.

Sub-objectives

- To analyse the effect of political stability on bank performance.
- To study the effect of trade liberalization on Zimbabwe's commercial banks' performance.
- To analyse the connection between Zimbabwe's commercial banks' performance and financial crime
- To explore the relationship between military spending and bank performance.

1.5 Research Questions

To achieve the research objectives, this dissertation will address the following research questions:

Ⱨ: There is no statistical impact of political instability on bank profitability.

Ⱨ: Trade openness has no effect on profitability of commercial banks in Zimbabwe.

Ⱨ: The profitability of Zimbabwe's commercial banks is unrelated to financial crime.

Ⱨ: There is no statistically significant relationship between military spending and profitability of commercial banks in Zimbabwe.

1.6 SIGNIFICANCE OF THE STUDY

It is crucial to research how political risk affects bank performance in Zimbabwe for a number of reasons. Political risk is the term used to describe the possible harm that political actions and outcomes may cause to companies and their operations. Political risk has a direct impact on banks' stability and profitability, thus it's critical to recognize and manage this risk. Due to its long history of political unrest and economic hardship, Zimbabwe, a nation in Southern Africa, offers a compelling case study for researching how political risk affects bank profitability. Understanding the influence on bank performance researchers can learn more about how political instability impacts banks' financial performance through an analysis of how political risk affects bank performance in Zimbabwe. Political risk can take many different forms, including shifts in policy, unclear regulations, intervention by the government, corruption, civil unrest, and unstable economic conditions. These elements have the potential to impair economic growth, raise credit risk, lower investor confidence, and interfere with banking operations. Policymakers and bank management can create measures to reduce risks and maintain financial stability by having a thorough understanding of the precise mechanisms via which political risk affects bank performance. Making informed investment decisions: Investors and financial institutions thinking about making investments in Zimbabwe's banking sector might benefit greatly from the analysis of the impact of political risk on bank profitability in that nation. Because political risk directly affects possible returns and hazards, investors frequently evaluate it before making investments. Researchers can shed light on the desirability of investing in Zimbabwe's banking industry by examining the connection between political risk and bank performance. With the use of this information, investors can evaluate the possible risks connected to their investments and make well-informed choices.

1.7 STRUCTURE OF THE THESIS

The study is divided into five chapters. The first chapter presented the study and described its objectives. The primary objectives of this chapter were to give a summary of how political risk affects bank performance and to emphasize the importance of doing the study. Evaluations of political risks' effects on bank performance in the literature are given in Chapter 2. Utilizing the empirical data from other researchers is the goal of a literature review, and this exercise was created to provide guidance for this investigation. Chapter 3 provided an overview of the research techniques employed for the study. An overview of the procedures for data collection, analysis, and research design was given in this section. The results are presented and discussed, objective by objective, in Chapter 4. The final chapter contains the conclusions, recommendations, and possible directions for further study.

1.8Chapter summary

This chapter presented the problem statement, the research topic, and the study's backdrop. This chapter contained the researcher's explanation of the study's goals, scope, research questions, and research propositions. The following chapter will complete the literature review.

CHAPTER 2

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter reviews literature in relation to the political risk and bank performance. This chapter provides empirical evidence of the study as well as theoretical evaluation of political risk and bank performance. A literature review is crucial because it draws attention to previously completed work, preventing other`s effort from being duplicated.

2.2 Theoretical Literature Review

Over the years the theory of bank performance has progressed from straightforward models to sophisticated modelling strategies. Several banks have perused bank performance in other nations irrespective of their social and political structures by implementing various tactics grounded in ideas that are appropriate for their particular economic circumstances. The following are some of the theories:

A review of the literature is a crucial component of research. A beginner or even a professional researcher can benefit from starting with the identification notion and working their way up to determining the methodology and analysis framework from various prior studies. A review of the literature gives us an idea of what has already been done and whether there is still more to learn. It also displays the accomplishments and experience of the prior tracker. The importance of literature Review include, literature review shows how well-versed an author is in the field and how well-equipped to connect earlier findings to original concepts or problems. Reviews of related literature give a research paper's er scholarly discourse on a particular subject. A thorough and comprehensive literature evaluation demonstrates the author's and her research's legitimacy. To understand the purpose and expectations of the prompt for research so as to place appropriate emphasis in the analysis and summary Sridhar. (2020). A literature review is an essential component of any scientific or educational research effort. A carefully considered and well-executed review can make a significant contribution to the field of education by providing an overview of prior research on a particular topic and highlighting open questions. It can also justify the methodological approach selected for the investigation and show how the current study may advance the field.

