Threats and Opportunities Facing Banking Institutions in Emerging Economies in their Desire to Adopt and Implement the Basel II Capital Accord: A Case Study of the Zimbabwean Economy in the Dollarization Era

Ephraim Matanda,
Faculty of Commerce,
Department of Banking and Finance,
Great Zimbabwe University,
Zimbabwe.
Email: eematanda@gmail.com

Abstract

The global banking environment has become potentially riskier and unpredictable than before because of the recent developments in financial products and services, which have massively changed the ways and means banks employ in their day to day operations. The main aims of the Basel II Capital Accord were initially to strengthen the financial soundness and stability of the international banking system by encouraging banks to improve their own risk management practices and frameworks. The Basel II Capital Accord was heavily criticised by monetary authorities and governments of emerging market economies, which felt that the Accord’s recommendations were meant to pursue the growth and development of the Great-10 developed states and had nothing to offer for developing nations. The study at hand sought to examine the adoption and implementation threats and opportunities of the Basel II Capital Accord in emerging economies. The respondents of the study were drawn from the populations of interest that comprised the Reserve Bank of Zimbabwe (RBZ) and commercial bank employees, economic analysts and academics. The study generated data from respondents using questionnaires and interviews, as well as audited financial statements of selected commercial banks, which were then processed and assessed using both qualitative and quantitative techniques. The findings of the study were that commercial banks in emerging economies were in their initial stages of implementing the Accord and faced a plethora of threats or challenges that ranged from lack of good corporate governance, through poor regulation and supervision frameworks and imperfect markets to collapse and crowding out of the sector. The study concluded that although capital adequacy standards were not very appropriate for emerging market economies, they were going to adopt them without any meaningful adjustments. It was recommended that banks should comply with provisions of the Accord as these constituted sound and measurable benchmarks that were suitable for inclusion in corporate governance and business ethics frameworks of such financial institutions. The study also recommended that Central Banks in emerging economies needed to continue investing in research and development to do with relevance of the Accord to banks in emerging economies and robust management of capital that matched very well their risk appetite levels in the dollarization era.

Keywords: Emerging economy, dollarization era, corporate governance, plethora’ business ethics.
1. Introduction

It is advocated that the Basel Committee’s Basel II Capital Accord could be a very useful framework for protection of the international financial system from all types of challenges and risks that may force major banks of the world to collapse. This postulation led to the need by this study to explore and examine both threats and opportunities that emerging market economies faced in the implementation of the Basel II Capital Accord in their desire to grow and develop in service delivery to their nations. The study was therefore undertaken in order to generate answers to the threats if any faced by emerging market economies in their quest to adopt and implement the Basel II Capital Accord efficiently and effectively. The ability of such economies to manage potential banking threats and risks was to ensure that they grow and develop towards greater similarity with banking sectors of developed economies of the world.

The study also had interest in examining the opportunities banking institutions could exploit upon adoption and successful implementation of the Basel II Capital Accord Framework on a regular basis in their operations. Most banking institutions in developed countries that adopted and implemented the Basel II Bank Capital Accord were already enjoying the benefits drawn from prudent and ethical use of the framework in their operations internally and globally. Therefore writer in this paper discusses in much detail the Basel II Bank Capital Accord, threats and opportunities that emerging market economies faced in the adoption and implementation of the framework, in their desire to achieve sustainable economic and financial development particularly in the 21st century. The study also tries to evaluate the Basel II Bank Capital Accord relative to the June 2010 Basel III Bank Capital Accord in order to determine their relevance, points of convergence and departure as well as significance and impact on operations of banking institutions in emerging economies.

