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Credit Risk and Profitability in the Zimbabwean Banking Sector: An ARDL Approach

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Abstract

Banks operate in a risk environment, and their successful performance depends on how they manage risks. Sound and profitable banking systems are able to tolerate negative distress and contribute more significantly to the growth of the financial system. Credit risk has the biggest and most detrimental effect, affecting the viability, systemic stability, and the efficient allocation of capital. There is no conclusive evidence of the connection between credit risk and bank performance documented in literature. This study sought to contribute to the ongoing debate on the relationship between credit risk and bank performance. It is distinct from other studies in terms of contextual and methodological perspectives. The study is contextualised to the Zimbabwe situation post economic crisis. Methodologically, it adopted an ARDL approach, deviating from other studies that have used fixed effects, random effects, and generalised methods. The results established that bank profitability is influenced positively by capital adequacy, bank size, loan market share and economic growth, while inflation has a negative effect on profitability. The result shows that credit risk has a negative and significant effect on bank profitability both in the short and long run. This means that an increased credit risk reduces the profitability of banks in both the short and long run. The implications of the result is that bank performance can be catalysed by instituting policies that reduces credit risk.

Keywords: ARDL; Banking; Credit risk; Profitability; Zimbabwe