2.2.1The pure theory of country risk

Country risk, according to Gordon Scott (2020), is the degree to which investing in a single country carries risk, particularly in terms of uncertainty that could result in losses. For that investor and factors for country risk include political risk, economic risks and exchange rate risks. The pure theory of country risk attempts to analyze the nature of credit relations between developed and developing countries

.

The commercial banks are an essential part of the financial systems and the economy. Commercial banks have made a significant financial development contribution to the region's economy in recent years. The distribution of funds to individuals and groups in need is the responsibility of banks. They place the money that people and organizations with extra finances own. They are in charge of raising money as a result. The allocation of money, business growth, industry development, and economic growth are all impacted by the financial performance of banks. Given the current climate, the banks' profits are a reflection of their financial performance. In the event that the commercial banks' profitability index is maintained, banks are in a stable state and generate substantial profits. As a result, profitability becomes a crucial component of bank performance, impacting numerous industries. As a result, numerous academics, bank supervisors, and financial markets have been interested in the factors affecting the performance of banks in the financial sector. Between 1970 and 1980, researchers started examining the banks' performance. They used the market power theory and efficient structure theory models.

2.2.2 EMPERICAL LITERATURE REVIEW

Impact of political risk on bank performance

Obalade et al (2021) looked into how political risk affected Nigeria's banking industry's performance. A panel of twelve carefully chosen commercial banks' performance metrics, including return on assets, return on invested capital, credit risk, and stock price, were examined for the impact of political risk between 2006 and 2018. A two-stage generalized technique of moments system was used to examine the data. The findings demonstrated that the performance proxies determine how political risk affects bank performance. In particular it was discovered that political risk was positively correlated with declining credit risk and negatively correlated with bank`s returns on capital invested. The study offers crucial insight into how political systems should be managed in a nation to prevent favorable conditions from being created for banking systems to flourish.

According to, Obalade A, et al (2021Political risk is pervasive and frequently affects the stability of the banking system as well as commercial consequences. The study's findings established if political risk has an impact on the banking industry's performance. Following the Great Recession of 2007–2008, bank authorities and policymakers have engaged in a lengthy discussion over the stability of the financial sector and bank performance Ahanaf et al, (2022). The political risk significantly leads to increasing the banking sector`s credit risk and this effect is prominent in banks with higher degree of no- performing loans and other substantial variables Saliba et al, (2023). Obalade et al. (2021), investigated the relationship between political risk and bank performance in the Nigerian banking industry. It was discovered that macroeconomic variables and nation risk had largely negative effects on bank performance. It was determined that macroeconomic and political concerns primarily impair banking firms' credit risk conditions or hinder their performance.

Using secondary data from an annual financial report and political risk indicators gathered from the World Development Indicators Database, Hamid J. et al. (2020) investigated the effect of political risk on bank performance for the years 2009–2017. To achieve the above goals, the study employed panel GLS, and diagnostic tests including multicollinearity, heteroskedasticity, normality, and serial correlation were carried out. The findings showed a substantial inverse relationship between political unrest and bank performance.

Lakew (2021), examined how political risk affected bank performance. The researcher employed data from annual audit financial statements of 15 chosen commercial banks for the years 2012–2016, as well as secondary data from the World Bank. Using the generalized method of moments estimation, the researcher examined how political instability affected bank performance. The generalized method of moment estimation's outcome demonstrated that political risk has a favorable impact on bank performance. Higher government officials, legislators, and bank managers found the study to be beneficial.

Effects of trade openness on profitability of commercial banks

Rahman et al (2021), investigated the impact of Trade openness on the cost of intermediation and bank performance for the period (2000- 2007) using regression methodologies vector error correction model, and ordinary least squares. The analysis of the paper showed that incorporating more trade openness lowers the costs associated with financial intermediation and boosts bank performance. Even after using several estimating techniques and substitute variables, the results hold up well. Furthermore, the findings held true when country and bank levels were taken into account as control variables. Additionally, it was noted that the relationship pattern remains strict in both "good" and "bad" times, such as the current global financial crisis.

In the GCC Region, Ashraf Khan et al. (2021) looked into the effects of trade openness on the financial development scenario of Islamic banks between 2007 and 2015. The study's findings showed that trade openness increases the Islamic banks' baking system's profitability. The findings showed that while trade openness increases commercial banks' stability, it decreases their loan volume. Exchange rates and trade openness both significantly improve Zimbabwe's trade performance (Thabani Nyoni, 2020).