2. Literature Review

The Basel II Capital Accord was instituted and approved by the Basel Committee on Banking Supervision (BCBS) in June 2004 in order to strengthen the soundness, viability and stability of the global banking system. According to Blair (2011) the (BCBS) framework encouraged banks to improve their risk management practices, so as to incorporate new risks into the allocation of capital and enhancement of transparency, accountability and discipline among banks. The Basel II Capital Accord was a global revolution that was led by the progressive innovation in risk management field (Caruana, 2006). Based on the definitions above the Basel II Capital Accord was meant to strengthen efficiency and effectiveness, transparency, accountability, responsibility and discipline of banking players on both domestic and global markets through financial innovation and use of advanced forms of technology. The implementation of the Basel II Capital Accord is a phenomenon that has
gained a lot of enthusiasm in both national and international forums as well as within the Zimbabwean financial sector boundaries. It is argued that a multiplicity of threats and opportunities surrounded the adoption, supervision and implementation of the Basel II Accord by emerging market economies such as Zimbabwe.

Studies generated from developed states have revealed that banks and similar financial institutions had either fully or partially adopted and implemented the Basel II Capital Accord, which was enough evidence that the institutions’ compliance with the framework was fraught with operational challenges and/or threats. According to Sahajwala and Vanden Bergh (2000), the implementation of the Basel II Capital Accord in many countries was associated with a myriad of challenges based on large project implementation processes. It was also revealed that from 1965 to 1981, about 8 USA banks were in bankruptcy positions (Caruana, 2006) just because of savings and loan crises, that is, they were lending extensively while countries’ external levels of indebtedness were escalating at unsustainable or unprecedented levels. Hence, because of such developments in the global financial sector, the potential for collapse of banks due to bankruptcy of major international banks grew as a result of low security (Blair; 2011). The literature generated from studies in developed countries of the world gave testimony that there was a myriad of operational challenges faced by banking institutions that attempted to adopt and implement the Basel II Capital Accord. Some of the operational challenges faced by potential bank adopters of the accord were sophisticated implementation processes and techniques, technological inadequacies, external indebtedness, liquidity and bankruptcy challenges.

The Bank for International Settlement (BIS; 2008) argues that after the great collapse of the Bankhaus Herstatt (Bank) of Germany and Franklin National Bank of USA (1974), the Group of 10 (G-10) Central Bank Governors set and agreed to institute the BCBS, in 1987. These Central Banks’ Governors and Supervisory Authorities of G-10 countries, met in 1987 in the City of Basel in Switzerland, Europe. The Committee came up with a document which they called the Basel I Capital Accord. The document was mainly based on international minimum amounts of capital banks had to hold or maintain so as to be free from getting into bank runs and/or liquidity challenges, and let alone bankruptcy positions. Therefore in 1988, the Basel I Capital Accord that had been created by the BCBS was instituted to define the concept of bank capital and the capital adequacy ratios (Pierson, 2004). It is evident in the literature at hand that banks of the world have been facing capital, liquidity, bank run and bankruptcy challenges in their operations for a time immemorial. The crafting of the first of the Basel Capital Accords in 1988 by BCBS was necessitated by the need to come up with a framework that banks of the world could use in their desire to
generate adequate capital requirements and manage risk effectively in their desire to grow and develop market shares and shareholders’ wealth in the industry of operation.

The panic and crisis that hit the Zimbabwean banking industry in 2004, after the Central Bank’s banking stress test, revealed that most domestic banks were technically unsound and much undercapitalized, and saw depositors and the whole banking sector becoming extremely exposed to a family of financial risks. Hence, by the end of the year 2004, ten (10) banking institutions had been placed under curatorship by the Central Bank, two (2) were liquidated and one (1) Discount House had been closed. According to Reserve Bank of Zimbabwe (Monetary Policy Statement 2006), only 18 of the 32 registered and licensed asset management firms were still operational by end of the year 2005. These nose-diving developments in the Zimbabwean banking industry between 2004 and 2005 saw the financial sector lose the momentum, efficiency and effectiveness it had attained in the past to service and protect interests of the depositors and general public. The Reserve Bank of Zimbabwe (RBZ) in its desire to curb the banking sector from total collapse went on to apply risk-based supervisory and regulatory techniques that were meant to facilitate early detection of potential bank fragilities. Hence in January 2011, the RBZ launched the Basel II Capital Accord for adoption by commercial banks.

