

CORPORATE GOVERNANCE OF BANKS: EVIDENCE FROM ZIMBABWE'S BANKING SECTOR

A Thesis submitted to the University of Manchester for the degree of Doctor of Philosophy
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TABLE OF CONTENTS

Contents	2
List of Tables	8
List of Figures	10
List of Appendices	11
Abstract	12
Declaration	13
Copyright Statement	14
Dedication	15
Acknowledgements	16
List of Abbreviations	17
CHAPTER 1: Corporate Governance of Banks: An Introduction.....	19
1.1 Introduction	19
1.2 Research Questions	24
1.3 Research Scope	24
1.4 Structure of the Thesis	25
CHAPTER 2: Corporate Governance as Religion: A Review of Literature.....	27
2.0 Introduction	27
2.1 Definitions of Corporate Governance	29
2.2 Corporate Governance from Different Theoretical Perspectives	30
2.2.1 Shareholder Model and Agency Perspective	30
2.2.2 The Stakeholder Model	30
2.2.3 The Stewardship Model	35
2.3 A Critique of the Theoretical Approaches	35
2.4 Corporate Governance Systems	37

2.4.1 Ownership Structure	38
2.4.2 Board of Directors	43
2.4.3 Corporate Governance and Performance	45
2.4.4 Corporate Governance in Developing Countries	47
2.5 Corporate Governance of Banks	48
2.5.1 Special Features of Banks	48
2.5.2 Agency Problems in Banks	50
2.5.3 Regulation of Banks and Corporate Governance	52
2.5.4 Ownership Structure, Corporate Governance and Bank Performance	53
2.6 Theoretical Framework	57
2.6.1 Linking the Agency Theory and Institutional Theory	57
2.6.2 An Institutional Perspective	59
2.7 Historical background and institutional environment	64
2.7.1 Overview of the Macroeconomic environment.....	64
2.7.2 Legal and Regulatory Systems.....	67
2.8 History of the Zimbabwean banking sector	70
2.8.1 Bank Ownership before liberalization.....	70
2.8.2 Financial sector liberalization	71
2.8.3 The 2003-2004 Banking sector crisis	73
2.8.4 Structure of the Banking Sector after the Crisis	78
2.9 Conclusion.....	81
CHAPTER 3 Methodology.....	82
3.0 Introduction	82
3.1 Research Approach	82
3.1.1 Qualitative Approach	83

3.1.2 Quantitative Approach	84
3.1.3 Triangulation of Approaches	85
3.2 Research Methods	86
3.2.1 Questionnaire Survey	86
3.2.2 Case Studies	87
3.2.3 Statistical Analysis of Bank Performance	91
3.2.4 Triangulation of Research Methods and Data	92
3.3 Fieldwork Difficulties	92
3.4 Limitations of the Research	93
3.5 Summary	94
CHAPTER 4: Corporate Governance in Zimbabwean Banks : Findings Based on Questionnaire Survey.....	95
4.0 Introduction	95
4.1 Questionnaire Survey	96
4.1.1 Design of Questionnaire	96
4.1.2 Administration of the Survey	96
4.1.3 Response Rate	98
4.2 Analysis of Survey Responses	99
4.2.1 Ownership Structure of Respondent Banks	100
4.3.2 Summary of Key Findings on Ownership Structure	110
4.3 Board of Directors	112
4.3.1 Board Size	113
4.3.2 Board Composition	115
4.3.3 Separation of the Roles of CEO and Board Chairman	116
4.3.4 Board Committees	116
4.3.5 Board Meetings	117

4.3.6 Board Qualifications	119
4.3.7 Arrest of Board Members	120
4.3.8 Board of Directors and Related Party Transactions	122
4.3.9 Sub-Summary of the Results on the Board	123
5.5 Opinions on Effect of Ownership Changes on Corporate Governance	125
5.6 Conclusions	130
CHAPTER 5: The Relationship between Corporate Governance and Bank Performance.....	134
5.0 Introduction	134
5.1 Performance of the Banking Sector	136
5.1.1 Profitability and Operational Efficiency of the Banking Sector (1999- 2008).....	137
5.1.2 Profitability Ratios by Bank Ownership types (2003- 2008)	140
5.1.3 Asset Quality Ratios (1999- 2008)	143
5.1.4 Asset Quality Ratios by Ownership types (2004-2008).....	146
5.1.5 Liquidity Ratios by Ownership type (2004- 2008)	147
5.1.6 Sub-Summary	150
5.2 Scoring Corporate Governance Practices in Zimbabwean Banks	151
5.2.1 Method of Corporate Governance Scoring	151
5.2.2 The Corporate Governance Scoring Results for Individual Banks	154
5.3 Correlation between Corporate Governance and Bank Performance	158
5.3.1 Data and Variables for the Correlation Analysis	159
5.3.2 Results of the Correlation Analysis between Corporate Governance and Performance	163
5.3.3 Correlation Analysis between CGS and Performance	166
5.4 Conclusion	167

CHAPTER 6: The Best Way to Rob a Bank is to Own One: Case Studies on Collapsed Indigenous Banks.....	170
6.0 Introduction	170
6.1 Selection of Cases	171
6.2 Group A Cases – UMB, Trust Bank and Royal Bank.....	173
6.2.1 Background of the Cases.....	173
6.2.2 Shareholding Structure of Group A Cases.....	175
6.2.3 Board Structure of Group A Cases.....	178
6.2.4 Corporate Governance Weaknesses in Group A Cases.....	180
6.2.5 Sub-Summary of Group A Cases	184
6.3 Group B Cases – NMB, Barclays and TN Bank	185
6.3.1 Background of Group B Cases.....	186
6.3.2 Shareholding Structure of Group B Cases.....	188
6.3.3 Board Structure of Group B Cases	194
6.3.4 Corporate Governance and Internal Control Weaknesses in Group B Banks.....	197
6.3.5 Corporate Governance and related practices in Group B Cases	200
6.4 Comparative Analysis of the Case Studies	205
6.4.1 Ownership Structure.....	205
6.4.2 Board of Directors of Case Study Banks.....	210
6.4.3 Malpractices as a result of Corporate Governance weakness.....	211
6.4.4 Sub-Summary	217
6.4.5 Institutional Arrangements and Corporate Governance of Banks.....	219
6.5 Conclusions	226
CHAPTER 7: Conclusions – Does Ownership Structure matter in the Corporate Governance of Banks	228
7.1 Introduction	228
7.2 Summary of the Structure of the Thesis	230

7.3 Theoretical Framework and Main Findings	231
7.3.1 Summary of the Theoretical Framework	231
7.3.2 Main Findings	232
7.4 Sub Summary	235
7.5 Areas of Future Policy Considerations	236
7.6 Limitations and Suggestions for Future Research	239
BIBLIOGRAPHY	241
APPENDICES.....	262

WORD COUNT WITH FOOTNOTES: 84,743

LIST OF TABLES

Table 2.1: An overview of Agency Theory	31
Table 2.2 Comparison of Rational Choice, Historical, Organisational and Discursive Institutionalism	61
Table 2.3: Zimbabwe Economic Data (1990 – 2007).....	66
Table 2.4: Financial Sector Growth Patterns in Zimbabwe 1992 – 2004	72
Table 2.5: Banks under Curatorship/Liquidation	74
Table 2.6: Banking Sector Mergers & Acquisitions (2003 – 2010)	79
Table 3.0: Details of the Interviewed Banks	90
Table 4.1: General Information on Respondent Banks	100
Table 4.2: CEO & Executive Directors Shareholding in December 2009	104
Table 4.3: Percentage responses on founder CEO participation in banks	105
Table 4.4: Ownership concentration by blockholders within surveyed banks	107
Table 4.5: Largest Shareholder within Private Indigenous Banks	109
Table 4.6: Composition of Boards of Directors within Banks	114
Table 4.7: Average Number of Board Meetings within Surveyed Banks (2009)	117
Table 4.8: Board Member qualifications in Selected Banks	120
Table 4.9: Bank Executives who were arrested	121
Table 4.10: Responses on Related Party Transactions within Surveyed Banks	123
Table 4.11: Effect of change in Ownership on Corporate Governance	125
Table 4.12: Opinions on effect of Board changes on Corporate Governance	128
Table 4.13: Responses on effect of Ownership changes on supervision & surveillance	129
Table 5.1: Paired test for Profitability Ratios of all Zimbabwean Banks (1999-2008).....	139
Table 5.2: Measures of Bank Profitability by Ownership Type (2003-2008)	140
Table 5.3: Measures of operational efficiency by Ownership Type (2004 -2008)	142
Table 5.4: Paired test for Asset Quality Ratios of all Zimbabwean banks (1999 -2008)	145
Table 5.5: Asset Quality Ratios by Ownership Type (Average, 2004 -2008)	146

Table 5.6: Loans to Asset Ratio by Ownership Type (2004-2008)	149
Table 5.7: Number of Questions in CGS subcategory and weighting of score	153
Table 5.8: Corporate Governance Score of Individual banks	155
Table 5.9: Corporate Governance Scores (CGS) by Ownership Structure	157
Table 5.10: Definition of Corporate Governance Variables	160
Table 5.11: Correlation Analysis Results	164
Table 5.12: Correlation Analysis between CGS and Performance	166
Table 6.1: Selection of Cases	172
Table 6.2: Directors interests in Trust Bank (2001)	176
Table 6.3: Royal Bank Initial Shareholding Structure	177
Table 6.4: Profile of the UMB's Directors	179
Table 6.5: Trust Bank Board of Directors as at June 2001	179
Table 6.6: NMB Top 10 Shareholders	190
Table 6.7: Barclays Bank Top Ten Shareholders (as at June 2009)	190
Table 6.8: TNFH Limited Top 20 Shareholders	192
Table 6.9: NMB Bank Directors as at 2002	194
Table 6.10: Barclays Bank Board Structure (30 June 2010).....	196
Table 6.11: TN Holding (Bank Holding Company) Board of Directors	196
Table 6.12: Ownership Structure of Six Case Study Banks	207
Table 6.13: Ownership Frauds and Violations	215

LIST OF FIGURES

Figure 1.1: Organisation of the Thesis	26
Figure 2.1: Managerial Agency Problem and Transaction Costs	33
Figure 2.2: Determinants of Ownership Concentration	42
Figure 2.3: Ownership Structure, Corporate Governance and Performance	54
Figure 2. 4: Annual GDP Growth in Zimbabwe, 1980-2007	65
Figure 2.5: Bank Dependence on RBZ Funding	76
Figure 2.6: Comparison of Listed and Unlisted Banks (As at January 2010)	78
Figure 4.1: Total Shares held by Top 5 Shareholders (as a percentage)	110
Figure 4.2: Comparative analysis of ownership structure patterns across banks	111
Figure 5.1: Trend Analysis – ROA Ratio by Ownership Type (2004 -2008)	141
Figure 5.2: Aggregate asset quality of the banking sector (1999- 2008)	144
Figure 5.3: Trend Analysis of NPL/Gross Loans by ownership type (2004 -2008)	147
Figure 5.4: Trend Analysis of Loan to Asset Ratio by Ownership Type (2004-2008)	149
Figure 7.1: Case Study design using Multiple Cases	171

LIST OF APPENDICES

Appendix 1: Questionnaire	87
Appendix 2: Definition of Quantitative Variables.....	137
Appendix 3: Asset Quality Ratios (2004 – 2008)	146
Appendix 4: Loan to Asset Ratio 2004 – 2008).....	148
Appendix 5: Corporate Governance Scoring (All Banks).....	153
Appendix 6: Trust Bank top ten Shareholders (2001).....	176
Appendix 7: Loans to Politicians – Extract from Edgar Tekere’s Biography.....	181
Appendix 8: KPMG Report on Trust Bank	184
Appendix 9: Royal Bank Summary of Curators Findings	184
Appendix 10: Corporate Structure of TN Holdings,.....	188
Appendix 11: NMB Board Sub-Committees as at March 2010.....	195
Appendix 12: TN Bank Limited.....	195

ABSTRACT.

Banks play a primary role in the intermediation of savings and investments. As a result, the stability and development of the financial sector is of paramount importance to most countries. In developed countries, the global financial crisis which led to the shocking collapse of Lehman Brothers and distress in other global financial giants such as AIG, Merrill Lynch, Royal Bank of Scotland (RBS) and Northern Rock have raised concerns about corporate governance in the financial sector and more specifically, the importance of a stable banking sector worldwide.

In developing countries, financial systems are heavily reliant on banking firms since they are the largest intermediaries. However, issues relating to substantial ownership by insider owners, poor legal and regulatory systems, corruption and the existence of distributional cartels have underscored the need for effective regulation and sound corporate governance aimed at curbing excessive risk taking by owners.

Whilst most studies have focused on corporate governance practices in banks with different ownership types, such as foreign, state and domestic banks, the effect of ownership structures on the corporate governance of banks has received little attention, particularly in developing countries. Literature suggests that whether the ownership rights of a bank are held by just a few shareholders or by many and whether these shareholders are insiders or outsiders has differing effects on corporate governance. This study analyses the effects of ownership structure on corporate governance in Zimbabwean banks.

The Zimbabwean banking sector has experienced major changes since the liberalisation of the financial markets in 1991. The sector expanded due to the entry of a significant number of private indigenous banks in a market previously dominated by foreign banks. Following this expansion, the sector suffered a near-systemic crisis in 2003 which resulted in the collapse of 13 of these newly registered banks and the arrest of several owner managers on allegations of abusing depositor's funds. After the financial sector crisis, the central bank implemented new corporate governance regulations in 2004 which introduced a separation between ownership and management. The objective of the regulation was to address the problems relating to insider ownership concentration and corporate governance weaknesses in banks.

The findings from this study indicate ownership concentration in all Zimbabwean banks regardless of ownership type, and insider ownership concentration in private indigenous banks before and after the 2004 regulations. The empirical evidence finds that banks with insider ownership concentration suffered corporate governance weaknesses which resulted in problems such as related party transactions, frauds, tunnelling and abuse of depositor's funds. This suggests that in developing countries, insider ownership concentration may result in corporate governance weaknesses whilst outsider ownership concentration can increased monitoring by outside blockholders.

The study also finds evidence of a weak legal and regulatory framework, poor enforcement and regulatory forbearance as some of the institutional arrangements which affected ownership structure and corporate governance in banks. The analysis concludes that the regulatory changes introduced by the central bank in 2004 may not have been ineffective in tackling insider ownership concentration and the resultant corporate governance weaknesses. The study questions wholesome adoption of Anglo-Saxon type provisions relating to separation between ownership and management without an empirical analysis of their appropriateness to developing countries.

Declaration

No portion of the work referred to in this thesis has been submitted in support of an application for another degree or qualification of this thesis or any other university or other institute of learning.

Lance Shingai Mambondiani, August 2011.

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DEDICATION

To Nathan Adam Takudzwa and Leanne Samantha Anesu

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LIST OF ABBREVIATIONS

ACL	Adversely Classified Loans
ALCO	Assets and Liabilities Committee
CARs	Capital Adequacy Ratios
CEO	Chief Executive Officer
CG	Corporate Governance
CIR	Cost to Income Ratio.
CSC	Cold Storage Commission
DPB	Deposit Protection Board
GCRC	Global Credit Rating Company.
GMB	Grain Marketing Board
IMF	International Monetary Fund
IOBZ	Institute of Bankers of Zimbabwe
IODZ	Institute of Directors of Zimbabwe
LLR	Loan Loss Reserves
MC	Management Controlled Bank
MPS	Monetary Policy Statement
NED	Non Executive Directors
NIM	Net Interest Margin
NMB	National Merchant Bank
NPLs	Non Performing Loans
OC	Owner Controlled Bank.
OECD	Organisation for Economic Cooperation and Development
PSF	Productive Sector Facility
QS	Questionnaire Survey
RBZ	Reserve Bank of Zimbabwe/central Bank
ROA	Return on Assets
ROE	Return on Equity

SSA	Sub Saharan Africa
Stanchart	Standard Chartered Bank
TNFH	TN Financial Holdings Limited.
TNH	TN Holdings.
TRUSTFIN	Trust Finance Limited.
UMB	United Merchant Bank.
UNCTAD	United Nations Conference on Trade and Development
WSJ	Wall Street Journal
Z\$	ZIMBABWE DOLLAR.
ZABG	Zimbabwe Allied Banking Group
ZBS	Zimbabwe Building Society
Zimbank	Zimbabwe Banking Corporation
ZSE	Zimbabwe Stock Exchange

CHAPTER 1

CORPORATE GOVERNANCE OF BANKS: AN INTRODUCTION.