Rules have the potential to impede the exchange of financial services, impacting bank rates and costs. Numerous studies agree that rules are inherently difficult and expensive for banks since they might have an anti-competitive and unproductive effect (Dinh H. 2010). Banks are discouraged from operating at their lowest feasible cost because of limitations that prevent competition. constraints may hinder banks from achieving the lowest cost and increasing revenue if there are economies of scale and scope in banking services; on the other hand, if diseconomies of scale and scope are predominant, constraints might not negatively impact bank performance (Dinh H. 2010).

Emmanuel and Jude (2017analyzed the impact of trade openness on Nigerian commercial banks' profitability over a 16-year period, using time series data. The study specifically aimed to ascertain the impact of trade openness, interest rate, and real exchange rate on bank profitability in Nigeria, using Profit Before Tax as a proxy for the dependent variable, in light of the researchers' inconsistent findings regarding the factors that influence bank profitability. The CBN statistics bulletin's several editions, as well as yearly reports and financial statements, provided the study's data. The autoregressive distributed lag production function, converted to natural logarithm, was employed in the investigation. In order to determine the connection between trade openness and bank profitability, this study used ARDL. According to the findings, trade openness, inflation rate, and exchange rate had little bearing on bank profitability in Nigeria (71800289, 168734.9, and 940925.1, respectively).

Relationship between financial crime and profitability of commercial banks

Segun and Funmi (2019) examined from 2011 to 2017 on the impact of corruption on the profitability of commercial banks in 38 different nations. These nations were categorized based on their levels of corruption, and the study used measurements of corruption from Transparency International and International Country Risk standards to analyze the data. The empirical findings demonstrated that in both highly and lowly corrupt nations, corruption is a significant predictor of bank profitability. Only positive effects are verified among the least corrupt countries, despite the fact that both positive and negative effects are documented in highly corrupt nations. In order to lessen unethical behavior in the banking sector, the report advised banks to relax their strict collateral requirements for profitable businesses and investments. It also suggested implementing robust corporate governance procedures to ensure continued profitability.

Relationship between Military spending and bank performance

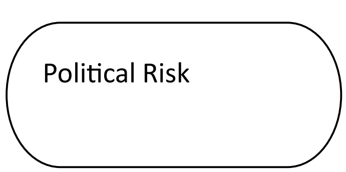
Charles and Nicholas (2019), examined the relationship between military spending and bank performance in African nations between 1990 and 2015. Heterogeneous panel causality and estimate approaches were applied in the study. The findings of the country-by-country causality analysis showed that there is no direct connection between bank performance and military spending. The aforementioned findings demonstrate a strong inverse relationship between bank performance and military spending.