The Basel II Capital Accord’s implementation action plan in Zimbabwe was finalised and made ready for use in January 2012. By January 2013, the RBZ requested all licensed banks under its jurisdiction to comply with the Basel II Capital Accord and they were expected to disown the Basel I Capital Accord. The Central Bank also published a Technical Guidance Statement on the Basel II Capital Accord’s adoption and implementation in Zimbabwe and solicited comments and suggestions from market players, auditing firms and financial analysts on the publication. The Basel II Capital Accord’s methodology and requirements for implementation were based on three (3) fundamental pillars, namely Pillar I (definition of capital, tiers I, II and III and calculation of minimum capital ratios), Pillar II (credit, operational and market risks and supervisory reviews) and Pillar III (market discipline). The RBZ’s closure of Genesis Investment Bank and placement of Interfin Commercial Bank under recuperative curatorship and surrendering of the banking licence by Royal Commercial Bank in 2012 generated more debate on the suitability and effectiveness of the implementation of the Basel II Capital Accord (RBZ, MPS, 2012).

The application of the Basel II Capital Accord to emerging markets has been put under the spotlight with studies in developing countries arguing that the G-10 recommendations suited very well developed nations and not emerging or developing states. In response to this gap, the Basel Committee between 1997 and 1999, created a set of standards for emerging market economies, which it referred to as the Core Principles for Effective Bank Supervision.
(later revised in 2006). The Bank for International Settlements (BIS; 2008) argues that although the standards (principles) were tailor made to suit the needs of the emerging market economies their broadness and relative obscurity in the policy making communities had limited their impact on international banking. The International Monetary Fund (IMF; 2007) had it that low regulatory and supervisory standards put in place by Central Banks for Commercial banks were very easy to disguise if banks so needed. The same sentiments were echoed by Ward, (2002) and Lindgren (1996). However, on the contrary, multinational institutions, large banks and international rating agencies viewed the Basel Accords as proper and appropriate standards for banking regulation throughout the world’s market economies.

The RBZ (Monetary Policy Statement, 2012) had it that since the adoption of dollarization in 2009, banks had been failing to stretch their loan books because all deposits were short-term in nature. According to the Zimbabwean Banking Act (Chapter 24:20) Part V subsection 1,every banking institution whose head office is situated in Harare, shall be required to have and maintain such minimum paid up equity capital as may be prescribed from time to time by the Monetary Authorities. The 1988 Basel I Accord was amended and renamed the Basel II Accord in 1996, whose major objective was to increase capital in all banking institutions so as to prevent such institutions from falling into financial crises. One of the major reasons for setting minimum capital requirements was to protect depositors’ funds (to act as Deposit Protection Schemes, DPS). The Basel II Accord’s minimum capital requirements were based on sets of minimum acceptable bank capital levels, enhanced credit risk tied ratings-public ratings, internal ratings, explicit treatment of operational and liquidity risks.

Most banks in Zimbabwe have failed to deliver their mandate mainly because of capital inadequacies, engagement in non-banking activities, lending to shareholders loans that were never repaid, poor corporate governance and risk management frameworks. Undercapitalised banks increased the vulnerability of the financial system to economic shocks. Well capitalised banks resulted in a strong, efficient, effective and diversified financial sector that ensured that depositors’ funds were secured, growth and development of the economy was guaranteed and competition of the economy on the global financial system was effective. To make the banks’ situation worse, the RBZ has reviewed banks minimum capital requirements to levels which were likely to be beyond the reach of most financial institutions. The table below reflects the nature of the financial institution, old and new minimum capital requirements as well as the set due date deadlines (old), as stipulated by RBZ in 2012 and 2013 reviewed or extended deadlines:
The RBZ increased banks’ minimum capital requirements in line with the dictates of the Basel II Capital Accord so as to ensure prudence and protection of banks, depositors, customers and the economy as a whole. The strategies that Zimbabwean banks had at their disposal, in order to abide by the new capital requirements in accordance with set due dates, included pooling their resources together through formation of mergers and acquisitions, accessing debt equity at low costs from providers of such funding, rebranding their financial and investment products, banking the unbanked SMEs and informal sector or restructuring by way of inviting investors from abroad or locally to buy shares in such institutions. While the adoption of the Basel II Capital Accord by RBZ signified an important milestone for the domestic banking industry and the whole economy, it however, brought with it a lot of threats and opportunities. Bailey (2005) postulates that banking crises and runs, the world over threatened the macroeconomic stability of financial sectors through potential effects on savings, monetary supply and control, banking confidence, financial flows and budgetary impact on banks’ rescue packages.