“Panics do not destroy capital; they merely reveal the extent to which it has been previously destroyed by its betrayal into hopelessly unproductive works.” John Stuart Mill, 1867.

1.1 Introduction

Poor corporate governance is widely viewed as one of the structural weaknesses responsible for some corporate failures and financial crises around the world. In some way, the highly publicised corporate failures of big companies such as Enron, WorldCom, Maxwell, BCC1 and Barings may have contributed to a resurgence of interest in how firms are governed, by whom and for whose benefit.

The outbreak of the 1997 Asian crisis is often cited as an example of a failure of corporate governance (Nam and Soogeun, 2001). Post crisis policy packages by regulators indicate that authorities around the world are concerned by financial crises and have given priority to putting sound corporate governance practices to minimise vulnerability. A significant concern regarding these reforms, which are based largely on the Anglo-American model, is how effective or relevant they are in developing countries because of embedded institutional and socio-cultural norms. Compared to developed countries, these different institutional factors in developing countries may impact corporate governance structures differently (Gustavson et al, 2009).

Within the banking sector, the importance of corporate governance and the need for competent banks, especially in developing countries is significant for many reasons. First, banks are the most important source of external finance for firms. Second, their role in allocating capital to other firms gives them considerable power to influence corporate governance in non-financial firms. Further,

banks are at the core of the payment systems in most countries and this interconnectedness makes a systemic crisis within the sector contagious and very costly (Arun and Turner, 2004). In developing countries such as Zimbabwe, banks assume even greater importance due to an overwhelmingly dominant position in the financial sector. This is because capital markets in many developing countries are at an early stage of development.

Banks play a primary role in the intermediation of savings and investments. As a result, the stability and development of the financial sector is of paramount importance to most countries. Different studies support the position that countries with efficient and strong financial and banking sectors experience higher rates of economic growth (King and Levine, 1993; Levine and Zervos, 1998; Rajan and Zingales, 1999). Banks are therefore, extremely important growth catalysts in most countries

Another reason why corporate governance studies have gained increased significance is based on the relationship between corporate governance and performance. This is despite the fact that the evidence justifying an empirical link between corporate governance and performance is rather mixed and contradictory. However, the adoption of appropriate and efficient corporate governance practices is considered critical in reducing bank fragility and increasing managerial efficiency and performance.

The numerous cases of banking crises around the world in the last two decades of the 20th century such as financial crises in the East Asian 'miracle' economies and in Japan have raised concerns about the stability of financial systems (Henderson, 1999). Episodes of systemic crisis and associated bank failures have highlighted a possible link between financial sector reforms, systemic crisis and corporate governance (Honohan, 1997). For these reasons, effective regulation and sound corporate governance aimed at curbing excessive risk taking by banks are vital concerns for stakeholders. Many financial crises in developing countries have been associated with changes in the regulatory

regime of banks and the process of liberalisation.¹ Some of the changes in these reform packages have altered the ownership structure of banking institution in developing countries and opened up the registration of indigenous players in a sector previously dominated by foreign banks.

Debates on the prime causes of banking crises around the world have indicated that there is no single cause. It has been observed that the causes of banking crises are multi-dimensional (Llewellyn, 1999). Of the 86 episodes of bank insolvency (1980-94) analysed in the Caprio and Klingebiel (1996) dataset, at least 20 of these are said to have featured 'cronyism' and connected lending whilst 30 cases pointed to over borrowing and premature liberalisation of the financial sector.²

More recently, the global financial crisis which caused distress in global financial giants such as AIG, Merrill Lynch, Royal Bank of Scotland (RBS), Northern Rock and the shocking collapse of Lehman Brothers has highlighted how financial innovation, risk and the increasing focus on non-traditional commission and fee based banking operations can cause serious and long-term damage to entire economies and the global financial architecture. Indications are that this global financial crisis was caused by bank excesses and poor risk frameworks in the sub-prime markets which may, among other issues, highlight increased fragility and poor corporate governance within the banks. The recent crises have also highlighted that banks have not been able to properly modify structures and incentive schemes designed for traditional banking operations to adapt to the general shift within most banks to non-traditional banking (*such as sub-prime mortgages or derivatives*) where financial innovation has increased bank risk parameters (Gorton, 2009).³

¹ See Llewellyn (1999), studies by William and Maher (1998) show that almost their entire sample of 34 economies (both industrialised and developing) that undertook financial liberalisation over the 1980s and 1990s experienced varying degrees of financial crisis. Similarly Kaminsky and Reinhart (1998) found that, in the majority of cases, their sample of countries that had experienced crises, the financial sector had been liberalised during the previous five years. They conclude that financial liberalisation helps predict banking crises across a range of countries.

² Cronyism refers to excessive political interference.

³ Many banks have moved from an "originate and hold" business model to "an originate and distribute" business model where in the latter model banks do not hold assets they originate, i.e. loans, until maturity, but rather distribute them to investors through the issuance of structured finance products.

Bank corporate governance is important since weak governance mechanisms may lead to a loss of market confidence which can trigger bank runs or a liquidity crisis, endangering the stability of the financial system. Banks are opaque and have a large number of stakeholders who can be affected by their operations. In addition to shareholders, the interests of depositors have to be addressed (Macey and O'Hara, 2003). Furthermore, the interest of regulators of sustaining a sound financial system should be accounted for (Boot and Thakor, 1993). Due to the special nature of banks, the range of stakeholders is wider compared to other companies.

In developing countries, issues such as weaker public and legal institutions, concentration of ownership, reliance on internal finance due to weak capital markets, the existence of special interest groups, dominant government ownership of banks and ineffective prudential regulation and supervision make it easier for banking agents and distributional cartels to misappropriate bank funds raising the risk of bank failures.⁴ These conditions further magnify the importance of good corporate governance mechanisms within banks.

In Zimbabwe, the banking sector has experienced major changes since the liberalisation of the financial markets in 1991. The sector has expanded due to the entry of a significant number of private indigenous banks. The registration of these local banks in a market previously dominated by foreign banks was intended to facilitate the objectives of financial liberalization by boosting competition in the banking sector and stimulating economic growth. Deregulation was also intended to lead to improvements in services to customers and expanding access to credit, especially to domestic small and medium scale businesses.

However, in 2003, shortly after deregulation, the Zimbabwean financial sector experienced a financial sector crisis which resulted in the collapse of 13 banking institutions between December

⁴ The opaqueness and information asymmetry gives strong incentives to bank insiders to pursue their own interest at the expense of the interests of shareholders. In developing countries this has led to abuse and systematic looting by bank managers due to lack of effective regulatory oversight.

2003 and June 2004. Within six months, 5 banks were placed under curatorship, 2 were under liquidation and 4 under the troubled bank fund. Most of these banks were the newly registered indigenous banks.⁵ Several private indigenous bank owners either fled the country or were arrested on allegations of fraud or abusing depositors' funds. Following the 2003 crisis, the central bank introduced new corporate governance regulations in 2004 in an attempt to change ownership structure and to improve corporate governance in banks.

The ownership structure of a bank is important in analysing bank corporate governance. Whether the ownership rights of a bank are held by just a few shareholders or by many and the effect of insider ownership concentration, particularly in developing countries require more research (Morck, Wolfenzon, & Yeung, 2005). However, it has been observed that previous studies analysing the ownership of banks have focused primarily on the impact of ownership type, particularly the impact of state and foreign ownership on corporate governance, economic growth and bank performance (La Porta et al, 2002; Berger et al, 2005).⁶

The number of studies addressing the impact of blockholders, management and bank ownership on corporate governance and performance are limited, particularly within developing countries (Arun and Turner, 2002a; Reaz, 2005). In Zimbabwe, there are only a few studies that have analysed corporate governance of banks (e.g. Muranda, 2006). However, there are no known studies that analysed the effects of ownership structure on corporate governance in banks. To the best of the researcher's knowledge, this study is the first to provide a detailed analysis of ownership structure and corporate governance in the banking sector before and after the 2003 financial sector crisis.

Although there is a study by Mangena and Tauringana (2005) analysing corporate governance and performance with respect to all the companies listed on the Zimbabwe Stock Exchange, no study has

⁵ Banks are defined as financially distressed when they are technically insolvent and/or illiquid.

⁶ See also Mico *et al.*, 2007.

so far analysed the relationship between corporate governance and bank performance specifically. The quantitative analysis conducted in this study, on the relationship between corporate governance and bank performance is believed to be one of the first to attempt such an analysis.

This doctoral thesis attempts to examine the effects of ownership structure on corporate governance in the Zimbabwean banking sector. The study is expected to contribute significantly to the discourse on corporate governance of banks in developing countries in general. Specifically, the thesis is also expected to become the reference point for future studies on corporate governance mechanisms within the Zimbabwean banking sector. The data collected for this research is also expected to contribute significantly to future datasets and research on Zimbabwean governance information such as ownership structure, shareholding pattern and features of board of directors.

1.2 Research Questions

To effectively analyse ownership structure and corporate governance in Zimbabwean banks, the thesis is to address the following research questions;

- 1. To what extent, and how has ownership structure affected corporate governance of Zimbabwean banks?*
- 2. What were the weaknesses in corporate governance in relation to ownership structure, and what were the resultant problems experienced by banks?*
- 3. Has the new regulation introduced in 2004, which separates ownership from management, been effective in tackling these corporate governance problems?*

1.3 Research Scope

As previously stated, the purpose of this study is to analyse the effect of ownership structure on corporate governance. To achieve this, the study uses banks in the commercial banking sector, with a particular focus on private indigenous banks. All the commercial banks were, however included for

comparative and methodological reasons. There are a number of reasons why this study focuses on commercial banks and private indigenous banks. First, commercial banks hold the largest share of deposits in the Zimbabwean banking sector, commanding close to 75 percent of the market share (RBZ, 2004). Second, after a monopoly by foreign banks, financial sector liberalization resulted in the licensing of a number of private indigenous banks. As a result, there was an exponential growth of private indigenous banks registered after deregulation. The ownership structure and corporate governance practices of these newly established banks provide a fertile ground for research. Third, all the banks which suffered distress or which collapsed as a result of the 2003 crisis were private indigenous or previously private indigenous banks. An analysis of the problems in these banks and comparison with other banks would be informative.

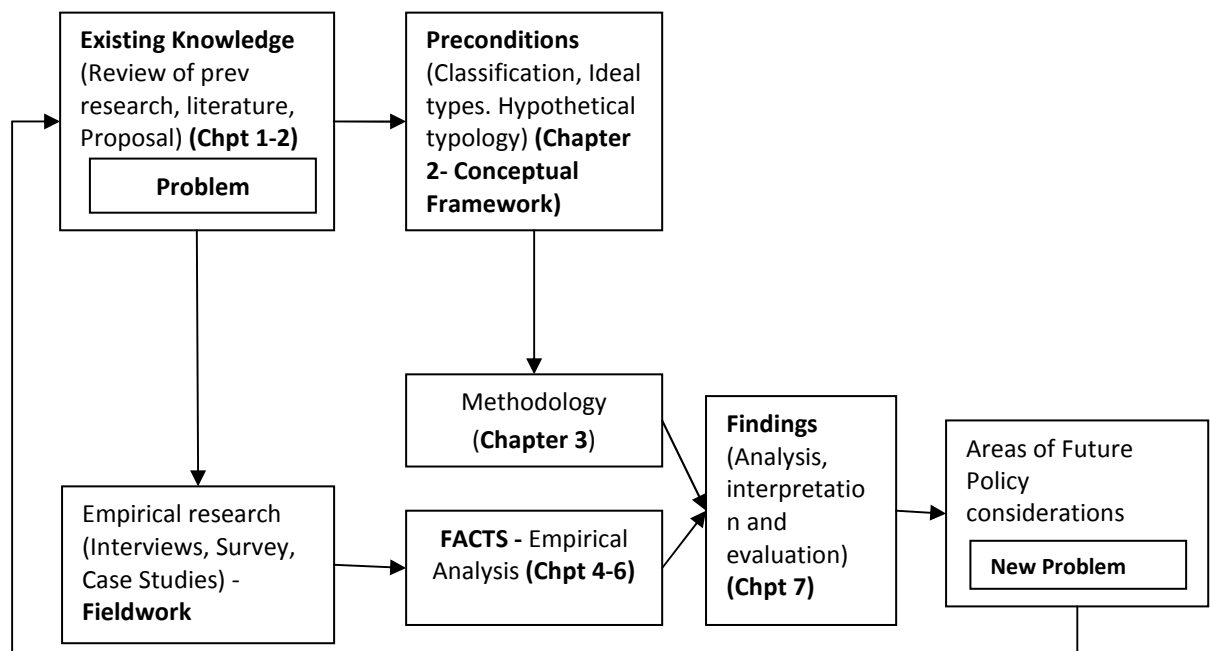
The main study period was set between 1991 and 2010. The 2003 financial sector crisis has been used as an important background. The study period covers the period from the liberalisation of the financial sector in 1991, the financial sector crisis in 2003, the introduction of the new regulation in 2004 until fieldwork was carried out in 2010. Based on this timeline, the study was able to analyse ownership structure and corporate governance in the banks before and after the 2004 financial sector crisis.

1.4 Structure of the thesis.

This thesis contains a total of seven chapters. After the introductory chapter, Chapter 2 reviews literature on corporate governance, ownership and the institutional perspective. It begins with a discussion on theories of corporate governance such as the agency theory, stakeholder, stewardship and political models of corporate governance. It then reviews literature on corporate governance of banks before moving on to literature on ownership structure, the extended agency theory and the institutional perspective. The chapter concludes with a historical background which provides an overview of the banking sector. Chapter 3 sets out the methodology chapter.

The three chapters which follow (Chapters 4-6) present the results of data analysis. Chapter 4 present the results from a questionnaire survey on the Zimbabwean banking sector and provides an overall picture of ownership structure and corporate governance of commercial banks. Chapter 5 presents a quantitative analysis of bank performance and correlates corporate governance and bank performance.

Figure 1.1: Organisation of the Thesis



Source: Author's own depiction.

In chapters 6, the research questions are further addressed by a series of case studies in order to allow an in-depth analysis of selected banks. Three cases of private indigenous banks established before 2003 are studied in Group A cases. A private indigenous bank established before 2003 and survived the crisis, a foreign bank, and a private indigenous bank established after 2003 are studied Group B cases. The chapter concludes with a discussion across the six case studies. Chapter 7 summarises the main findings of the research and presents some policy considerations. The structure of the thesis is presented in Figure 1.1.

CHAPTER 2

CORPORATE GOVERNANCE AS RELIGION: A REVIEW OF LITERATURE.

2.0 Introduction

Corporate Governance has recently emerged as an important issue across the world. In developing countries, ownership tends to be concentrated within insiders, capital markets are under-developed and do not attract sufficient capital, and market transactions are based often on the abuse of inside information for personal enrichment (Gregoric, et al, 2001). Within the industrialised nations, recent incidents such as the collapse of large businesses such as Enron, Barings and Maxwell have brought back the focus on the importance of corporate governance.