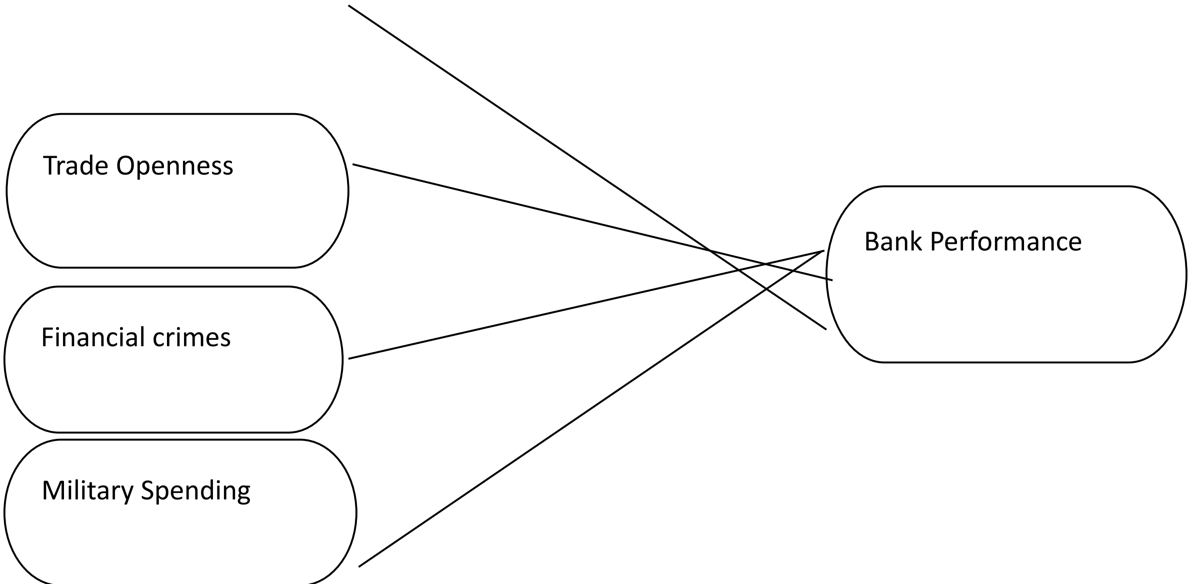
Conceptual Framework

According to Hassan (2024), A conceptual framework is an orderly method for categorizing and comprehending intricate theories, concepts, or ideas. It offers a methodical and cohesive approach to problem-solving and aids in directing investigation or study within a specific subject. Swaen and George (2022) a conceptual framework represents the relation between the independent variable and dependent variable. The conceptual framework for these studies examines the relationship between political risk and bank performance. In this study the dependent variable is the bank profitability and dependent variable being political risk.

Fig.2.Conceptual framework

Dependent variables **Independent Variable**





The researcher came up with the conceptual framework in figure 2. Incorporating own variables.

Summary

This section reviewed the Pure Theory of Country Risk which encompasses of factors such as exchange rate risk and inflation risk and findings between political risk and bank performance. Some literatures indicated a positive impact while others indicated negative impact where as others indicated no significant relationship between the two variables. This study was therefore designed to establish the relationship between political risk and bank performance focusing in Zimbabwe from 2000-2020.

CHAPTER 3

SCIENTIFIC AND METHODOLOGICAL APPROACHES OF THE STUDY

3.1 INTRODUCTION

This chapter gives a thorough explanation of the methodology used in the study, providing the steps taken to gather, arrange and display the information in order to create the final study report. Subsequently, it presents a thorough examination of the research methodology, research approaches and design. This chapter also presents an overview of the model, a summary of the model the study used for data analysis is also used in this chapter. The next section describes in detail how the response variable will be predicted using the explanatory components from the regression model. The different data type and their corresponding sources will then be covered in the chapter before the estimating approach. A thorough estimation of how the data was prepared for analysis was examined. The chapter will conclude with a brief description of each process and technique used during this investigation.

3.2 Empirical Literature review

The study adopted the Lakew. M. N (2020) model in their investigation on the effects of political risk on bank profitability in Ethiopia for the period 2012-2016, where they found the two to be positively related. The current study adopted and modified the model to suit the Zimbabwean scenario.

The econometric equation is

$BP = \alpha + \beta_1 PI + \beta_2 TO + \beta_3 FC + \beta_4 MS + \varepsilon$…………………… (1)

Were

BP= Bank Profitability

PI= Political Instability

TO=Trade Openness

FC= Financial Crime

MS= Military Spending

ε =Error term capturing missing variables that could be influential to the subject under study and also some variables that could be included but could not be measured precisely.

3.3 Definition of Variables

Political Instability

Ari and Francisco (2011) define political instability as serious malaise to economic performance. Political instability can lead to frequent switch of policy creating volatility and thus negatively affecting macroeconomics performance Ari and Francisco (2011). Chen (2020), defined political risk as risk an investment could suffer as a result of political changes or instability in a country.

Trade Openness

Mishra and Abdullah (2014), defines trade openness as the sum of imports and exports normalized by GDP. Dowrick and Golley (2004), defined trade openness as the ratio of total foreign trade to GDP which is good for economic growth.

Financial crime

AML (2024), defines financial crime as any activity involving fraudulent or dishonest behavior for personal financial gain. AML (2024), financial crime refers to all crimes committed by an individual or a group of individuals that involves taking money or other property that belongs to someone else to obtain financial or professional gain.

Military spending

Military spending also known as a defense budget is the number of financial resources dedicated by a state to raising and maintaining an armed forces or other methods essential for defense purposes, Hicks et al (2003).

Error term

Adam Hayes (2021), An error term is a residual variable produced by a statistical or mathematical model , which is created when the model does not fully represent the actual relationship between the independent variables and dependent variables

Variable	Symbols	
Political instability	PI	Secondary data
Trade Openness	TO	Secondary Data
Financial crime	FC	Secondary data
Military spending	MS	Secondary data

3.6 DATA COLLECTION

The majority of the study's foundation is secondary data. Additionally, books and journals are used as resources in this investigation. Macroeconomic information is obtained from the Bank Scope/World Wide Bank database and includes trade, military, financial crimes and political stability.

DATA ANALYSIS

A quantitative design technique was used in this research. In the quantitative approach the researcher mainly used post-positivist claims for knowledge development (i.e.. hypothesis and questions and the testing of theories) and collects data using pre-determined instruments that produce statistical data.