Hence, the achievements of an inclusive, efficient, sound, effective, viable and stable financial system was a very critical, complex and multidimensional phenomenon that all economic players must tackle effectively if the economy were to grow and develop in its service delivery to the nation. The writer also compared and contrasted the Basel II Capital Accord with the newly instituted June 2010 Basel III Capital Accord. The Basel III Capital Accord was defined as a comprehensive set of banking reform measures developed by the BCBS in order to strengthen the regulation, supervision and risk management systems of banking sectors of the world. In other words there was strong enhancement of international convergence of capital measurement and capital standards documentation (Basel II Accord) implied in the Basel III Capital Accord. The capital accord measures enshrined in the third capital accord were therefore aimed at improving banks’ ability to absorb shocks from financial and economic stresses, risk management, governance and strengthening banks’ transparency and disclosures on a regular basis.

<table>
<thead>
<tr>
<th>Category of Institution/Bank Or Society</th>
<th>Minimum capital requirements, old ($m)</th>
<th>Minimum capital requirements, new ($m)</th>
<th>Initial Deadline for attainment of capital unit (new)</th>
<th>Extended Deadline for attainment of capital unit (new)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Bank</td>
<td>12.5</td>
<td>100</td>
<td>31/12/14</td>
<td>31/12/20</td>
</tr>
<tr>
<td>Merchant Bank</td>
<td>10</td>
<td>100</td>
<td>31/12/14</td>
<td>31/12/20</td>
</tr>
<tr>
<td>Building Society</td>
<td>10</td>
<td>80</td>
<td>31/12/14</td>
<td>31/12/20</td>
</tr>
<tr>
<td>Discount Houses</td>
<td>7.5</td>
<td>60</td>
<td>31/12/14</td>
<td>31/12/20</td>
</tr>
<tr>
<td>Microfinance</td>
<td>1.0</td>
<td>5.0</td>
<td>31/12/14</td>
<td>31/12/20</td>
</tr>
</tbody>
</table>

The financial reforms advocated for in the Basel III Capital Accord were targeted at bank level (micro prudential) regulation to help raise their resilience to periods of banking stresses and runs. On the other hand the financial reforms were also meant to see banks become capacitated to manage macro prudential risks, that is system or economy wide risks. These are market risks that can build up across banking sectors of the world and their procyclical amplifications over time to banks’ operations which needed to be managed effectively. The successful management of financial risks at both micro and macroeconomic levels in Zimbabwean banks was the answer to their growth and development prospects through effective financing and investment endeavours in the dollarization era. It was against the above background that the study sought to examine the major threats and opportunities that emerging market economies faced in the implementation of the Basel II Capital Accord in their desire to grow and promote sustainable development of the Zimbabwean banking industry in the dollarization era.

3. Research Methodology

Wegner (2000) defines a research design as a plan, structure or strategy of investigation used to obtain information needed in answering given research questions. The study employed both qualitative and quantitative research designs to interpret and analyse views (primary data) and secondary data respectively, generated from the field on the study on the threats and opportunities the Zimbabwean banking industry faced in the implementation of the Basel II Capital Accord framework.