The importance of corporate governance as a paradigm is premised on the belief that good governance plays an important part in the existence and development of companies; it inspires and strengthens investor confidence by ensuring a company's commitment to competitiveness and profitability (Stiglitz, 2003). Further, good corporate governance is important in ensuring the protection of the rights of shareholders, strengthening the Board of Directors, improving operational efficiency of businesses, providing protection to financial and other lending institutions, creating wealth and economic value, stressing ethics and values and to keep economic, environmental and social sustainability (Bhattacharyya, 2003).

Whereas the literature on corporate governance in developed economies focuses on overcoming the problems produced by the separation of ownership and control, corporate governance in developing countries raises a variety of issues which may be different to those in developed

countries. Weaker institutions, greater concentration of ownership, state ownership of firms, a greater reliance on internal finance for investment capital, to mention a few, suggest that companies in developing countries may face different corporate governance problems from those in the developed countries (Reaz, 2005).

Corporate governance of banks has been argued to show to some extent, different features from that of other types of firms, due to the special nature of banking (Arun and Turner, 2004). Corporate governance of banks is particularly important as poor corporate governance may result in bank failures which endanger the stability of the financial system. Poor corporate governance in banks may also lead to lost market confidence in the bank's ability to manage assets, which may in turn trigger bank runs and liquidity crises (Basel Committee on Bank Supervision, 2006). In addition, it has been observed that bank operations are less transparent, the range of stakeholders affected by their operations is wider and the different characteristics of traditional and non traditional banking operations impose challenges on bank corporate governance (Westman, 2009). Therefore, corporate governance in banks deserves special attention.

The main purpose of this chapter is to present a theoretical framework for analysing the ownership structure and corporate governance in the banking sector of Zimbabwe, by reviewing theoretical and empirical literature. This chapter is organised as follows; the next section is a general overview of literature on corporate governance. In this section, the various definitions and models of corporate governance are presented. A critique of these different models is also made. The following section discusses the special nature of banks and literature on corporate governance of banks. The section after this discusses the conceptual framework adopted in this thesis and the last section summaries the chapter.

2.1 Definitions of Corporate Governance

There is no uniform definition of corporate governance. Different studies have used different definitions depending on the subject of enquiry. According to Fama and Jensen (1983), corporate Governance is defined as the set of mechanisms through which outsiders are protected from expropriation by insiders (including management, family interests and/or governments). A study by Shleifer and Vishny (1997) defines corporate governance as the ways in which investors ensure themselves that they will receive maximum return on their investments. Other definitions have focused on corporate governance and how it describes all the institutional processes, which include the appointing of the controllers and/or regulators involved in organizing the production and sale of goods and services (Turnbull, 1999). Tirole (2001:4) also defines corporate governance as the design of institutions that induce or force management to internalize the welfare of stakeholders. Both these definitions suggest an institutional approach to analyse the corporate governance problem.

There are different definitions in terms of the ways in which capital providers can be guaranteed appropriate rewards. Some focus on the internal structure, in particular the board of directors. For instance, Blair (1995) applies the term Corporate Governance to refer to the structure and functioning of boards of directors. A wider definition quoted by Ticker (1994) focus on the board room but extends to include 'owners and others interested in the affairs of the company, including creditors, debt financiers, analysts, auditors and corporate regulators'. Such wider concerns in the discussions on corporate governance form the basis of the Stakeholder Model which is discussed later in this chapter.

The challenges faced by firms in developing countries cited earlier in this chapter, such as insider ownership concentration and weak institutional frameworks require that a wider corporate governance definition should be adopted. A definition which only focuses on the relationship between shareholders and managers would be inadequate for developing countries due to insider

ownership concentration and the potential abuse of stakeholder rights. Owners with concentrated shareholding in banks may use company resources for their personal benefit affecting the interests of other stakeholders. Within developing countries therefore, corporate governance are the practices which can overcome and minimize malpractices by companies through the establishment of a system which limit potential abuse by shareholders with concentrated shareholding (Samantaray et al., 2003).

2.2 Corporate Governance from different theoretical perspectives.

A study by Hawley and Williams (1996) which broadly undertook a literature review of corporate governance in the US as a background paper for the Organisation for Economic Cooperation and Development (OECD) identified different models of corporate governance which are discussed within mainstream literature such as the agency theory, the stakeholder and the stewardship theories. Recent literature has also discussed another model referred to as the Political Model (Turnbull, 1999). The next section reviews these theories one by one.

2.2.1 Shareholder Model and the Agency perspective

Agency theory sees the corporation as a nexus of contracts, concerned primarily with the relationship between shareholders and managers (Jensen and Meckling, 1976; Fama and Jensen, 1983; Hart, 1995; Shleifer and Vishny, 1997).⁷ According to Hawley and Williams (1996), the agency theory revolves around the central problem of constructing rules and incentives to align the behaviour of agents with the interests of the principal where the objective of the firm is to maximise shareholder wealth through allocative, productive and dynamic efficiency (Blair, 1995). The agency theory is therefore focused on the primacy of shareholder value by constructing contracts to

⁷ The main thrust of this body of literature has been concerned with analysing the optimal contracts between shareholders and managers (Fama and Jensen, 1983; Eisehardt, 1989), which has led to the majority of the literature on the subject focusing on incentive mechanisms to control the behaviour of managers, focusing mostly on compensation, the composition of the board of directors, and the market for corporate control as the primary issues (e.g. Blair, 1995; Shleifer and Vishny, 1997).

effectively align the behaviours of managers (agents) with the desires of the principles (owners) and avoiding self interest behaviour by the agent (Hawley and Williams, 1996).

The theoretical underpinnings of the agency theory were largely developed from the classical thesis, “*The Modern Corporation and Private Property*” by Berle and Means (1932) which describe the fundamental agency problem in modern firms where there is a separation of ownership and control.⁸ This separation may result in the divergence from the corporate objective of maximising shareholder wealth because managers (agents) have the opportunity to act in their own self-interest rather than the interests of shareholders (Mwiti, 2003). The principal-agent problem is the key issue of corporate governance. The agency relationship is a contract in which one or more persons (the principal/s) engage another person (the agent) to take actions on behalf of the principal(s). This engagement involves the delegation of some decision-making authority to the agent.

Table 2.1: An overview of Agency Theory

Key Idea	Principal-agent relationships should reflect efficient organisation of information and risk bearing costs.
Unit of Analysis	Contract between principal and agent.
Human Assumptions*	Self interest; bounded reality; risk aversion.
Organisational assumptions	Partial goal conflict among participants; efficiency as effectiveness criterion; information asymmetry between principal and agent.
Information assumptions	Information as a purchasable commodity.
Contracting problems	Moral hazard and adverse selection; risk sharing.
Problem domain	Relationships in which the principal and agent have partly differing goals and risk preferences.

Source: Eisenhardt (1989:59).

*Three fundamental behaviour assumptions about agents and principals underlie the agency theory: Both agents and principals are assumed to be (a) rational and (b) self-interested, whereas the agent is assumed to be (c) more risk-averse than the principal (Jensen and Meckling, 1976).

⁸ In their own statement the authors clearly express this separation by saying “*it has often been said that an owner of a horse is responsible. If the horse lives he must feed it, if the horse dies he must bury it. No such responsibility attaches to a share of stock. The owner is practically powerless through his own efforts to affect the underlying property. The spiritual value that formerly went with ownership have been separated from it, the responsibility and the substance which have been integral part of ownership in the past are being transferred to a separate group in whose hands lies control.*”

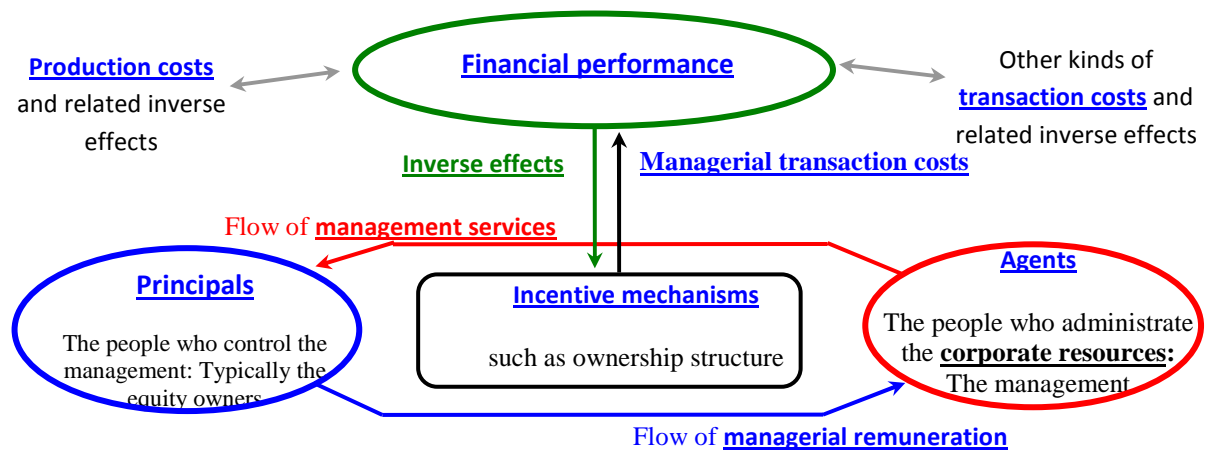
According to Eisenhardt (1989) and Wright et al (2001), the key assumptions of the agency theory are self-interestedness, bounded rationality and risk aversion. An overview of the agency theory and its assumptions is detailed in Table 2.1.

As a result of the conflicts and congruencies between external providers of capital (principals) and the manager of the firm (agents) and also between large (both internal and external) and small shareholders, Shleifer and Vishny (1997) suggests that the concentration levels of ownership is an important factor in the monitoring of managers by shareholders. The theory also assumes that each of the players (whether principal or agent) will attempt to maximise their own wealth through either self interestedness or opportunism (Nanka-Bruce, 2009). Opportunism is seen as a deliberate hidden operation of the agent based on asymmetrical information to achieve personal benefit at the expense of other parties to the contract (Popov and Simonova, 2006).⁹

According to Jensen and Meckling (1976), since the interests of the agents and principals are often different, there are some costs connected with the relationship which need to be spent in order to limit the 'effort aversion' by managers. The expenses ('agency costs') are incurred as principals/owners ensure that agents/managers act in their principals interests (Jensen and Meckling, 1976). In this regard, the separation of ownership and control in a firm can be viewed as a result of "efficient form of economic organization" (Fama, (1980: 89). Figure 2.1 outlines the relationship between the principal-agent relationship and agency costs.

⁹ According to the authors' opportunism can be classed into five categories: 1. That relevant parties have incongruent interests; 2. That information is asymmetrical leading to an unfair advantage that can be used for economic rents; 3. That asymmetric information can be manipulated to prevent affected parties from disciplining the agent; 4. That the other parties might have the usefulness of the information reduced, and 5. That operations may be premeditated and that necessary information on the operation process may be distorted in the process.

Figure 2.1: Managerial Agency problem and Transaction costs



Source: Williamson (1985).

In summary, the agency theory is based on the primacy of shareholder value and assumes that human behaviour is opportunistic and self serving. The agency theory and its assumption of self interestedness has been criticised for being too narrow in its analytical focus since shareholders are not the only ones who make investments in a corporation (Vives, 2000; Arun and Turner, 2003). There are other different resource providers with a potential to affect the economic performance of a firm. Recent literature has also started to take a more holistic view of corporate governance systems as being embedded in larger institutional and legal frameworks in which firms and their stakeholders are based (Davis and Useem, 2002). This has resulted in a more general application of the agency theory which will be discussed later on in this chapter.

2.2.2 The Stakeholder Model

Although the agency theory has dominated debates on corporate governance, it has been criticised for its limited application (Davies et al. 1997). The changing behaviour in the corporate sector has raised the importance of the stakeholders when theorising about corporate governance (Reaz, 2005). In the stakeholder model, the corporation is seen as being responsible to a wider

constituency of stakeholders other than just shareholders (Vives, 2000; Oman, 2001). In this regard, a firm should be run in the best interests of all its stakeholders rather than just shareholders (Clarkson, 1994). Blair (1995) suggests that stakeholders, such as employees, have a residual risk in the firm and therefore should have a more important governance role.¹⁰

The stakeholder model also holds that corporations should be socially responsible institutions managed in the interests of the public. In this regard, the goal of the directors and management should be to maximise total wealth creation while aligning the interests of critical stakeholders with that of shareholders (Blair, 1995). Freeman (1984) who is often credited with the development of the stakeholder theory defines stakeholders as those individuals whose support is essential for the continuation of the firm's existence.

However, one of the major criticism of the stakeholder model has been that it is difficult, if not impossible, to ensure that these wider objectives are fulfilled. The broad nature of the stakeholder theory has also been subject to a lot of criticism. Goyder (1998) and Sternberg (1997) have argued that the stakeholder theory replaces the accountability of business to shareholders, with accountability to *everyone* and therefore to no one. Sternberg (1997) also argues that the stakeholder theory is incompatible with corporate governance, since it denies that corporations should be accountable to their shareholders, and as a result, it has no common and effective standard against which corporate agents can be judged.

Despite this criticism, various corporate governance studies have expressed support for the stakeholder view. When analysing corporate governance of banks, the stakeholder approach is often discussed as the appropriate theoretical framework since banks have different stakeholders such as shareholders, depositors and regulators (Arun and Turner, 2002).

¹⁰ The Cadbury Report (1992) also suggests that while the Director's Report is addressed to the shareholders, it is also important to a wider audience including employees.

2.2.3 The Stewardship Model

Whilst the agency theory is based on the assumption that human beings engage in self-interested behaviour or that managers cannot be trusted and should be fully monitored, the stewardship model suggests that managers are good stewards of the corporation; who are trustworthy and work diligently to attain high corporate profits and shareholder returns (Donaldson & Davis, 1994). According to this theory, the economic performance of a firm will improve if power and authority is concentrated in a single executive who is both CEO and chairman (Reaz, 2005). This is in contrast to most corporate governance models which suggest a separation between the roles of chairman and CEO to increase board independence.

The assumption underlying the stewardship theory is that the behaviours of the executive are aligned with the interests of the principals (Davis et al, 1997). Whilst the distinction between the agency theory and the stewardship theory is that individuals within the company can act as either stewards or as self seeking agents, this is said to be contingent upon the institutional context in which they operate (Turnbull, 1999). In this regard, the stewardship model could be considered a part of a much broader corporate governance framework.

2.3 A critique of the theoretical approaches

The corporate governance debate is often polarized between supporters of the shareholder model (Contractarians/Neo-classics) and those of the stakeholder model (Communitarians/Networkers) raising concerns about the credibility and validity of such a dichotomised approach. The shareholder theory is based on the hypothesis that markets work perfectly, that social values can deviate from market values, a firm belief that the shareholder is the only 'principal' and the hypothesis that there is only one scarce factor of production, which is capital. The capacity of the shareholder model to maximize utility has been criticised on the ground that it is predicted upon the notion of perfect competition (Letza and Sun, 2002). Where the conditions for perfect competition do not exist, as is

the case in most developing countries, the argument falters. As deviations from the conditions of perfect competition increases (e.g. imperfect markets, incomplete contracts, and information asymmetries) after a certain point, firms will not be maximising societal utility by pursuing shareholder interests.

In contrast to the shareholder model, the proponents of the stakeholder model argue that those who are responsible for the governing of firms have responsibilities to parties other than shareholders, based on the belief that businesses, especially large, public corporations, have an obligation to contribute to the betterment of society in a manner distinct from the maximization of corporate profit and the obedience to the law (Arun and Turner, 2002; Kahn, 1997). According to Reed (1999), the stakeholder approach is grounded on a variety of normative theoretical perspectives, which include Kantian ethics, a (feminist) ethics of care, the ethics of fiduciary relationships, societal contract theory, a theory of property rights, a theory of the stakeholders as investors, communitarian ethics and critical theory.