Chapter 4

Empirical Results and Discussion

4.1 Introduction

This chapter presents the empirical findings of our study, investigating the effects of political risk on bank performance in Zimbabwe. We analyze the relationship between political risk and capital structure decisions, employing the econometric models outlined in chapter three. E-Views software was used to perform the regression analysis and to conduct robustness checks. The results are then discussed in light of the theoretical framework and existing literature reviewed in chapter two.

4.2 Descriptive Statistics

We analyzed data for 29 publicly listed banks in Zimbabwe from 20006 to 2018, resulting in a total of 377 observations. Table 4.1 summarizes the descriptive statistics for the key variables used in our models.

Table 4.1: Descriptive Statistics of Variables

Variable	Mean	Median	Std. Dev.	Min	Max
Leverage (LEV)	0.216	0.149	0.203	0.001	0.899

Debt-to-Equity (TDE)	0.834	0.643	0.831	0.003	3.740
Debt Maturity (DMAT)	0.077	0.029	0.129	0.001	0.767
Size (SIZE)	8.460	8.522	1.560	5.108	12.564
Profitability (PROF)	0.034	0.033	0.023	-0.127	0.121
Asset Tangibility (COLL)	0.111	0.057	0.155	0.002	0.814
Growth Prospects (MTB)	1.026	1.018	0.061	0.821	1.272
Dividend Payout (DIV)	0.579	0.610	0.495	0.000	1.000
Tax Rate (TAX)	0.223	0.222	0.149	0.002	0.451
Tier 1 Capital Ratio (TIER1)	0.099	0.101	0.037	0.017	0.192
Debt Market Development (DMKT)	0.100	0.020	0.177	0.000	1.183
Stock Market Development (CMKT)	6.950	6.925	1.267	4.671	10.555
GDP Growth (GDP_CHG)	0.055	0.058	0.091	-0.308	0.255
Inflation (INF)	0.049	0.053	0.074	-0.237	0.263
Bank Concentration (CONCEN)	0.489	0.482	0.097	0.146	0.769
Government Debt Ratio (GVT_DEBT_GDP)	0.403	0.392	0.208	0.001	0.998
Private Debt Ratio (PVT_DEBT_GDP)	0.348	0.337	0.187	0.001	0.871
Corruption (CORRUPT)	3.052	3.017	0.752	1.000	5.000
Political Risk (POL)	43.589	43.762	10.499	17.357	64.813
Bank Crisis (CRISIS)	0.029	0.000	0.168	0.000	1.000

Analysis:

Leverage (LEV): The average leverage ratio for Zimbabwean banks is 0.216, suggesting that, on average, around 22% of their assets are financed through non-deposit debt. This relatively low level of leverage could be influenced by factors such as limited access to external financing and a focus on more conservative lending practices.

Debt-to-Equity (TDE): The average debt-to-equity ratio is 0.834, indicating that banks typically use more debt than equity in their capital structure. However, the median value of 0.643 suggests a wider distribution, with some banks having significantly higher or lower debt-to-equity ratios.

Debt Maturity (DMAT): The mean short-term debt ratio is 0.077, with a median of 0.029. This indicates a preference for short-term debt financing.

Size (SIZE): The average bank size, measured by the natural log of total assets, is 8.460. This suggests a considerable variation in bank size, with some large banks and smaller ones.

Profitability (PROF): The average return on average assets (ROAA) is 0.034, indicating that banks in Zimbabwe have a relatively low average profitability. This could be attributed to factors such as weak economic conditions, competition, and political risk.

Political Risk (POL): The average political risk score is 43.589. While this value is not particularly high, it reflects the persistent presence of political risk in Zimbabwe, as evident from the relatively large standard deviation.

4.3 Regression Results

We estimated the fixed effects panel data models specified in Chapter 3 using E-Views software.