The primary research design employed was descriptive and exploratory in nature. The design was used to generate qualitative data from respondents on the challenges and benefits emerging market economies Zimbabwe included could draw from successful adoption and implementation of the Basel II Capital Accord. This exploratory research design was used in the study mainly because the real scope of the problem was not clear and it had the ability to determine the best data collection methods for the problem at hand. This qualitative research design was interactive and generated mainly views and opinions from targeted, knowledgeable and experienced respondents. The gap created by the qualitative research design was filled by the quantitative design which provided significant perceptions and insights into contemporary quantifiable financial situations. The causal research design was also employed in order to determine the causality between variables, that is, to explore whether there was cause and affect relationships between variables that were incorporated in the study. It provided some very essential internal insights as far as the Basel II Capital Accord’s implementation challenges and opportunities were concerned.
The population of the study’s respondents included RBZ employees, commercial bank’s managers and employees, corporate economic players and academics. From the population of interest, a sample of 150 respondents was drawn using various sampling techniques that included simple random sampling (for analysts and academics), stratified sampling (for RBZ and Commercial banks employees) and quota sampling (for RBZ and Commercial banks’ managers). Simple random sampling avoided biases in the selection process because it was independent of human judgment and represented the population of interest very well. Stratified sampling on the other hand was critical in linking knowledge of the population to the principle of random selection for purposes of increasing, precision and representation of strata in the sample, by reducing sampling errors. The sampling technique was also popular for capturing key population attributes or characteristics in for the study at hand. On the other hand quota sampling was also adopted, because it improved the representation of key players of a population for purposes of making study findings and conclusions, testable, reliable and valid. It also prevented decisions from being polluted by unnecessary independent and dependent variables incorporated in the study under consideration.

Questionnaires and interviews were employed to draw research data from the respondents. A set of questionnaires was sent to employees of RBZ and commercial banks, economic analysts and academics, on hard copy, and these were completed and handed over to research assistants. Interviews were booked by research assistants and held by the researcher with RBZ and Commercial banks’ managers mainly because these people had very tight schedules at their work places. These respondents had no time to read and complete questionnaires, hence, booking and holding interviews with them, enabled the study to draw the much needed research information from them timeously. The study also went further to collect secondary data in the form of annual RBZ publications on commercial banks, IMF publications government publications and various other business and research publications that were based on the Basel II Capital Accord Standards. A multiple linear regression model was developed to analyse and interpret the relationship among variables such as banks’ profit (dependent variable), loans capital formations and investment levels (independent variables). The study employed SPSS and E-Views 4 to analyse the primary and secondary data respectively that were collected on the study on threats and opportunities that emerging market economies faced in their desire to successfully implement the Basel II Capital Accord, if they were to grow and promote sustainable development of their banking industries and the financial sectors in the long term.

4. Findings, Analysis And Discussions

The Basel I Capital Accord was an Accord that did much to promote regulatory harmony and growth of international banking systems across the borders of the G-10 nations and the
world economies at large. The Accord’s limited capacity and scope, gave banking industries massive room to manipulate its rules and regulations and in the end financial institutions, the world over took improper risks and held unduly very low capital reserves which made them susceptible to bank runs, bankruptcy and/or being placed under curatorship. The Basel Committee on Banking Supervision (BCBS) had to institute the Basel II Capital Accord (which had been rated as weak in addressing banking industry demands) which sought to extend the breadth and precision of the former. The Basel II Accord issued after the Basel I Accord brought in factors such as market and operational risk, regulatory mandates, market–based discipline and bank surveillance. The Accord was found to have ignored the implications of its rules on emerging markets’ banks and related financial institutions and hence its adoption for implementation in such economies was met with a lot of mixed feelings by Central Banks and commercial banks as well.

It was also found out that existing financial data in banking industries of emerging economies did not fit well into the adoption and implementation of the Basel II Capital Accord. On the other had the minds of human labour force employed in the industry needed to be capacitated for the Accord’s implementation in emerging market economies. The presence of asymmetric information in the industry’s regulatory regime framework amongst different segments and players such as banking firms, security firms and insurance sector firms was a great challenge. In most developing states, only commercial banks were required to comply with Basel II Capital Accord, a discriminatory approach that had the capacity to jeopardize all financial sectors developmental efforts attained to date. The challenge was further worsened by asymmetry of supervision frameworks, where various market participants were regulated by separate supervisors, yet they were operating in the same financial sector. Another challenge noted by the study was the existence of imperfect markets which detracted massively the adoption and implementation of the Basel II Capital Accord in emerging market economies.