The problem, however, with a normative analysis of the stakeholder theory is that while it is grounded in a variety of theoretical perspectives, in practice, the stakeholder approach does not explicitly root itself in a given theoretical tradition, but operates at a level of individual principles and norms for which it provides little formal justification Reed (1999). Another approach to the stakeholder theory is the social entity theory which holds that the corporation and its governance are grounded in the moral order of the community of protecting the weak from exploitation by the powerful (Million, 1993).

The polarity between shareholder and the stakeholder approach has been a cause for concern. Letza and Sun (2002) argue that this polarized and dualistic approach has several assumptions embedded in the models and theories which render them controversial and questionable as theoretical foundations. Both theories posit that there is only one ideal model in corporate governance; either

shareholding or stakeholding. While the shareholding perspectives exclusively emphasises the priority of shareholders' interest over stakeholders, by contrast, the stakeholding perspectives attempt to legitimise wider stakeholders' interests by rejecting the priority of shareholding value. Both sides claim their own model to be the ideal and perfect and thus to be the only objective 'truth' and the other as 'false', suggesting that the shareholder value and stakeholder interest cannot exist side-by-side because they are conflicting and irreconcilable (Sullivan, 1997).

The polarised theorising between the shareholder and stakeholder models is said to have created a practical crisis and academic dilemma in corporate governance as the contrary presuppositions between theories/models and 'excessive theoretical compartmentalisation' makes it easy to 'lose sight of the ways in which various schools of thought are related to each other' (Astley and Van de Ven, 1983:245, quoted in Sullivan and Conlon, 1997). In the analysis of corporate governance in banks, it has been argued that the unique nature of banks requires a broader stakeholder view which encapsulates both shareholders and depositors (Arun and Turner, 2002).

Literature suggests that the agency theory has often been adopted as providing a necessary lens through which the ownership structure of firms can be viewed (Jensen et al, 1976). The theory is often applicable where the analysis is between shareholders and managers. However, alternative theoretical perspectives have considered that a more generalised or extended agency approach which can be used to analyse the conflict, not only between shareholders and managers, but amongst all stakeholders (Wahl, 2008). In this regard, the generalised agency theory adopted in this study has been combined with institutional perspective.

2.4 Corporate Governance Systems

Internal and external mechanisms can be used to discipline managers of companies (Oman, 2001). These mechanisms include shareholding structure, the board of directors, markets, government,

laws and regulations and regulators and international standards (Alexander and Dhumale, 2001). This section discusses the importance of some of these elements and their effect on corporate governance.

2.4.1 Ownership Structure.

There have been different opinions regarding the ownership of firms and how it affects corporate governance particularly in developing countries. The critical question in ownership research has been regarding how firms are owned and for whose benefit? Historically, ownership is seen as the exclusive possession or control of something that may be an object or some kind of property (Wahl, 2008). Frenchman Pierre J. Proudhon (1809-1865) once described any form of ownership to be considered as theft. His radical approach argued that as long as ownership is connected with privileges, which serve for the expropriation of others, society should inhibit the resulting accumulation of wealth and power.

According to Berle and Means, contemporary firms (in developed countries) are characterised by professional managers with modest, if any, ownership stakes in the firms they manage whilst ownership is often in the hands of outsider blockholders (Wahl, 2008). In developing countries however, the opposite appear to be true, firms are characteristically owner-managed, with significant insider ownership concentration (Brownbridge, 1998).

The effect of ownership structure on corporate governance is one of the central themes of this study. Whether ownership rights of a firm are held by just a few shareholders, or by many, and what the relative size of ownership stakes of different shareholders is, is of central concern to corporate governance literature (Weib, 2010). At a firm level, the level of ownership concentration and the connected blockholdings play an important role for the monitoring and risk oversight of firms (Berle and Means, 1932; Holderness and Sheehan, 1988).

Ownership structure is defined by the distribution of equity within a firm with regard to voting and capital, but also the identity of the equity partners (Daily et al., 2003). Ownership structure is important to corporate governance since it affects the incentives of managers and thereby the efficiency of firms (Wahl, 2008). Another concept central to the effects of ownership structure on corporate governance is the concept and definition of control. In some studies, control is taken to refer to the ability of a particular individual or group to effectively determine the decision making process within a firm (Fama and Jensen, 1983: 304). Firms are generally classified as being owner-controlled if a dominant stockholding interest owns a specific fraction of the firm, and as being management-controlled if the stock holding interests are so diverse that no single interest or coalition of interests can effectively control the firm (Berle and Means, 1932).

Literature suggests that controlling shareholders with concentrated shareholding face strong incentives to monitor managers and maximise profits when they retain substantial control in firms. These incentives which are emphasised by Jensen and Meckling (1976) and Shleifer and Vishny (1986) also restrain the diversion of corporate resources by the controlling shareholders, and enhance the value of minority shares (La Porta, et al, 1998). In contrast, the traditional weakness of dispersed shareholding at the firm level is that there are diminished incentives to exercise control by owners and therefore does not provide protection against managerial opportunism (Fama, 1980; Thomsen and Pedersen, 2000).

i. The Insider Ownership or Network System

The ownership structures which arise out of different degrees of concentration are often classified into the insider or network system and the Market oriented or outsider system. These systems have evolved out of national traditions and institutional arrangements such as the country's legal system or taxation rules. Literature suggests that corporate governance systems in developing countries are characterised by 'strong Owner/Manager' and 'Weak minority Owners' depicting the insider system

(Frye, 2004:15). This form of concentrated insider ownership minimises the separation between ownership and control and gives insiders potential information advantages which can be exploited for personal benefit at the expense of outside owners (Blasi *et al.* 1997).

An insider system is often characterised by highly concentrated holdings, concentrated voting powers and a multiplicity of intertwined inter-firm relationships and cross holdings (Maher and Andersson, 1999). Features of the insider system include bank-dominated relationships, pyramidal ownership structures, familial control, illiquid capital markets and a high degree of cross holdings although individual countries may not exhibit all of these features. One advantage of the insider system is that it can overcome the problems with the monitoring of management associated with dispersed ownership. This is because, the controlling rights are aligned and majority shareholders have the incentive and power to monitor management (Bathala *et al.*, 1995). However, in developing countries, the insider model has been associated with more corporate governance weaknesses rather than strengths. Poor minority investors, rivalry between elite groups, weak property rights, weak legal and judiciary systems have led to problems of controlling owners expropriating stakeholder rights for their personal benefit (Brownbridge, 1998).

ii. The Market-oriented or Outsider Ownership System

Unlike the insider system, the outsider system of corporate governance is characterised by a widely diffuse ownership structure, liquid stock markets and a low level of inter-corporate cross holdings. In the outsider system, which is typical of the United States and the United Kingdom, firms are also diffusely held with no single equity-holding stakeholder owning a reasonably large number of shares to exert control. The system also promotes a more open and equitable distribution of information, placing emphasis on the protection of shareholder rights. The existence of a ready market for corporate control and an instant supply of managerial labour provide the checks and balances on the expropriating interests of the managers.

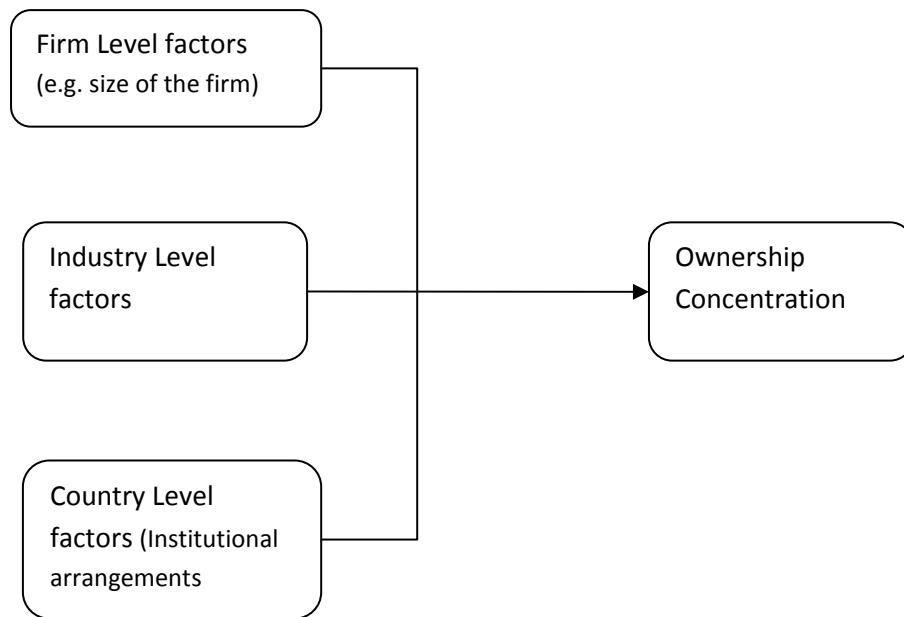
The outsider system is now increasingly characterised by the domination of institutional investors such as mutual funds, pension funds and other financial institutions. This is largely attributed to favourable tax incentives by government to collective schemes, mutual funds and unit trusts. The US capital markets are highly liquid and particularly efficient. The strong framework of laws and an independent regulatory organ, the Securities and Exchange Commission (SEC) ensure that equity is not accumulated by any one shareholding group.

The advantages of dispersed shareholding in the outsider system are in the enhanced liquidity of stocks and better risk diversification for investors. The importance of markets and financial institutions in providing the much-needed control over management by actively trading in the capital markets is particularly significant. However, the outsider system also has its weaknesses. The dispersed ownership raises the costs of monitoring agents by individual shareholders. As discussed previously, dispersed shareholders have little or no incentive to monitor management because of information asymmetry and free-riding problems. Only when substantial shareholding is concentrated in the hands of one or a few investors will such investors be incentivised to exercise their right of monitoring and control.

iii. Ownership concentration

Studies on corporate governance in developed countries discussed in the previous section suggests that among other things, the concentration of ownership in firms is associated with improvements in corporate governance, since insiders with complete control and ownership of their companies seek to maximise value. However, evidence from a number of developing countries suggests an inverse relationship between concentrated ownership and corporate governance or performance as a result of moral hazard problems (Brownbridge, 1998).

Figure 2.2: Determinants of Ownership concentration.



Source: Author's own compilation

According to several studies by Demsetz and Lehn (1985), Thomsen and Pedersen (2000) and La Porta et al (1998) ownership concentration in firms is believed to be influenced by firm, industry and country level determinants as highlighted in Figure 2.2. At the firm level, issues such as firm size, legal origin and firm risk are believed to have an influence on the level of ownership concentration.¹¹ The level of ownership concentration is also said to be influenced by industry level factors such as the regulation of a particular industry (Demsetz and Lehn, 1985). At the country level, institutional factors such as the legal origin and the legal and regulatory environment have been viewed as important determinants in explaining the complete variance in ownership structure between countries (La Porta et al, 1998).

¹¹ For example, at the firm-level, the size of a firm will have a negative effect on the level of ownership concentration. The price of a certain ownership stake of a relatively small firm will be lower than some ownership stake of a larger, more valuable firm.

iv. Institutional investors.

The role of institutional investors in corporate governance has received considerable attention. There is increasing evidence which suggests that institutional investors are more willing to monitor management actions and deter managerial opportunisms (Weir, *et al*, 2002). This assumption is based on the institutional investor's resources and better access to information about the company and presumed expertise (Graves & Waddock, 1994).

However, other studies fail to support the notion that institutional investors are effective monitors of management due to problems such as conflict of interests (e.g., Gaved, 1997; Pomeranz, 1998). The study by La Porta *et al* (1998) also finds that large, institutional shareholders do not always use their influence through board representation to exercise control over management. As a result, institutional shareholders are not always there to monitor the controlling shareholder or stop the expropriation of minority rights.

2.4.2 Board of Directors

The structure of the board of directors has been used by stakeholders as an important determinant to mitigate managers' self serving behaviour. According to Fama and Jensen (1983), the top-level decision control device in firms is a board of directors that deals with the agency problem caused by the separation of ownership and control. Of all monitoring mechanisms, the board is viewed as the "ultimate internal monitor" whose "most important role is to scrutinize the highest decision makers within the firm" [Fama (1980)] and "the common apex of the decision control systems of organizations, large and small, in which decision agents do not bear a major share of the wealth effects" [Fama and Jensen (1983)]. Board features such as board size, board composition and independence, board qualifications and separation between the roles of the CEO and the chairman are some of the important determinants of the board being able to effectively carry out its fiduciary function of monitoring the actions of management (Sullivan, 1998).

i. Board Size

Literature suggests that board structure is important for the effective functioning of the board (Yermack, 1996 and Dalton et al., 2006). Some empirical studies have established a link between board size and performance (Anderson and Reeb, 2003). However, other studies have contradicted this position, finding no link between board size and firm performance (Holthausen and Lurcker, 1993). The evidence is quite inconclusive with studies producing conflicting results.¹²

There is literature which suggests that a large board is more likely to have a greater range of expertise to monitor the actions of management effectively (Beasley, 1996; Forbes and Milliken, 1999; Cohen et al, 2002) or in securing critical resources (Pearce and Zahra, 1992; Goodstein et al, 1994). Contrary evidence argues that small boards are more effective with large boards considered to be less cohesive and slow in decision making processes (Lipton and Lorsch, 1992).

ii. Board composition and board Independence

The board of directors includes directors who are managers of the firm (inside directors) and those who are not full-time employees of the firm (outside directors). Outside directors are widely believed to play significant role in monitoring management than inside board members (Weisbach, 1988). The degree of board independence, represented by the presence of outside directors (Non Executive Directors) is perceived to play an important monitoring role. Agency theorists, generally suggest that a higher proportion of non-executive directors on the board improve the ability of the board to monitor managerial performance.¹³

¹² A study by Holthausen and Lurcker (1993) whilst considering board size as among one of the variable likely to influence firm performance, fail to detect a consistent relationship between board size and firm performance. However, a study by Yermack (1986), using Tobin's Q as a measure of firm performance, finds an inverse relationship, which suggests that small boards are more effective.

¹³ Ibid.

However, the relationship between the presence of non-executive directors and corporate performance is not clear-cut. Literature indicates mixed findings from empirical findings. A study by Hossain *et al.* (2000) finds a positive relationship between the proportion of outside directors and firm performance. By contrast, Agrawal and Knoeber (1996) find that board outsiders significantly reduce firm value. Other studies also fail to detect a relationship between the proportion of outside directors and performance (Daily and Dalton, 1998).

iii. Separation of Chairman from CEO

A separation between the roles of the CEO and Chairman of the board can be important. This is because a CEO who is also chairman of the board wields too much power and control over firms which can result in entrenchment and a subsequent abuse of power. Some empirical studies argue that a non-executive chairman has no superior knowledge of the firm's internal and environmental terrain and therefore argue that a unified leadership (duality) improves corporate governance and firm performance (e.g. Dalton *et al.*, 2004).

iv. Qualification of board members

A board that displays a wide diversity of board background may be more likely to improve their monitoring capabilities. Diverse groups tend to be more creative and to produce higher quality decisions. The educational qualifications and experience of the board are viewed as being important in deepening their perceptions of issues such as risk and monitoring and also reduces board complacency (Bacon & Brown, 1975).

2.4.3 Corporate Governance and Performance

Although studies have shown contradictory results, some findings have suggested a positive relationship between corporate governance and performance (Zingales, 1994; Shleifer and Vishny, 1998; Weiss and Nikitin, 1998). The assumption is that managers and owners of firms who show

efforts in implementing good corporate governance mechanisms will increase market credibility and will subsequently collect funds at lower cost and lower risk (Nanka-Bruce, 2009). As a result, one of the primary reasons why the corporate governance of firms attracts so much attention is because the quality of corporate governance may have an impact on firm performance (Reaz, 2005).