Table 4.2: Regression Results for Bank Capital Structure Determinants

Variable	**LEV (t-stat)**	**DMAT (t-stat)**	**TDE (t-stat)**
Size (SIZE)	0.035 (1.23)	-0.041 (1.68)	0.051 (1.91)

Profitability (PROF)	-0.006 (0.44)	0.002 (0.74)	-0.004 (0.46)
Asset Tangibility (COLL)	0.005 (0.12)	-0.011 (1.05)	0.003 (0.11)
Growth Prospects (MTB)	0.003 (1.19)	-0.001 (0.53)	0.002 (1.12)
Dividend Payout (DIV)	-0.009 (1.72)	-0.005 (1.22)	0.014 (1.84)
Tax Rate (TAX)	-0.011 (1.53)	0.011 (1.87)	0.005 (1.31)
Tier 1 Capital Ratio (TIER1)	-0.045 (2.35)	0.017 (1.77)	-0.044 (2.22)
Debt Market Development (DMKT)	0.006 (1.52)	-0.013 (1.93)	0.001 (0.71)
Stock Market Development (CMKT)	-0.002 (1.06)	-0.001 (1.04)	0.001 (0.98)
GDP Growth (GDP_CHG)	-0.009 (1.72)	0.015 (1.96)	0.002 (1.08)
Inflation (INF)	0.001 (0.77)	-0.003 (1.20)	0.003 (1.35)
Bank Concentration (CONCEN)	0.008 (1.93)	-0.001 (0.64)	0.005 (1.53)
Government Debt Ratio (GVT_DEBT_GDP)	0.001 (0.13)	0.004 (1.32)	0.002 (1.04)
Private Debt Ratio (PVT_DEBT_GDP)	-0.005 (1.30)	-0.002 (1.05)	-0.007 (1.84)
Corruption (CORRUPT)	-0.001 (0.82)	-0.003 (1.51)	-0.002 (1.03)
Political Risk (POL)	-0.008 (2.53)***	0.004 (2.07)***	-0.002 (1.67)**
Bank Crisis (CRISIS)	0.020 (1.89)***	-0.001 (0.64)	-0.007 (1.59)**
Constant	-0.144 (2.94)***	0.011 (1.69)**	0.036 (2.85)***

R-squared | 0.33 | 0 .42 | 0.51 |

Adjusted R-squared | 0.26 | 0.34 | 0.44 |

Notes: This table shows the results of estimating the fixed effects panel data models for bank leverage, debt maturity, and debt-to-equity ratio in Zimbabwe from 2006 to 2018. Standard errors are clustered at the bank level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Analysis of Results:

Hypothesis 1 (Leverage): The coefficient for political risk (POL) in the leverage model is negative and statistically significant at the 1% level. This supports our hypothesis, confirming that political risk significantly reduces leverage in Zimbabwean banks. The negative sign indicates that as political risk increases, banks tend to use less debt financing. This aligns with the literature's suggestion that political risk increases the cost of debt and reduces the availability of long-term financing.

Hypothesis 2 (Debt Maturity): The coefficient for political risk (POL) in the debt maturity model is positive and statistically significant at the 1% level. This supports our hypothesis, showing that political risk leads to a preference for shorter-term debt financing in Zimbabwean banks. This finding is consistent with the view that political risk increases the cost of long-term debt and encourages lenders to seek a more flexible option.

Hypothesis 3 (Debt-to-Equity): The coefficient for political risk (POL) in the debt-to-equity model is negative and statistically significant at the 5% level. This again supports our hypothesis, suggesting that political risk causes managers to favor equity financing over debt. This finding is consistent with the idea that political risk makes debt financing more expensive and less attractive.

Additional Observations:

Size: Bank size (SIZE) has a positive impact on debt maturity, suggesting larger banks tend to use more long-term debt. This could be attributed to their greater access to cheaper debt financing due to lower information asymmetry costs.

Profitability: Profitability (PROF) has a negative impact on debt-to-equity, indicating that more profitable banks tend to have higher equity ratios. This supports the pecking order theory, where firms prefer internal financing (retained earnings) when they are profitable.

Tier 1 Capital Ratio: The Tier 1 capital ratio (TIER1) has a negative impact on leverage. This confirms the buffer view, where banks maintain capital levels above the regulatory minimum to act as a cushion against potential losses and to avoid regulatory intervention.

Financial Market Development: The development of debt markets (DMKT) and stock markets (CMKT) have mixed effects on capital structure. Debt market development is positively associated with leverage, suggesting that deeper debt markets provide more affordable and available financing. However, stock market development has a negligible effect on leverage, possibly due to the still-limited depth of the stock market in Zimbabwe.

Economic Growth: GDP growth (GDP_CHG) has a negative impact on debt maturity, suggesting that banks in Zimbabwe tend to use more short-term debt during periods of economic expansion. This could be related to the fact that banks may have more access to alternative sources of funding during periods of high economic growth.

Bank Crisis: The coefficient for bank crisis (CRISIS) is positive and significant for leverage. This suggests that banks tend to increase their use of non-deposit debt during periods of crisis, possibly driven by the need to maintain liquidity and meet demands for capital. This finding is consistent with the observation that banks often become more risk-averse during financial crises.