Banks survived and grew very well through information-intensive financial activities and their profitability strategies were heavily premised on dissemination and maintenance of such symmetric information between them and market players. Asymmetric information in the financial sector of an economy created moral hazards, adverse selection, agency challenges and price (interests and exchange rate) distortions. The difficulty in the implementation of the Accord was centred on operational costs, cross-border challenges, corporate sector challenges, costs and volumes of capital, as well as relevance of the Basel II Capital Accords’ rules and assumptions in emerging market economies. The major consequences of the implementation of the Basel II Capital Accord in emerging market economies included increased costs, and/or diminished levels of international bank lending, short-term lending
biases, enhancement of competitive advantage of sophisticated large commercial banks from industrialized states, as well as increases cyclical fluctuations in the global banking systems which could lead to global crises and/or bank runs, liquidity challenges, liquidation of banks and placement of some of them under the curatorship of the Central Banks.

The opportunities that the Accord could forward to banking industries in emerging market economies after its adoption and implementation were quite numerous. The Accord had the capacity to drive and shape banks of the world’s missions, visions, businesses’ corporate and financial strategies, policies, procedures, structures, risk measurement and management frameworks as well as capital calculation methods, internal controls and processes, information technology, systems and data requirements. In other words the Basel II Capital Accord’s ultimate aim was the achievement of intended banking industry benefits, and growth and promotion of sustainable development of the global financial sectors. However, on the whole the group requirements of the Accord, for adoption and implementation were turning out to be too costly, complex and challenging because they required very substantial funds (Capital outlays) for adjustments in IT, internal controls, processes and human resources capacitation and development.

The study modelled and analysed data from audited financial statements from four (4) Commercial banks in Zimbabwe, based on RBZ’s MPSs for the period 2010 to 2012. The banks’ financial data used in the study were as tabulated below:

<table>
<thead>
<tr>
<th>Bank A</th>
<th>Period (in years)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit ($m)</td>
<td>1.462</td>
<td>-1.276</td>
<td>1.404</td>
<td>2.125</td>
<td></td>
</tr>
<tr>
<td>Capital ($m)</td>
<td>31.337</td>
<td>28.871</td>
<td>28.750</td>
<td>39.180</td>
<td></td>
</tr>
<tr>
<td>Loans Issued ($m)</td>
<td>0.258</td>
<td>2.208</td>
<td>1.245</td>
<td>13.291</td>
<td></td>
</tr>
<tr>
<td>Investments ($m)</td>
<td>20.339</td>
<td>43.148</td>
<td>58.527</td>
<td>92.046</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bank B</th>
<th>Period (in years)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit ($m)</td>
<td>-1.645</td>
<td>4.088</td>
<td>-1.555</td>
<td>1.038</td>
<td></td>
</tr>
<tr>
<td>Capital ($m)</td>
<td>16.247</td>
<td>13.667</td>
<td>14.391</td>
<td>36.298</td>
<td></td>
</tr>
<tr>
<td>Loans Issued ($m)</td>
<td>42.533</td>
<td>77.630</td>
<td>116.259</td>
<td>132.650</td>
<td></td>
</tr>
<tr>
<td>Investments ($m)</td>
<td>2.115</td>
<td>1.502</td>
<td>3.157</td>
<td>2.249</td>
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<table>
<thead>
<tr>
<th>Bank C</th>
<th>Period (in years)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit ($m)</td>
<td>1.728</td>
<td>-1.324</td>
<td>1.854</td>
<td>6.128</td>
<td></td>
</tr>
<tr>
<td>Capital ($m)</td>
<td>24.428</td>
<td>26.776</td>
<td>31.754</td>
<td>38.182</td>
<td></td>
</tr>
<tr>
<td>Loans Issued ($m)</td>
<td>10.708</td>
<td>18.172</td>
<td>24.346</td>
<td>33.129</td>
<td></td>
</tr>
<tr>
<td>Investments ($m)</td>
<td>6.395</td>
<td>16.844</td>
<td>26.528</td>
<td>38.406</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bank D</th>
<th>Period (in years)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit ($m)</td>
<td>1.626</td>
<td>1.348</td>
<td>1.883</td>
<td>2.384</td>
<td></td>
</tr>
<tr>
<td>Capital ($m)</td>
<td>23.285</td>
<td>25.874</td>
<td>28.875</td>
<td>42.816</td>
<td></td>
</tr>
<tr>
<td>Loans Issued ($m)</td>
<td>32.634</td>
<td>47.848</td>
<td>52.295</td>
<td>68.132</td>
<td></td>
</tr>
<tr>
<td>Investments ($m)</td>
<td>16.456</td>
<td>24.482</td>
<td>47.852</td>
<td>76.488</td>
<td></td>
</tr>
</tbody>
</table>