A study by Black, Jang, and Kim (2000) investigated the relationship between corporate performance and good corporate governance in Korea. The results from their study find a positive relationship between corporate governance and performance. A study by Klapper and Love (2002) use firm-level data from 14 emerging stock markets and find that better corporate governance is highly correlated with better operating performance and higher market valuation.

Although most research supports a positive correlation between firm level corporate governance with firm performance, some studies have questioned this link and whether the relationship, if it exists at all, is robust (e.g. Core et al, 2006; Lehn et al, 2006; Shabbir, 2008; Arcot and Bruno, 2007; Love, 2010) . The causality of this relationship is believed to be less clear and there is some evidence which suggests that causality may operate in reverse (that is that better firm performance leads to better corporate governance (Love, 2010). The majority of the identification methods that have been employed to date have also been questioned.¹⁴

It has also been noted in literature that whilst there are several studies which have looked at the relationship between corporate governance and performance in developed countries, only a few of these have established direct empirical evidence on the relationship in developing countries (Reaz, 2005; Mangena and Taurigana, 2005). In the Zimbabwean banking sector, no study has so far been undertaken linking corporate governance with bank performance.

¹⁴ Ibid.

2.4.4 Corporate Governance in developing countries

In developing countries, corporate governance is believed to need special emphasis for a variety of reasons. Information problems are more acute, financial accounts are less reliable, contracts are more difficult to enforce and macro-economic variables affecting the value of firm assets are more volatile (Goldstein and Turner, 1996). Financial markets in developing countries are perceived to be more prone to agency problems such as adverse selection and moral hazards and banks are considered more vulnerable to financial distress (Long and Vittas, 19992).

There is a vast difference between the institutional frameworks in developed and developing countries (Black, 2001). Numerous observers have pointed to ineffective state institutions in developing countries as an impediment to better corporate governance (Reaz, 2005). The institutional environment facing owners, managers and shareholders is particularly different from that in developed economies. Legal institutions are much less reliable and managers may lack an incentive to improve corporate governance regulations because they know that the laws may not be enforced. Most investors are also hesitant to use the courts due to the length of time it takes to obtain a satisfactory resolution (Black, 2001).

One other important factor in the development of ownership structures in developing countries relates to how firms are funded. Unlike in developed countries, firms in developing countries rely on internal sources of funding and banks are no exception. This can result in high levels of ownership concentration by insiders. As a result, the existing mainstream theories based on firms in developed countries with well developed capital markets may offer little guidance on the corporate governance implications for firms which rely on internal sources of finance. In exploring the corporate governance of banks in transitional economies, it is important to consider how all these factors which include concentrated ownership, weak court systems and extensive internal finance affect the corporate governance of banks.

2.5 Corporate Governance of Banks

2.5.1 Special feature of Banks

Banking institutions demand higher corporate governance standards because they differ fundamentally with other types of firms. Banks are financial institutions. Financial institutions are different from non-financial ones because the former play an important role as intermediaries channelling funds from lenders to borrowers (Arun and Turner, 2002). This is especially true in developing countries where non-banking financial institutions are less developed. Banks are special from non-financial firms and also unique to other types of financial institutions. Firstly banks have a pivotal position in the economy for two main reasons: they are the main source of finance for a large number of borrowers; and more importantly they manage the payments system.

If the banking system is placed in jeopardy, the resultant financial disruption is likely to be more serious than it would be with other sectors of the financial system. Some banks have a broader impact on the macro sector of the economy by facilitating the transmission of monetary policy by making credit and liquidity available in difficult market conditions.

The uniqueness of a bank lies partly in its capital structure. Loans are considered to be a bank's main assets whilst bank liabilities are largely in the form of deposits. Deposits are quite liquid and are available to their depositors (the creditors of banks) on demand; while loans are illiquid with longer maturities. This means that banks hold illiquid assets and issue liquid liabilities and thereby create liquidity for the economy. The capital structure of a bank is special in comparison with other firms because banks tend to have very little equity. Banks typically receive 90 percent or more of their funding from debt, in the form of deposits. This means that creditors of a bank provide far more capital than the shareholders (Reaz and Arun, 2005). The special nature of banks makes the agency problem more complicated and also calls for protection of not only shareholders and but also depositors (Furfine, 2001).

An analysis by Levine (2003) outlines two other characteristics that justify a separate analysis of the corporate governance of banks. Banks are generally more opaque than non financial institutions and as a result information asymmetry between insiders and outsiders makes it difficult for shareholders to monitor bank managers. The opaqueness of banks also makes it easier for owner managers/insiders to exploit outside investors. Often, this abuse characterized by such practises as insider lending makes fraudulent activities more likely, at the expense of outside equity investors, depositors and ultimately tax payers, in the event of a collapse (Furfine, 2001).

According to Arun and Turner (2002), the corporate governance of banks in developing countries is important for several reasons. First, the banking sector dominates financial systems in most developing countries and contributes significantly to economic growth. Second, banks are the most important source of finance for the majority of firms due to underdeveloped financial markets. Third, banks are the main depository of the country's savings.

The problem of the corporate governance of banks in developing countries is also best understood in the context of financial sector development over time. The emergence of banks owned by local private investors (indigenous banks) after a wave of financial liberalisation in the 1980s was significant in this transformation (Levine, 1997). A combination of factors such as low entry requirements and low minimum capital requirements allowed undercapitalized banks without adequate financial or managerial resources to be registered (Brownbridge, 1998). Managers were given greater autonomy to make decisions in an environment of underdeveloped regulatory and legal frameworks (Arun and Turner, 2003). Most of these banks subsequently failed as a result of liquidity constraints, mismanagement, fraud, insider trading and tunnelling (Brownbridge, 1998). Financial sector liberalisation was followed by financial instability and distress, the most notable example being the East Asian crisis in the 1990s (Henderson, 1999). Prudential reforms were implemented after this period of instability although evidence suggests that these prudential reforms have not been effective (Brownbridge et al, 2000).

The issue of concentrated ownership of banks due to underdeveloped capital markets in developing countries raises the problem of powerful corporate insiders with close links with the governing elite, described by Arun and Turner (2002) as 'distributional cartels'. The existence of such cartels often leads to insider lending. Insider lending is identified as a major cause of bank failure around the world (Caprio, 1997). Due to the concentration of ownership in developing countries, conflicts among the majority controlling shareholders, minority shareholders and other stakeholders are more likely to be of greater importance than conflicts between principals and agents which has been identified as the main problem in a dispersed ownership arrangement (Shleifer and Vishny, 1997). This may suggest a different kind of corporate governance problem in developing countries to that suggested by Berle and Means.

2.5.2 Agency Problems in Banks

The principal-agent problem in banks can arise in a wide range of situations. The problem arises, because of the delegation of decision making process from one stakeholder group to another in a situation where the objectives of the different stakeholder groups differ (Aguilera and Jackson, 2003). Within the narrow interpretation of agency theory, the agency problem exists between owners and managers because of the separation of ownership and control. As a consequence, managers may pursue their own objectives at the expense of shareholders (Berle and Means, 1932; Barth, 1991, and White, 1991).

However, literature reviewed earlier suggests that a number of forces may counteract this tendency. First, if outside (non-managerial) ownership is sufficiently concentrated, outside shareholders have a strong incentive to monitor managerial behaviour (Demsetz *et al*, 1997). Second, it has also been argued that if managers have a sufficient ownership stake in the firm, their incentives will be aligned with those of outside shareholders, minimising the agency problem (Demsetz and Len, 1985; Jensen and Meckling, 1976). Third, the takeover market is also believed to constrain managerial behaviour

(Demsetz *et al*, 1997). This perspective of the owner/manager agency problem suffers from the limitation that it has a narrow focus on agency problem.

Within the extended agency theory, due to problems with asymmetrical information there are also agency problems between bank owners and depositors because a bank has superior information to its depositors about its own financial condition and the nature of its deposit contracts. This leads to an adverse incentive where bank owners can increase the bank's risk profile in ways which may be contrary to the interests of the bank's creditors or debt holders such as depositors or the central bank. By undertaking projects with limited liability and legal protection, bank owners bear only a portion of the downside risk but stand to gain through higher profits. In contrast, the depositors do not enjoy any upside potential but bear most of the downside risk if the bank is unable to service its debts (Levine, 2003).

This agency problem between depositors and shareholders is one of the most studied agency problem in banks. This problem receives the most attention from central banks in the design of regulatory structures such as capital adequacy requirements and deposit insurance arrangements based on the view that financial markets can be subject to inherent instability. Corporate governance problems can arise because management have different risk preferences from other stakeholders such as the central bank, owners or creditors. Problems can also arise because management have limited competence in assessing the risks involved in the decisions they make, although they may still have freedom of action to make the wrong decisions due to inadequate control systems and information asymmetry (Prowse, 1995).

The principal-agent problem is said to be more acute in banks since managers may have information advantages which gives them the opportunity to take self interested actions by engaging in unobserved, socially costly behaviour or abuse (Alexander and Dhumale, 2001). Moral hazard (or adverse incentives) arises in a variety of principal agent relationships characterised by asymmetric

information and can be caused by a number of factors. These include negative real interest rates in the economy which may cause borrowers to choose investments with higher returns when successful but with lower probabilities of success, increasing the risk of speculative behaviour and non performing loans (Stiglitz and Weiss, 1981).

It has also been observed in literature that moral hazard is inversely related to bank capital. Owners of poorly capitalized banks have little money of their own to lose from risky investments in the event of a bank failure. As the bank's capital falls, the incentives on owners to pursue strategies which preserve the solvency of the bank are reduced because once bank owners have enough capital of their own invested, there is greater incentive to invest in more prudent assets. (Berger et al, 1995). Moral hazard also becomes serious when banks lend to 'related parties' such as connected directors or managers. Insider lending has been noted as one of the major causes of bank failures across the world (Caprio, 1997). This is because the incentive for imprudent and fraudulent management increases where all the profits arising from a particular project are internalised. These moral hazards reveal corporate governance weaknesses which can be corrected by strict regulation and supervision by central banks.

2.5.3 Regulation of Banks and Corporate Governance

Banks are often heavily regulated because of their significant importance in the economy and also because they are a likely source of fiscal and political revenue. Prudential regulation by governments has an impact on reducing the opacity of banks and help in overcoming adverse effects of information asymmetry and transaction costs (Levine, 2003). Developing models of Corporate Governance in banking requires an understanding of how regulation affects the principal's delegation of decision making authority and what effects this may have on the behaviour of their delegated agents (Jensen and Smith, 1984).

It is considered both reasonable and desirable for depositors and bank creditors to rely on regulators to prevent bank failures and thereby to protect the creditors from illiquidity and principal losses in the event of collapse. Banking regulators act as government designated agents to prevent bank failures. The rationale for creditor's reliance on bank regulators is also reasonable, since regulators make the rules governing banking activities and then use their legal authority to obtain unique access to private information about each bank. Other stakeholders such as depositors, other bank creditors and even minority shareholders do not have access to such information.

Literature on financial sector crises in both the developed and the developing countries suggest that whilst the problem of bank distress is multidimensional, regulation and supervision is a key way to prevent or limit the damages of poor internal control mechanisms (Llewellyn, 1998; Juan, 2003). Government policies that can reduce the adverse effects of information asymmetry and transaction costs have the effect of enhancing the governance of banks and social welfare objectives.

Strong regulation and supervision of banks is important in countries with weak institutional mechanisms particularly in developing countries (Arun and Turner, 2002). This is because of weaknesses such as poor disclosure and transparency and poor quality of accountancy data provided by banks in their financial results. Observations suggest that in many cases, standard accounting and auditing procedures are not rigorously applied and in some cases there is wilful misrepresentation of the financial position of banks (Llewellyn, 1999). A major concern with regulation in developing countries is political interference and regulatory capture which is considered serious where government officials have links with banks. Evidence suggests that regulatory capture is more widespread in the financial sector than in other industries (Kaufmann, 2002).

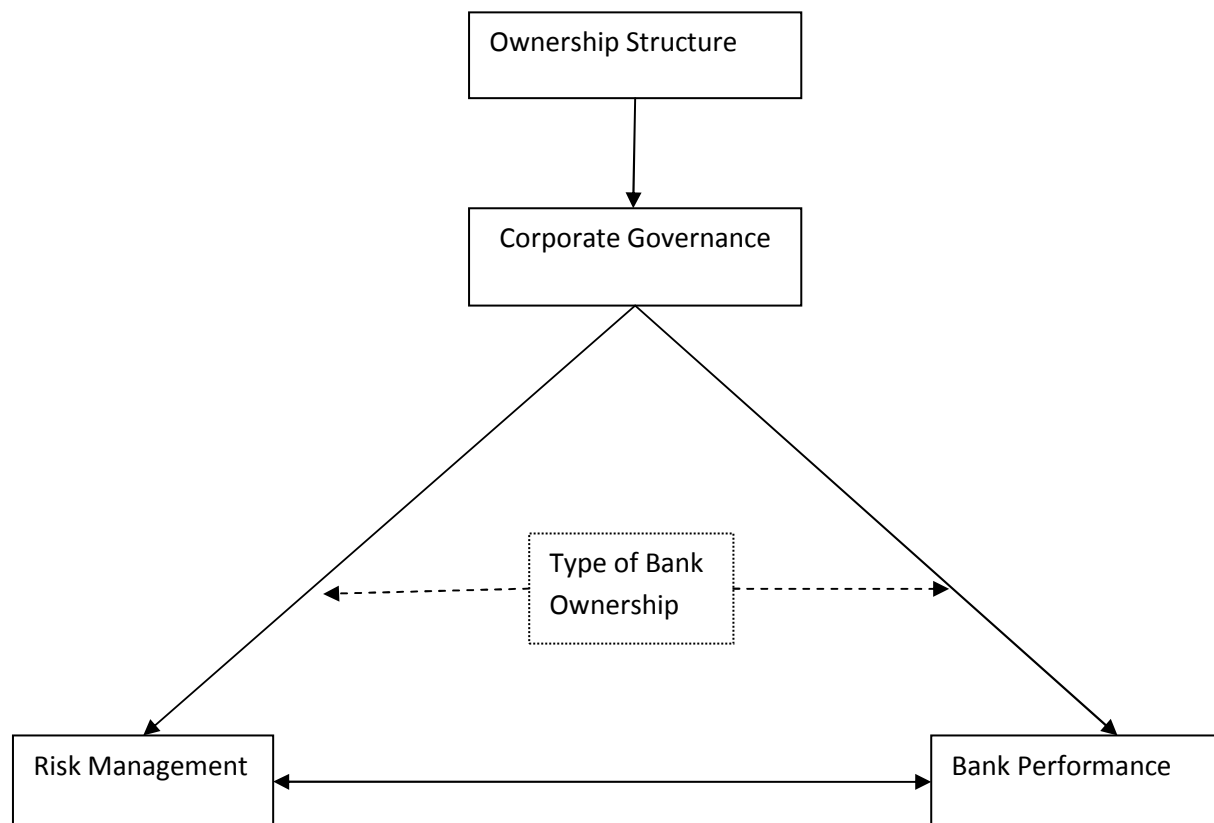
2.5.4 Ownership structure, corporate governance and bank performance

Although the results regarding the relationship between corporate governance and performance have been mixed as discussed earlier, some empirical evidence suggests a link between ownership

structure, corporate governance and bank performance (Nanka-Bruce, 2009). Ownership structure is believed to have a direct effect on the corporate governance practices adopted in a bank (Tandelilin *et al*, 2007). Figure 2.3 outlines the perceived connection between ownership structure, corporate governance and firm performance.