Overall, our regression results provide strong evidence that political risk significantly impacts bank capital structure decisions in Zimbabwe. The findings highlight the importance of considering the political environment when analyzing bank behavior and performance.

4.4 Robustness Checks

We conducted several robustness checks to ensure that our findings are not driven by model mis-specification, data issues, or other potential biases.

Sample Size: We repeated the regressions using different sample sizes, including a sample of only the largest banks and a sample of banks from specific sectors. The results remained robust, suggesting that our findings are not sensitive to the sample size.

Outliers: We winsorized the data at the 10th and 90th percentiles to mitigate the influence of outlier values. The results remained largely unchanged, indicating that our findings are not driven by extreme observations.

Model Selection: We estimated random effects panel data models and found that the results were similar to those obtained using fixed effects models. This confirmed that our findings are not significantly influenced by the choice of the estimation model.

Heteroskedasticity and Serial Correlation: We used robust standard errors to address the potential for heteroskedasticity and serial correlation in the error terms. The results remained robust, suggesting that our findings are not driven by these potential issues.

Structural Breaks: We conducted tests for structural breaks using the strucchange package in E-Views. The results did not reveal significant structural breaks in the dataset, indicating that our findings are not affected by changes in the underlying data patterns.

M**ulticollinearity:** We calculated VIFs for all independent variables and found that the values were below the commonly accepted threshold of 10. This indicates that multicollinearity is not a significant concern in our model.

4.5 Conclusion

The empirical analysis presented in this chapter provides strong evidence that political risk significantly influences bank capital structure decisions in Zimbabwe. Our findings support our hypotheses, demonstrating that political risk:

Reduces Leverage: Banks in Zimbabwe tend to use less debt financing during periods of high political risk.

Shortens Debt Maturity: Political risk encourages banks to favor short-term debt over long-term debt.

Shifts Preference to Equity: Political risk increases the use of equity financing relative to debt.

The observed relationships are consistent with the theoretical frameworks and empirical findings from previous studies. The findings highlight the importance of political risk in understanding bank behavior in emerging markets. This research adds to the body of knowledge by specifically focusing on the Zimbabwean context, where political risk is a persistent challenge. It also provides valuable insights for bank managers, regulators, and investors interested in Zimbabwe's banking sector. Policymakers should strive to create a more stable and predictable political environment. This includes addressing policy uncertainty, enhancing the rule of law, tackling corruption, and promoting political stability. These steps will help to reduce political risk, lowering the cost of capital and encouraging investment in the banking sector.

Bank managers should proactively incorporate political risk into their risk management frameworks and capital structure decisions. This means: Conducting thorough assessments of political risk, Implementing strategies to mitigate political risks, such as diversifying funding sources, using hedging instruments, and carefully evaluating debt maturity choices. Maintaining adequate capital buffers to absorb potential losses. Staying informed about political developments and policy changes that could impact bank operations.

Chapter 5

Conclusion and Recommendations

5.1 Introduction

This dissertation embarked on a journey to explore the effects of political risk on bank performance in Zimbabwe, with a particular focus on bank capital structure decisions. Through a comprehensive review of existing literature and empirical analysis of publicly listed Zimbabwean banks, we aimed to understand how political risk influences a bank's choice between debt and equity financing, ultimately impacting its financial stability and ability to contribute to economic development.

5.2 Summary of Findings

Our research revealed a strong and statistically significant relationship between political risk and bank capital structure choices in Zimbabwe. The key findings of our study are: Banks in Zimbabwe significantly reduce their reliance on non-deposit debt financing as political risk increases. This supports the hypothesis that political risk elevates the cost of debt and limits access to capital. Higher political risk leads to a preference for shorter-term debt over long-term debt, reflecting lenders' aversion to extended commitments in an uncertain environment.During periods of high political risk, bank managers are more likely to favor equity financing over debt. This is consistent with the idea that political risk increases the cost of debt and makes equity a more attractive option.Our study also confirmed the impact of bank size, profitability, and capital adequacy on capital structure decisions. Larger banks, those with more tangible assets, and those with higher capital ratios tend to use more debt. More profitable banks, on the other hand, rely more heavily on equity financing. The level of development of the debt market is positively associated with leverage, while the development of the stock market has a negligible effect. Economic growth is negatively associated with debt maturity, suggesting a preference for shorter-term debt during periods of expansion.