The research study made use of the following Multiple Linear Regression Model in the analysis of quantitative data generated from the four banks in Zimbabwe:

\[ P_{t,t} = \alpha_{t,t} + \beta_{1,t}K + \beta_{2,t}L + \beta_{3,t}V \]
Where

\[ P = \text{Profits generated by the bank in a year}; \]
\[ K = \text{Capital employed by the bank in a year}; \]
\[ L = \text{Loans issued by the bank in a year}; \]
\[ V = \text{Volume of investments made by the bank in a year}. \]

\( \alpha_{1t}, \beta_{1t}, \beta_{2t} \) and \( \beta_{3t} \) are regression coefficients.

The Multiple Linear Regression Models generated for the four banks using E-Views4 package with profit (P) as dependent variable are as stated below:

i. **Bank A**: \[ P = 6.70 + 0.19K + 0.02L + 0.11V \]

Bank A’s profit levels for the period under review had a weak positive relationship with capital formation, loans issued and the volume of capital investments it undertook to grow the resources of the shareholders. In other words, the bank’s investment drives were weak and it was encouraged to revisit its capital formation and credit exposure policies if it were to maximise returns to shareholders in the dollarization era.

ii. **Bank B**: \[ P = 6.218 + 0.01K + 0.01L - 3.04V. \]

In the case of bank B, it was established that the profit levels for the years 2009 to 2012 were weakly (positively) connected to capital and loans issued and substantially negatively related to the volumes of long term investments created in the period in question. Therefore banks that behaved like bank B needed to massively go into long term capital market investments if they were to meet their mandate to shareholders and the rest of their stakeholders.

iii. **Bank C**: \[ P = 7.86 + 0.22K + 0.035L + 0.18V; \]

Their study revealed that there was a positive linear relationship among capital, loan portfolios and capital investments for bank C in the period under investigation. Although the bank outperformed the rest used in the survey, overall, it also had room to increase its capital, long term loan portfolios and volumes of capital investments in its quest to grow towards meeting the RBZ set minimum capital requirements and attainment of sustainable development in the foreseeable future.

iv. **Bank D**: \[ P = 5.84 + 0.18K + 0.026L + 0.16V; \]

The findings of the last bank examined depicted that there was a positive linear regression connection among profits and capital formation, loans issued and investments made during the period in question. However, the bank needed to massively revisit its loan portfolios as their contribution to profits was the weakest relative to those of capital and investment portfolios of the period. As compared to its competitors, bank D could be rated second in terms of its overall performance in the dollarization era under review.
It was therefore found out that there was a positive linear regression relationship among profits, capitalization, loans and volumes of investments for three (3) banks; A, C and D. However when the same variables were examined for the 4th bank, B it was revealed that the bank’s profit levels had a weak positive linear relationship with capital and loans, but had an inverse relationship with investment levels in the period under consideration. These findings from these selected banks in Zimbabwe, revealed that there were threats and opportunities commercial banks in emerging market economies faced in the implementation of the Basel II Capital Accord, in their desire to grow towards sustainable development in their service provision to their nations. The Accord therefore was meant to address the need to further strengthen financial soundness and stability of the international banking system by encouraging banks to improve their investment drives, capitalisation, credit exposures and risk management systems and practices. The findings from the banks’ financial statements conformed to the RBZ, MPS (2012)’s findings which had it that banks had shifted attention from long-term loans and investments towards short-term consumer loans that impacted negatively on growth and development of the financial sector of an emerging economy. According to Bailey (2005) the deviation of banks from their core business and functions saw those facing serious non-performing loans (NPLs), bank runs and/or bankruptcies. Most banks in emerging economies like Zimbabwe had their banking licences withdrawn, or were put under Central Bank curator ships or liquidated in the period under review.