Literature also suggests that the banks under different ownership structures and ownership types have reported differences in performance and risk. Studies analysed earlier, suggest that owners with an equity interest in banks have the ability and the incentive to monitor the actions of their banks and are inclined to act more prudently if they have something to lose, minimising the agency problem (Demsetz and Lehn, 1985; Jensen and Meckling 1976).

Figure 2.3: Ownership Structure, corporate governance and performance



Source: Adapted from Tandelilin *et al* (2007).

Another study by Saunders, Strock and Travlos (1990) looks for evidence that ownership structures can mitigate owner/manager problems at banks. They find a positive relationship between insider holdings and firm specific risk consistent with earlier findings that manager's incentives become more aligned with those of outside shareholders as the proportion of insider holdings rises. Contrary to this view, a study by Hellman (1998) suggests that managers who hold large ownership stakes in banks should favour weak corporate governance.

The identity of bank owners is also considered to be an important determinant of corporate governance and performance. Different types of bank ownership (State, Foreign and Private) are believed to have differing effects on corporate governance and performance based on empirical studies discussed below. In this regard, state or public banks are defined as banks in which the state is the majority controlling shareholder, foreign banks those in which the majority shareholder is a foreign shareholder whilst private indigenous banks refers to banks in which the majority shareholders are private local shareholders.

Literature suggests that foreign banks encourage the adoption of best management and prudential supervisory practises in the banking industry (Levine, 1996). Data also shows that countries that allow entry of foreign banks have more stable financial systems and fewer episodes of financial crisis (Derminigie-Kunt, Levine and Min, 1999; Bath et al, 2005). Some studies have established a positive relationship between foreign investments and good corporate governance practises (Thadden, 2000).¹⁵ This is because foreign investors may insist on changes in corporate governance practices prior to making an investment decision.

In terms of individual bank performance, studies by Claessens et al (1999) find that foreign banks are more profitable than domestic banks in developing countries although the opposite is true in

¹⁵ The overwhelming findings from transition economies, at least in Central and Eastern Europe, is that outside, preferably, foreign owners are crucial in bringing about active and deep restructuring of firms. Foreign owners may also bring new skills and expertise that are more valuable in a well-governed firm.

developing markets. A further study by Dermirguc-Kunt and Huizinga (1999) in 80 countries over the 1988-1995 periods finds that foreign banks have higher margins and profits than domestic banks in developing countries, whilst the opposite is true for industrial countries. In terms of impact, several studies have analysed the impact that foreign banks have on domestic banks. Micco et al (2004) find that the presence of foreign banks is associated with increased competitiveness of domestic banks.

It has also been observed that foreign banks are better than domestic banks at monitoring 'hard' information (e.g. accounting information, collateral value), but have a disadvantage in monitoring 'soft' information (e.g. entrepreneurial ability) with the result being that foreign banks lend to safer and more transparent customers (Mian, 2006). Lastly, a study by Giannetti and Ongena (2007) documents that foreign presence can help mitigate connected lending problems and improve capital allocation.

Local banks have been particularly vulnerable to adverse incentives and selection problems compared to foreign owned banks (Brownbridge, 1998). This may be because local banks often operate in segments of the credit market where these problems are most acute (the low end of the market with the least creditworthy borrowers with limited collateral). This foreign/indigenous dichotomy itself has probably become a problem in bank classification with the former often considered superior to the latter (Weib, 2010). Many local banks are believed to be characterised by deficiencies in the institutional mechanisms for constraining adverse selection and moral hazards such as under-capitalisation, lack of adequate expertise and weak supervising systems (Brownbridge, 1998). Local banks are also notably linked with politicians which increase the problem of moral hazards (Arun and Turner, 2002).

Another common phenomenon in developing countries is the government ownership of banks. Evidence suggests a negative relationship between state ownership of banks and banking sector development and efficiency (Levine, 2003). Empirical findings indicate that state owned banks

typically have larger NPLs than private banks and countries with the highest share of state-owned banks, on average, have the highest percentage of NPLs and operating costs (Mishkin, 2005).

2.6 Theoretical Framework

2.6.1 Linking the agency theory and institutional theory.

The critique on the various theoretical approaches discussed earlier has indicated that philosophical accord has failed to inspire conceptual congruence across disciplines. Different normative foundations have translated into different explanations. Economics based theories advocate for an efficiency-based conception of control and a doctrine of shareholder maximisation (Jensen, 1993), whilst socio-legalists advocate political and social explanations that emphasize an organisation's embeddings in realistic social contexts (O'Barr et al. 1992; Roe 2004). The different philosophical construction, have each framed governance structures and behaviours in terms of their particularistic concept of control.¹⁶

The dichotomous approach to corporate governance and a one size fits all Anglo-Saxon theoretical approach has been criticized as ignoring the continuous and ongoing interaction between choices made and the context in which they are embedded (Muller, 1995). This approach has been described by Sullivan and Conlon (1997) as a static corporate governance analysis which presuppose ready-made concepts and taken-for-granted notions for 'the purpose of theorising and model building to those pre-existent conceptual templates' (Letza and Sun, 2002; 54). Based on this approach, shareholding or stakeholding is pushed as a true representation of what seems to be an optimal and universal reality.¹⁷

However, 'process philosophers' have inspired a *processual* thinking of the corporate governance paradigm which encourages the multiplicity of corporate governance reality and pluralist claims in

¹⁶ Palmer and Dunford (1996) have reasoned that the dissimilar ontological and epistemological assumptions of different metaphors, if unchallenged, inspire competing and contradictory images.

¹⁷ Ibid.

theorising and analysis based on the observation that one size cannot fit all (Letza and Sun, 2002). This approach seems to have been adopted by a number of international organisations such as the OECD Principles of Corporate Governance (2004) and the Basel Committee on Banking Supervision (2005). The basic construct of this processual thinking is that the social world in our minds such as corporate governance is not an objective representation of a fixed, external reality or some universal principles as claimed. Rather it has to be viewed as a social construct which represents or reflects the periodic patterns of continuously shifting ideas, paradigms, social norms, codes of behaviour, and modes of thinking. (Letza and Sun, 2002:57).

Based on this processual approach, and with the view of bridging this theoretical chasm, this study adopts a generalised agency theory combined with the institutional perspective in interpreting the interactions among stakeholders based on the institutional constraints they face. There are several reasons why this framework was adopted for this study. First, most studies analysing the corporate governance of banks have highlighted the limitations of the 'traditional' agency theory based on its focus on the primacy of shareholder value at the expense of other stakeholders such as depositors and regulators (Arun and Turner, 2004). According to the discussions in the literature review chapter, besides agency problems between shareholders and managers, agency problems in banks can also be experienced in two other areas. Agency problems can exist between managers and other stakeholders due to differences in preferences and also between bank owners and depositors. A generalised agency theory would be able to capture all three types of agency problems.

Second, studies such as Aguilera and Jackson (2003) agree on the usefulness of institutional theory in extending models within an agency theoretical framework due to the contextual influences to assist in explaining 'key constructs' such as the nature of self-interest and the oversight responsibility available to principals. Institutional arrangements such as organisational and national culture or regulatory frameworks might have an impact on how the agency problem is construed.

This new institutional foundation by Williamson (1998) has offered frameworks regarding the role of institutions in corporate governance that are based in a rational actor model of corporate governance. In this regard, self-interested individuals, as envisaged by the agency theory, might prefer to cooperate rather than be opportunistic (Nanka-Bruce, 2009). This will lead to conformity by the actors to basic principles and consequences which serve to link the agency theory with the institutional theory (Gomez-Meija et al, 2005). Third, the unique challenges within developing countries discussed earlier, such as weak legal and regulatory systems, corruption and government interference in banks, among others, require a contextualised discussion on how these factors affect corporate governance in developing countries. The next section will discuss the importance of the institutional approach as a supplementary theory to this analysis.

2.6.2 An Institutional Perspective

The reasons why institutions are said to matter is because laws, customs, and established practices in institutional and organisational settings can play a powerful role in shaping the behaviour of individuals (Levi, 1990). Institutions have been defined as anything from formal organisational arrangements to forms of patterned behaviour operating through roles, rules and scripted behaviour (North, 1990). Other writers have gone further to argue that institutions are important because they shape the power and preferences of actors (Levi, 1990; Hall, 1986).

Whilst old institutionalisms is said to focus on formal rules, the new institutional approach has changed focus from formal rules to a society centred focus, with almost each of the social science disciplines having its own new institutionalism (Levi, 1990). In economics, there have been many arguments about how and why institutions matter (Hodgson, 1988). It has been argued that institutions can play an important role in reducing transaction costs and various forms of market uncertainty and information costs. It is also viewed as helping to monitor and enforce contracts and agreements (North, 1990). In sociology, emphasis is placed on the way in which institutional life

establishes normative orientations, conventions and taken for granted practices that shape and influence behaviour (DiMaggio and Powell, 1991). In the political science approach, there has been a renewed interest in how institutional arrangements shape the behaviour, power and preferences of actors in politics.

i. The institutional Paradigm

Four main types of institutional paradigms discussed in literatures are outlined in Table 2.2, they are; rational choice institutionalism, historical institutionalism, discursive institutionalism and organisational institutionalisms (Campbell and Pedersen, 2001). Rational choice institutionalism borrows heavily from economics. It assumes that actors are rational and selfish, utility maximising individuals who pursue self interests and as a result build economic and political institutions to solve the problems of exchange, such as reducing transaction costs, and managing the principal agent relations (North, 1990, 1981). Their preferences are assumed to be shaped or determined by the institutional context derived from formal and informal rules and practices of institutional settings in question.¹⁸

In contrast, historical institutionalists tend to emphasise the 'embeddedness' of institutions and question the rationalist's assumption that meaningful conceptions of rationality can be developed prior to the analysis of particular forms of behaviour in particular institutional settings. Organisational and Discursive institutionalism focus on the culture of the organisation and how institutions are framed through discourse respectively. This study adopts the rational choice institutionalism based on the economics approach. This is because the assumptions in this approach, that actors are selfish, utility maximising individuals who pursue self interests and build economic institutions to solve the problems such as reducing transaction costs, and managing the principal

¹⁸ Ibid.

agent relations is closer to the generalised agency theory assumptions of self interestedness discussed earlier in this chapter.

Table 2.2: Comparison of Rational Choice, Historical, Organisational and Discursive Institutionalism

	Rational Choice Institutionalism	Historical Institutionalism	Organisational Institutionalism	Discursive Institutionalism
Problematic	How do institutions solve problems of exchange and collective good production?	How do institutions shape capacities for action and institution building?	How are institutions culturally constituted, rationalised and legitimized.	How are institutions constituted, framed, and transformed through discourse?
Conditions of change	Shift in costs and benefits	Crisis and exogenous shock Contradictory institutional logics.	Increased environmental uncertainty. Political-cultural shifts	Perceived political economic crisis. Presence of alternative discourse.
Mechanisms of change	Interest based struggle conflict, bargaining strategic gaming.	Interest, idea, and ideologically-based struggle, conflict, bargaining. Learning, feedback, and experimentation.	Imitation, diffusion, translation.	Translation, displacement, bricolage.
Epistemology & Methodology	Positivist deductive search for general theory.	Comparative inductive search for historically specific theory.	Positivist deductive search for theory. Interpretive inductive search for historically specific explanation	Interpretive search for historically specific explanation. Archaeology of texts.

Source: Campbell and Pedersen, (2001).

It has been argued that the most relevant and promising corporate governance research seeks to understand the institutional context in which it occurs, in contrast to the traditional agency or transaction cost perspective (Davis, 2005). Extending the generalised agency theory with rational choice institutionalisms is therefore important in understanding the formal and informal rules and context in which the agency theory is analysed. From this perspective, institutions are defined based on the approach by North (1990) as anything from formal organisational arrangements to forms of patterned behaviour operating through roles, rules and scripted behaviour.

Rational choice institutionalism approach adopted in this study borrows heavily from economics and adopts a positivist approach that emphasises a ‘deductive’ methodology. This means that

explanations and working hypotheses are deduced and abstracted from principle assumptions about the motives and behaviour of actors. In this instance, as discussed earlier in this chapter, the rational choice approach assumes that actors are rational. These assumptions are then tested by studying bargaining and exchanging relations in order to develop general theories that hold across time and space (Bates, 1998).

ii. Isomorphism

Another critical assumption within the institutional theory is that all social actors are seeking legitimacy, and or reinventing legitimacy norms within the institutional environment (North, 1990). This constraining mechanism that forces one unit in a population to resemble other units that face the same environmental conditions causing similarity of structure, thought, and action is referred to as isomorphism (DiMaggio and Powell, 1983). Three types of isomorphism have been identified in sociology by these authors in their pioneering study. They are coercive, mimetic and normative isomorphism. Some of these theoretical constructs are relevant to the analysis made in this thesis.

Coercive pressure are often made and enforced by the state and public authorities and firms are punished for non performance. Based on this assumption, one of the major influences of adherence to effective corporate governance will be the presence of institutions that can force or coerce organisations into transparent and fair governance practices (Radaelli, 2000). Having a well defined regulatory and legal framework with good enforcement standards can be thought of as a way to force economic actors to observe the rules and not engage in questionable behaviour. In the absence of a strong legal and regulatory environment, property rights will suffer, minority shareholders will be abused and moral hazards for owner managers will increase (LaPorta, Lopez-de-Silanes, Shleifer & Vishny, 2000).

Mimetic isomorphism occurs when social actors imitate other social actors which are viewed as successful and legitimate. Imitation may occur for competitive reasons (Scott, 2001) or in ambiguous

and uncertain situations, where organisational changes are imitated to obtain legitimacy (Baretto and Baden-Muller, 2006). Normative isomorphism is usually done to acquire professionalism within an organisational segment. Formal training and professionalization create an institutional environment through mutually agreed norms and routines (DiMaggio & Powell, 1983). For this study, coercive and the mimetic isomorphism are considered to be relevant in analysing the role of institutions in the corporate governance framework of Zimbabwean banks.

Coercive isomorphism is analysed through the central bank's regulatory capacity to set rules, monitor compliance, sanctions certain activities, and punish non compliance. Force, fear and expedience are central ingredients of the regulative pillar (Scott, 1995). Mimetic isomorphism will be used to analyse the corporate governance practises within indigenous firms and the tendency towards a 'safety in number' effect and the adoption of similar corporate practices by most of the banks.

It has been widely agreed that corporate governance systems of a country is embedded in institutional settings. The quality of a country's legal traditions and institutions plays an important role in the financial development and ownership patterns of firms through enforcement of contracts, and property rights. Corporate governance according to Durnev and Kim (2005) has more value in weaker legal and institutional regimes. La Porta *et al* (2000) also argue that when a country's investor protection laws are good, it reduces expropriation of minority investors. The same study concludes that concentrated ownership within firms can be a response by owners to counter weak investor protection laws. Extending the generalised agency theory with the institutional perspectives is intended to analyse ownership structure and corporate governance of banks within Zimbabwe's institutional context.