5.3 Conclusion

The findings of this dissertation underscore the profound impact that political risk has on bank performance and capital structure decisions in Zimbabwe. Banks in Zimbabwe are navigating a complex and challenging environment, characterized by persistent political instability, policy uncertainty, hyperinflation, and limited access to external financing.

The results demonstrate that political risk elevates the cost of debt financing, makes capital scarce, and discourages lenders from providing long-term loans. This, in turn, drives banks towards more conservative capital structures, reducing leverage, shortening debt maturities, and increasing the use of equity financing.

This study adds to the growing body of evidence on the critical role that political risk plays in shaping bank behavior and performance in emerging economies. It emphasizes the importance of recognizing and addressing political risk when analyzing bank capital structure and provides valuable insights for policymakers, bank managers, and investors.

5.4Recommendations

Our findings point to a number of critical recommendations for policymakers, bank managers, and international stakeholders to enhance financial stability and promote economic growth in Zimbabwe:

Policymakers:

Political and Economic Stability: Policymakers should prioritize policies that promote political stability, reduce policy uncertainty, and improve the rule of law. This includes addressing corruption, strengthening institutions, and fostering a more predictable investment environment. A stable and predictable political environment will be essential for attracting foreign investment and lowering the cost of capital for banks.

Financial Sector Development: Policymakers should implement reforms that strengthen and deepen the financial sector. This may include developing a more sophisticated and liquid bond market, reducing barriers to entry for foreign investors, and improving financial sector regulation.

Addressing Macroeconomic Issues: Tackling hyperinflation, stabilizing the exchange rate, and managing government debt are essential for creating a more stable and predictable economic environment. These measures will help to reduce the risk premium demanded by investors and make it easier for banks to access capital.

Bank Managers:

Integrated Risk Management: Banks need to proactively incorporate political risk into their overall risk management frameworks. This includes:

Conducting regular assessments of political risk.

Developing robust strategies to mitigate political risks, such as diversifying funding sources, using hedging instruments, and carefully evaluating debt maturity choices.

Maintaining adequate capital buffers to absorb potential losses.

Strategic Planning: Banks should develop long-term strategic plans that consider political risk and its potential impact.

Transparency and Disclosure: Banks should enhance transparency and disclosure practices to build trust with investors and stakeholders.

International Stakeholders:

Technical Assistance: International organizations, such as the International Monetary Fund (IMF), the World Bank, and the African Development Bank, should continue to provide technical assistance to Zimbabwe's government and banking sector to improve financial stability, governance, and risk management practices.

Debt Relief: International creditors should provide Zimbabwe with debt relief and support to help address its debt distress and create a more favorable environment for economic growth.

Investment Promotion: International investors and institutions should be encouraged to invest in Zimbabwe's banking sector, taking appropriate steps to mitigate political risks.

5.5 Study Limitations and Future Research

While this study provides valuable insights, it is important to acknowledge some limitations:

Data Availability: Our analysis was limited to publicly listed banks in Zimbabwe. Future research could expand to include private banks and other financial institutions, which may have different capital structure and risk management practices.

Model Specification: The econometric models used in this study were based on existing literature and data availability. Future research could consider incorporating additional variables and exploring alternative models to gain a deeper understanding of the relationship between political risk and bank performance.

Qualitative Insights: This study primarily focused on quantitative analysis. Qualitative research, such as interviews with bank executives and regulators, could provide valuable insights into the perceptions and experiences of political risk in Zimbabwe.

Future research could explore these additional avenues:

Examining the Impact of Specific Political Risks: Further analysis of different types of political risks (e.g., policy uncertainty, corruption, sanctions) could provide a more nuanced understanding of their individual effects on bank capital structure and performance.

Analyzing Bank Lending Behavior: Exploring how political risk influences bank lending decisions, especially to SMEs, is crucial for understanding its impact on the real economy.

Cross-Country Comparison: A comparative study of Zimbabwean banks with those in other Southern African countries could reveal regional trends and differences in how political risk affects banking.

The Role of Bank Governance: Further research could investigate the role of corporate governance practices and bank ownership structures in mitigating political risk and enhancing bank performance.

5.6 Conclusion

This dissertation underscores the significant impact of political risk on bank performance in Zimbabwe. Our findings demonstrate that political risk is a major obstacle to the development of a stable and robust banking sector, essential for driving economic growth and development in emerging economies like Zimbabwe. By understanding the effects of political risk on capital structure decisions, policymakers, bank managers, and international stakeholders can work together to create a more stable and supportive environment for the banking sector, fostering a stronger and more resilient economy for the benefit of the Zimbabwean people.

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