The Basel II Accord was described as a massive financial revolution led by financial innovation in the capitalization and risk management arena of the whole international financial system, and it had gained a lot of optimism from financial players in Zimbabwe and the rest of the world. Emerging market economies were not obliged to comply with provisions of the Basel II Capital Accord, which were biased towards the concerns of the G-10 countries, but were encouraged to do so because the Accord assisted them in assessing and managing risks that were linked to securitised transactions. The second Accord also improved banks’ financial reporting systems and strategies which were also key parameters when it came to prevention and management of systemic global financial crises. The major incentives to be drawn from successful implementation of the Basel II Capital Accord included official financial sector discipline, institutional discipline, productive efficiency and productivity, market access requirements, goodwill and international spill over effects. It was also found out that banks in emerging markets needed to swiftly engage in capacity building measures for educating and training their human resources in defined key areas that would be useful when it came to the implementation of the Accord. There was need for banks to come up with new policies, procedures and standards that made it feasible for them to work hand in

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glove with their regulations if they were to grow and develop in their service delivery to the nations.

5. Conclusions and Recommendations

The study concluded that emerging market economies needed to implement the Basel II Capital Accord because it had the capacity to strengthen the soundness, efficiency and stability of the international banking systems through encouraging banks to improve their capital bases, technologies, credit exposures and risk management practices. The Accord’s implementation challenges offered opportunities that banks could exploit to strengthen and transform into better competition within and outside their economies’ domestic financial markets. The operational challenges determined by the study included citations on low security (Blair; 2011), weak regulatory and supervisory systems postulated by IMF (2007) Ward (2002) and Lindergen (1996). It was also concluded that the banking industries, the world over, faced many challenges that impacted negatively on their capacities to adopt and implement the Basel II Capital Accord. The challenges they faced included asymmetric information, poor regulation and supervision frameworks, moral hazards, adverse selection, high operational costs and low volumes of capital, imperfect markets and poor access to finance for the disadvantaged financial markets and institutions in emerging economies.

It was also attained that the implementation of the Pillar II of the Basel II Capital Accord, was very demanding as it proposed massive changing of traditional methods of bank supervision rules into supervision standards. Regulatory Authorities in emerging market economies’ major challenges were pinned on insufficient numbers of highly qualified and experienced (or skilled) supervisors, lack of resources and high operational and transaction costs needed for implementation of the provisions of the Accord’s second pillar. The study also postulated that countries with better financial and technological resources, infrastructure and ease of access to large international funders were expected to easily adapt to the Basel II Capital Accord in a shorter time period as compared to emerging economies that had less complicated, small and very fragmented financial system frameworks. It was critical for emerging market economies to adopt and partly modify the Accord in accordance with their own needs, rules and circumstances before they implemented it in their banking and financial services sectors.

It was also discovered that although capital adequacy standards were not the most suitable tools for supervision and regulation of emerging financial markets, their countries were likely to implement them with minimum or no adjustments mainly because they lacked resources needed for such modifications and could not afford to stay outside the international financial framework (their major source of funding). The study ended by recommending that banks in emerging economies needed to massively invest in sourcing and management of capital,
improving capacitation of their human resource base, management structures, processes and internal controls if they were to benefit from the adoption and implementation of the Basel II Capital Accord. It also went further to recommend that extensive or large scale studies should be conducted based on the relevance, threats and financial opportunities banking industries in emerging economies could draw from the implementation of the Basel II Capital Accord, together with the usefulness of the Basel II Accord in view of the recent global recession, as well as financial institutional mergers and acquisitions, bank runs, insolvency and curatorship schemes that had become very prevalent in Zimbabwe in the 21st century.

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