2.7 Historical background and Institutional environment

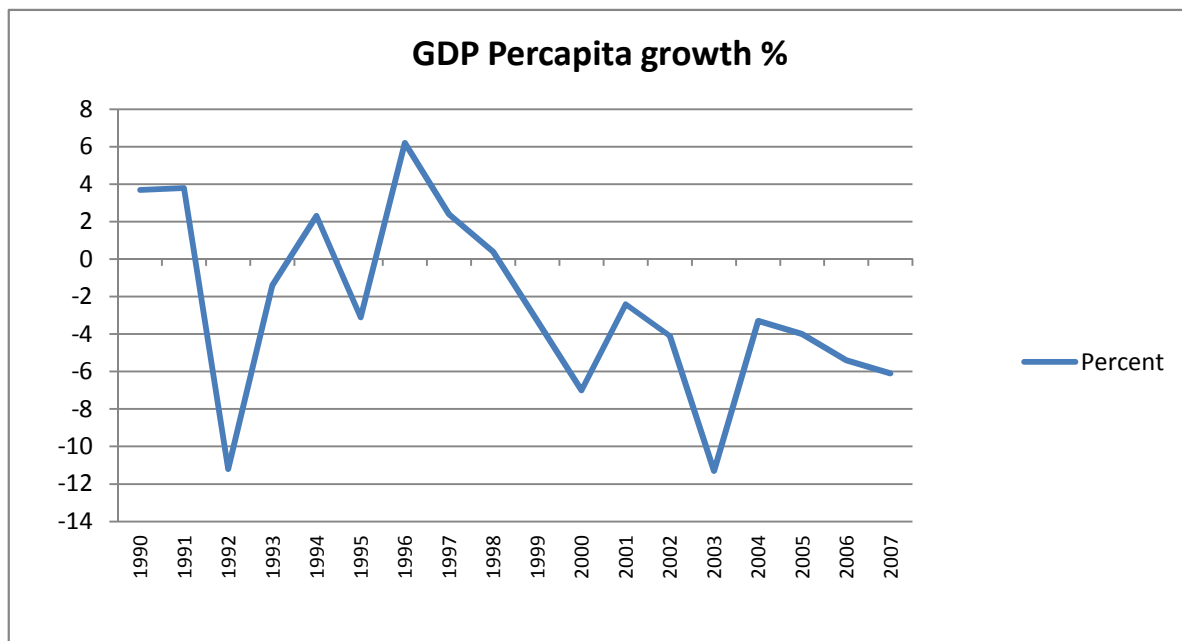
The banking sector in Zimbabwe has experienced several institutional and regulatory changes overtime. These changes are important in understanding how the current corporate governance architecture developed and the institutional mechanisms which may have contributed to this evolution. The purpose of this section is to provide background information regarding some country specific features which may be important in contextualising the research. An overview of the history of banks is important in understanding how ownership structures and corporate governance practices evolved and the institutional arrangements which could have affected this development.

2.7.1 Overview of the Macroeconomic Environment

Zimbabwe, a developing country in Africa is characterised by a long history of economic and political instability (Mangena and Tauringana, 2005). As was the case in many African countries, Zimbabwe adopted an IMF prescribed structural adjustment programme (ESAP) in 1991 to remove state controls on the economy. The country had a fixed structure of interest rates, the state allocated resources to specific sectors of the economy at concessionary rates to stimulate growth, and exchange rates were controlled and fixed against major foreign currencies. Before liberalisation of the sector, all commercial banks were foreign owned. No locally owned (private indigenous) banks were allowed to set up in Zimbabwe until 1991.

From 1997, the country experienced an economic meltdown of unprecedented proportions which lasted for more than a decade. Research by the *Economist* Intelligence Unit revealed that the country's economy shrunk by more than 40% between 1997 and 2005 (Economist, 25 February, 2006). Figure 2.4 highlights the deterioration of GDP Growth over this period. Table 2.3 also indicates an increase in inflation figures, which were higher than real interest rates, resulting in negative real rate of return over this period.

Figure 2.4: Annual Growth in Zimbabwe, 1980 -2007



Source: John Robertson. "August 2007 Forecast Paper," Robertson Economic Information Services for Zimbabwean Statistics

Although Table 2.3 indicates a decline in fundamentals since 1991, the Zimbabwean economic crisis is often traced back to the 14th of November 1997, a day analysts refer to as 'Black Friday', when the Zimbabwe dollar lost 71.5 percent of its value against the US Dollar (Mambondiani, 2007). The stock market subsequently crashed, wiping away 46 percent from the value of shares as external investors scrambled out of the Zimbabwe Dollar. As of November 2008, Zimbabwe's official year on year inflation had reached 231 million percent, the highest in the world. Unofficial estimates suggested that the true inflation figure was in the quintillions (Mambondiani, 2008a).

The hyperinflationary environment posed challenges for businesses to stay afloat amidst operational challenges such as shortages of foreign currency, expensive raw materials and shortages in most basic commodities (Mangena and Tauringana, 2005). Unemployment was estimated to have reached 92 percent.

Table2.3: Zimbabwe Economic Data (1990 – 2007).

Year	Real GDP Per Capita Growth	Consumer Price Inflation	Lending Rate	Real Interest Rate
1990	3.7	15.5	11.7	-5.6
1991	3.8	46.5	15.5	-8.5
1992	-11.2	46.3	19.7	-21.8
1993	-1.4	18.6	36.3	8.1
1994	2.3	21.1	34.8	12.6
1995	-3.1	25.8	34.7	12.2
1996	6.2	16.4	34.2	12.6
1997	2.4	20.1	32.5	13.7
1998	0.4	46.7	42.0	10.7
1999	-3.3	56.9	55.3	-2.6
2000	-7.0	55.2	68.2	12.6
2001	-2.4	112.1	38.0	-35.3
2002	-4.1	198.9	36.4	-96.7
2003	-11.3	598.7	97.2	-267.7
2004	-3.3	132.7	278.9	-71.0
2005	-4.0	585.8	235.6	-2.1
2006	-5.4	1,281.1	496.4	-520.2
2007	-6.1	108,8441.1	N/A	N/A

Source: Hanke (2008). International Monetary Fund, World Economic Outlook database. April 2008, <http://www.imf.org/external/pubs/ft/weo/2008/01/weodta/index.aspx>; International Financial statistics database, May 2008.

A quarter of the population is believed to have immigrated to neighbouring countries as a result of the economic crisis (Mambondiani, 2008b). In the same period, Zimbabwe's currency became virtually worthless against major trading currencies, with 1US\$ worth Z\$1.5 Quadrillion on the parallel market where much of the country's foreign currency was sourced (Mambondiani, 2010).

The economic crisis had a devastating impact on all economic sectors such as the agricultural, manufacturing and the banking sectors. Agricultural production fell significantly during this period; statistics show that annual wheat production fell from a high of 300,000 tons in 1990 to less than 50,000 in 2007 (Coltart, 2008). The tobacco industry which was Zimbabwe's single largest generator of foreign currency, accounting for a third of Zimbabwe's foreign exchange earnings in 2000 was also adversely affected. Tobacco earnings declined from US\$600 million in 2000 to less than US\$125

million in 2007. The manufacturing sector was operating at 10 percent of its capacity, shrinking by more than 47 percent between 1998 and 2006 (Mambondiani, 2008).

The economic crisis also had an impact on Zimbabwe's financial sector. In 2003, the sector suffered a liquidity crisis which affected banks, asset management companies and microfinance institutions. This crisis resulted in the collapse of a number of financial institutions. The central bank also extended over Z\$2 trillion in liquidity support to struggling banks through the Troubled Bank Fund (TBF) (IMF, 2005). Due to its relevance to this study, the financial sector crisis is discussed in greater detail later in this chapter. The deteriorating macroeconomic environment discussed in this section highlight the difficult economic environment in which firms operated. Although not defined as part of the institutional arrangements in this study, the macroeconomic environment provides a context in which the study is analysed.

2.7.2 Legal and regulatory system.

i. Laws and regulations for all companies.

Zimbabwe follows a blend of English common law system and some Dutch civil law commonly referred to as Roman and Dutch law. As a former British colony, most of the commercial practises in the country are imported from the British system. There are statutes which govern companies in general and banks in particular. Zimbabwean companies operate under a single tier board structure with the board as the ultimate body responsible for ensuring companies operate in accordance with the articles of association (Mangena and Tauringana, 2005).

One of the pieces of law which is very important for Zimbabwean companies is the Companies Act (Chapter 24:03). The statute which is derived from the UK Companies Act of 1948 regulates the pre-incorporation, incorporation and outlines the responsibilities of companies operating in Zimbabwe.

The Act requires companies to have at least two directors but does not set a maximum limit as to

how many directors a company should have. Companies listed on the Zimbabwe Stock Exchange are governed by the Zimbabwe Stock Exchange Act of 1996 and the ZSE listing rules (2002).

ii. Laws and regulations for the banking sector

Besides the general company legislation discussed above, Zimbabwean banks are also required to comply with various other regulatory requirements. The Banking Act of 1999 (Chapter 24:20) is the principal legislation regarding how banks are managed. The Act also outlines corporate governance structures that have to be followed by the sector. The central bank is governed by the Reserve Bank of Zimbabwe Act (Chapter 22:15).

The 1965 Banking Act had no provisions regarding ownership limitations on the amount of shareholding that an owner could have, nothing on the maximum ratio of shareholder funds that could be lent to any one borrower or guidelines on insider lending, no definition of risk assets nor the amount of capital required to support bank lending.¹⁹ Although the central bank introduced bank supervision around 1988, until the amendment of the Banking Act in 2000, this was non-binding and performed on a moral suasion basis (Banking Survey Africa, 2004). The Act had no provisions for the inspection of banks except where a case could be made for an enquiry into fraudulent or other criminal activity. Zimbabwe did not have prudential regulations or corporate governance codes for the banking sector until after 2000 when the regulatory framework was amended.

The Banking Act (Chapter 24:20), the Banking Regulations, 2000, and the Reserve Bank of Zimbabwe Act (Chapter 22:15) were enacted and came into effect in 2000. These pieces of legislation provided the legal framework for prudential supervision of the banking sector. The new regulatory regime enhanced the role of the Reserve Bank of Zimbabwe in the process of licensing of banking institutions as it required the appointment of the Registrar as the licensing authority and the Reserve Bank as the supervisory authority.

¹⁹ Ibid.

iii. Corporate Governance Codes

Before the central bank's 2003 crusade to overhaul corporate governance practices within the banking sector, the Institute of Directors Zimbabwe (IODZ) had been at the forefront of promoting corporate governance in the country. IODZ actively recommended that companies needed to adopt the UK Cadbury's Report (1992), or the King's Report on corporate governance to ensure best international practice.²⁰ In 2001, the IODZ was instrumental in the commissioning of the country's first corporate governance manual entitled: *The Principles of Corporate Governance in Zimbabwe: Manual for Best Practice* (IODZ, 2001) which was launched by the Ministry of Industry and International Trade.²¹ Both the code and the ZSE Listing rules incorporate the Combined Code on Corporate Governance and the King's Report (1994). Companies are encouraged to adopt either of the two which implies that in terms of policy, the Corporate governance principles for Zimbabwean companies are much closer (at least on paper) to those in the UK. However, adoption of the Zimbabwean corporate governance code by companies is not mandatory.

Besides the local corporate governance codes discussed in the previous section, there are a number of regional corporate governance codes which may also have affected the development of corporate governance practices in the Zimbabwean banking sector. The code of best practice developed by the Commonwealth secretariat and derived from the corporate governance code of the Organisation for Economic Co-operation and Development (OECD) is one of them.²² The King's Report from South Africa also provides guidelines on effective corporate governance practices and the framework for the protection of shareholders and has been widely implemented by Zimbabwean companies.

²⁰ The King's Report (1994) of South Africa is the most influential corporate governance code issued in Southern Africa and adopted in many African countries. The code was intended to keep standards of corporate governance in South Africa in line with those in the rest of the world. The report makes recommendations regarding issues such as non-executive directors, audit committees, and remunerations committees.

²¹ The code was a private sector initiative was also supported by the International Finance Corporation

²² Commonwealth Association for Corporate Governance Guidelines: Principles for Corporate Governance in the Commonwealth (November 1999).

International codes such as the Combined Code in the UK and the OECD Principles of Corporate Governance have been equally prominent in local companies.

The central bank introduced the banking sector's first corporate governance codes in 2004. Two guidelines on corporate governance were issued, namely, *Corporate Governance (Guideline No. 01 – 2004/BSD)* and *Minimum Internal Audit Standards in Banking Institutions (Guideline No. 2 – 2004/BSD)*. Compliance with these corporate governance codes and guidelines was made mandatory and any banks which failed to meet the guidelines was threatened with deregistration. The corporate governance manual has specific provisions regarding ownership structure and board arrangements, disclosures requirements and the minimum internal audit standards in banking institutions. The purpose of these guidelines was to increase stakeholder protection through the introduction of sound corporate governance practices.

The institutional settings discussed in this section are important in understanding the formal and informal rules, practices and organisational behaviour which could have been important in the evolution of ownership patterns and corporate governance mechanisms in the banking sector. This is in line with the institutional approach adopted in the previous chapter. In this regard, the institutional environment which constitutes formal and informal rules, regulations and enforcement mechanisms have the capacity to heavily influence the ownership structure corporate governance culture within banks.

2.8 History of the Zimbabwean banking sector.

2.8.1 Bank ownership before liberalisation

Before Zimbabwe attained independence in 1980, all commercial banks operating in the country were foreign owned. There were four commercial banks recorded as the first banks to operate in the then Rhodesia. These were Standard Chartered Bank, Barclays Bank, Grindlays Bank Limited and Rhobank Limited. These four banks were important in the early development of the country's

financial sector and the corporate governance practices adopted in the banking sector in the early 1800s.

Prior to 1965, the banking sector was primarily servicing the white population. As of 1963, Black African clients within the Federation are said to have accounted for £0.2 million of the £18.1 millions of private individual deposits, and £3,4 million of the then £24.2 millions of savings and fixed deposits (Clarke,1980). Inadequate data exists on Bank or Group profits during this period except for Rhobank which had local representation. Most of the banks did not publish local accounts. Even if they did, under the existing colonial legislation, this would only have been partial disclosure since there was no obligation to provide disaggregated accounts for banks.

2.8.2 Financial sector liberalisation

Until the introduction of the financial sector reforms through the *Economic Structural Adjustment Programme* (ESAP) in 1991, all commercial banks were still foreign owned. The restructuring of banks was not even a major component of the financial sector reforms. When the sector was opened up in 1991, private indigenous banks were allowed. Infact, new licenses were issued to indigenous banks only, with no new foreign banks being licensed (Mumvuma, 2002). A number of merchant banks and discount houses were immediately licensed with the first indigenous owned commercial bank being licensed in 1997.

The main objective of the financial sector reforms in 1991 was to remove some financial controls on the financial sector. The removal of some of these controls led to the deregulation of the industry and the licensing of new private indigenous banks. This was meant to increase competition and improve banking services (Harvey, 1995). The aim of the IMF prescribed liberalisation policies was to improve the health of the financial sector in particular and the growth and development of the nation in general.

However, despite the relaxation of the licensing rules, and although local banks had been licensed in other bank classes, there was still no indigenous commercial bank operating in Zimbabwe until 1997, more than 17 years after independence. Indigenous commercial banks, started, owned and managed by local people or institutions had already appeared in a number of African countries such as Kenya, Nigeria, Uganda and Zambia (Harvey, 1998). In Zimbabwe, it has been observed that the delay in registering private indigenous banks was because the cost of starting up institutions under other banking types such as discount houses, asset management companies, finance houses and merchant banks was much lower than that of setting up commercial banks.²³ The result was a rapid increase in the number of financial institutions registered in other bank classes.

The liberalisation of the financial sector led to the emergence of a disproportionately large number of indigenous banks being licensed, with the encouragement of the government through the Ministry of Finance which was at the time headed by a nationalist minister, Dr Bernard Chidzero.²⁴

Table 2.4 shows that the number of financial institutions licensed between 1992 and 2003 increased by 115.8 percent from 19 to 43. Between 2004 and 2009 the growth of the sector reduced to single digits, with the commercial banking sector growing by 5.88 percent.²⁵

Table 2.4: Financial Sector Growth patterns in Zimbabwe: 1992 - 2004

Type of Fin Institution	1992	2002	Dec 2003	June 2004	Growth
Commercial Banks	5	15	17	16	220
Merchant Banks	4	6	6	6	50
Finance Houses	4	7	7	5	25
Discount Houses	3	7	8	9	200
Building Societies	3	5	5	5	66.67
Total (sector wide growth)	19	40	43	41	115.8

Source: Muranda (2006).

²³ Ibid.

²⁴ In his budget statement of 1991, the then Minister of Finance, Dr Bernard Chidzero announced that as part of the new reform measures which the government was embarking on, the financial sector was to be opened up to allow for new banks and financial institutions to be established.

²⁵ By comparison, the number of Merchant Banks, Finance Houses and Discount Houses rescinded by -33.33 percent, -100 percent and -88.88 percent respectively. These three categories had the largest number of indigenous players granted licenses after financial sector liberalisation.

Whilst the liberalisation of the financial sector achieved the government's objective of increasing the number of indigenous players in the banking sector, it also led to a number of problems. The number of registered banks more than doubled, whilst the Banking Act (1965) was not amended to accommodate the expansion. The Ministry of finance was still responsible for the registration of new banks. The liberalisation of the sector resulted in rapid changes in the market environment.

2.8.3 The 2003-2004 Banking Sector Crisis

Faced with deteriorating macroeconomic conditions and a hyperinflationary operating environment, most banks increased their investments in speculative and non-core activities such as stock market trading, foreign currency dealings and investments in illiquid asset such as properties and motor vehicles to remain profitable. In some cases, banks are alleged to have used funding borrowed from the central bank through the overnight accommodation window to invest in these speculative activities to increase profitability (RBZ, 2003). Hyperinflation resulted in declining savings from banking customers and as a consequence, banks had to source expensive money to fund their lending. Inflation also resulted in reduced interest income due to poor deposit ratios. In some cases, banks borrowed from the central bank to fund daily transactions. The deteriorating macroeconomic conditions also increased competition within the banking sector as banks sought to remain competitive.

In an attempt to deal with the emerging weaknesses, the central bank announced through its monetary policy in December 2003, a temporary withdrawal of the overnight accommodation or lender of last resort function to deter abuse by errant banks.²⁶ The withdrawal of the lender of last resort function caught the financial sector by surprise after years of regulatory forbearance. When it was reinstated, the central bank hiked the interest rate on the overnight accommodation facility to a punitive 400 % per annum. Banks which were heavily invested in illiquid assets attempted a fire sale

²⁶ This followed the appointment of Gideon Gono as the new Governor of the central bank in 2003.

of their illiquid investments such as properties, vehicles and stock portfolios. The rushed sales led to a crash of the stock exchange and the properties market.²⁷ The central bank's departure from the previous approach of forbearance may have been due to concerns that the failure of some of the weak indigenous banks would threaten systemic stability. Before this, the government, in an attempt to control inflationary pressures had previously adopted an economic policy of negative real interest rates, which encouraged banks to borrow cheap from the central bank.

As a result, a number of commercial banks experienced serious liquidity challenges after this policy shift. The liquidity problems culminated in the collapse of 13 banking institutions between December 2003 and June 2004. Within six months, 5 banks were placed under curatorship, 2 were under liquidation and 4 under the troubled bank fund. Table 2.5 lists the banks that were under distress during the financial sector crisis.

Table 2.5: Banks under Curatorship/Liquidation

Name of Bank	Date of Establishment	Date of Curatorship	Total deposits Billions, Sept 04	Mrkt share % of commercial bank deposits
Under Curatorship				
Trust Bank Corporation*	January 1996	23 Sept 04	157.5	3.0
Royal Bank of Zimbabwe Ltd	8 May 2002	4 August 04	90.6	1.7
Intermarket Discount House Ltd	January 1991	12 March 04	n.a	n.a
Intermarket Banking Corporation	January 2003	12 March 04	11.0	0.2
Intermarket Building Society	12 March 2004	12 March 04	75.5	1.4
Barbican Bank Ltd	December 2002	15 March 04	49.4	0.9
Time Bank of Zimbabwe Ltd	10 May 1997	27 Oct 04	112.9	2.1
CFX Bank Ltd	July 2004	17 Dec 04	127.6	2.4
CFX Merchant Bank	April 2002	17 Dec 04	23.9	0.4
Under Provisional Liquidation				
First National Building Society	Before 2002		n.a	n.a
Rapid Discount House	15 October 1997	26 April 2004	n.a	n.a
Century Discount House		2 January 2004	n.a	n.a
Liquidated				
United Merchant Bank (UMB)	January 1995	29 April 1998	n.a	n.a

Source: Reserve Bank of Zimbabwe, Quarterly Monetary Policy Statement, Oct 2004 and January 2005 and author's own compilation from fieldwork data.

*The highlighted banks are the banks analysed as case studies later in this thesis.

²⁷ See Makoni (2005).

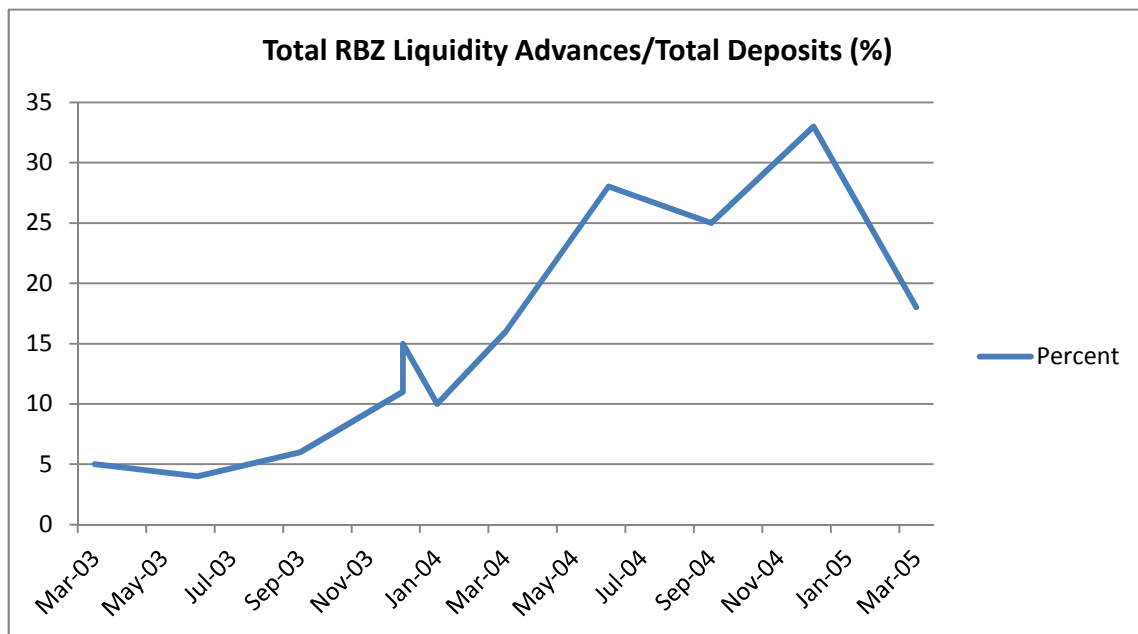
The situation worsened in 2005 when more banks were affected, creating a sector wide crisis. All the banks which suffered distress were the new generation of indigenous bank which had been registered between 1991 and 2003, after the deregulation of the financial sector. However, despite the magnitude of the crisis, the data in Table 2.5 shows that most of the distressed banks were relatively small in size, collectively accounting for only 12 percent of total bank deposits in 2003 and 16 percent of total banking assets. The largest of the distressed banks was Trust Banking Corporation which had a market share of approximately 3 percent and Z\$157.5 billion in deposits.

Over many years and well before the 2003 crisis, the central bank had a practice of providing open-ended liquidity support to banks on a *'no questions asked basis'*. Brownbridge (1998) makes the observation that in most African countries, political pressure may have been brought to bear on central banks to extend liquidity support to politically connected banks in times of distress. It is believed that the government's initial policy of liquidity support and forbearance may have been driven by an unwritten policy objective of supporting the newly registered indigenous banks to compete for business against long established foreign banks in an attempt to indigenise the financial sector (IMF, 2005).

As a result of this policy, most banks were able to access the overnight accommodation window and to borrow short term funds from the central bank. In many cases however, the funds which were borrowed cheap from the central bank were diverted and invested in non core, often speculative investments such as stocks, properties and vehicles to hedge against inflation (Makoni, 2005). This resulted in an artificial increased demand for funding under the lender of last resort function. It would appear that that some banks used the lender of last resort function as a *'lender of first resort'*. Figure 2.2 shows that pressure on the central bank had already started to mount after dependence on central bank funding rose sharply in 2003.

Since the total advances by the central bank increased from an amount equal to about 4 percent of bank deposits at mid year (2003) to 15 percent at the end of 2003, it became clear that some of the banks were experiencing some serious liquidity challenges (IMF, 2005). By December 2003, the demand for funding through the overnight accommodation window from mainly indigenous banks continued to increase. This was despite the increase in statutory reserve requirements from 20 percent to 30 percent for commercial banks following the December 18, 2003 monetary policy statement.²⁸ The spike in the liquidity advance after 2003 relates largely to the support offered to distressed banks.

Figure 2.5: Bank Dependence on RBZ Funding



Source: IMF (2005).

The impact of the crisis on public confidence was severe. This was the first time in the history of the sector that more than one bank had been placed under curatorship or liquidated at the same time.

The result was a massive depositor flight from the indigenous banks which were deemed to be weak

²⁸ The December 2003, Monetary Policy Statement was the first by the newly appointed Governor of the central bank Dr Gideon Gono which marked a shift in the manner in which banks were to be supervised. The Governor announced a tough new regime which immediately led to increased spotlight on the liquidity positions of some indigenous banks previously rumoured to be suffering from a liquidity crisis.

banks to the conservative foreign banks which were largely unaffected by the unfolding liquidity crisis.

After the 2003 financial sector crisis, a number of draconian pieces of legislation discussed in the previous section were drafted to give power to the central bank to swiftly enforce ownership changes and restructure the financial sector. At the time, it appears the government believed that the banking sector in general and capricious greed by indigenous owner managers in particular was the root of country's economic crisis (RBZ, 2004). The first set of laws introduced were intended to empower the central bank to arrest and detain for longer periods, bank owners who were accused of frauds which threatened the stability of the financial sector.

The laws were not passed through parliament, but enacted using Presidential powers which seems to highlight their importance. These were the *Presidential Powers (Temporary Measures) (Asset Management) Regulations (2004)*, *Statutory Instrument 16 of 2004* and *Presidential Powers (Temporary Measures) (Financial Laws Amendment) Regulations, 2004, Statutory Instrument 14 of 2004*. According to these tough new laws, anyone charged with corruption, money laundering proceeds of crime, externalisation of foreign currency whether directly or indirectly, could be detained for seven days before appearing before a court of law. Previously, an accused could only be held for 48 hours before being charged. In accordance with these new measures, a judge or magistrate could order further detention of an accused persons for 21 days if he or she was satisfied there were grounds for the charge. Further, courts were disempowered from giving bail to anyone charged under this law for 14 days from the date the further detention was issued.²⁹

These new measures were used to arrest or charge bank owners or managers of financial firms mostly in private indigenous banks who were said to have abused depositor's funds through

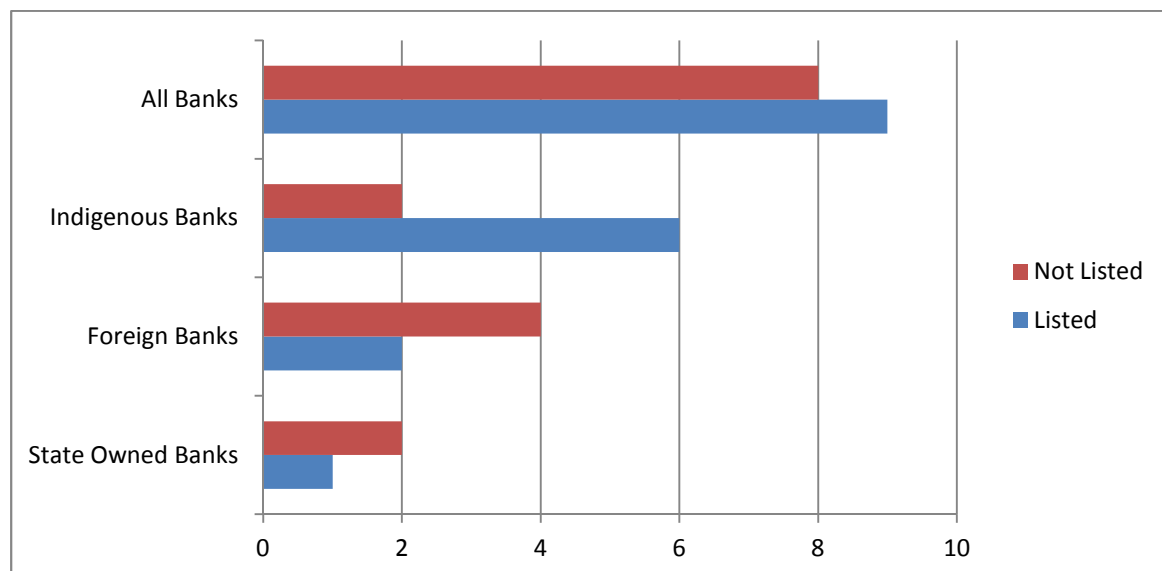
²⁹ The temporary measures became to be known as the Makamba regulations after the arrest of a prominent businessman linked to the ruling ZANU-PF (James Makamba) According to Police investigations, Makamba was accused of externalising US\$716 000, £63 650, R1,8 million and Z\$1,1 billion. His mobile phone company Telcel, was said to have externalised £1050, R2,1 million and U\$1,5 billion.

fraudulent means. Several bank owners were also arrested on similar allegations relating to frauds or abuse of depositor’s funds. Other bank owners such as Dr Julius Makoni, Otto Chekeche, James Mushore and Francis Zimuto of NMB Bank (formerly National Merchant Bank) , Mthuli Ncube (Barbican Bank), Nicholas Vingirayi (Intermarket Bank) skipped the country to the United Kingdom when the police announced that they were being investigated for externalisation of foreign currency. All these directors were CEOs and founders of the private indigenous banks which had been set up after liberalisation of the financial sector. The departure of these founder CEOs contributed to ownership changes in the banking sector.

2.8.5 Structure of the Banking Sector after the crisis

This section concludes with a brief outline of the current structure of the Zimbabwean banking sector and how this has changed since the banking crisis. As at December 2009, the Zimbabwean banking sector comprised of 17 commercial banks. Of this total, 8 banks (47.05percent) are private indigenous, 6 banks (35 percent) are foreign owned whilst 3 (17.05 percent) are public/state owned.

Figure 2.6: Comparison of Listed and Unlisted Banks (As at January 2010)



Source: Author’s own compilation from Archival Data.

Of the 17 banks in the commercial banking sector, a total of nine banks are listed on the Zimbabwe Stock Exchange. When presented by ownership type, Figure 2.6 indicates that six of the listed banks are private indigenous banks, two are foreign and one is state owned.

Table 2.6: Banking Sector Mergers & Acquisitions (2003-2010)

Name of Bank	Year of Merger	Mergers or Takeovers of Collapsed Banks	Takeover by or of a Foreign Investor	Merger with or Takeover of Local Institution
ZABG (State Owned)	2004	Formed from amalgamation of collapsed banks Trust Bank, Royal Bank and Barbican Bank		
FBC Bank (Indigenous)	2004 2005	Took over Zimbabwe Building Society (ZBS) which had been under the control of a government minister.		Merged with Southern African Reinsurance with both companies delisting from ZSE and relisting as FBCH.
ZB Fin Holdings (State owned)	2006	Took over Intermarket Bank, Intermarket Building Society and Intermarket Re-insurance		
Metropolitan Bank (Foreign takeover).	2007		Loita Capital a foreign investor bought 60 percent equity in the bank.	
Kingdom Bank (Indigenous)	2007			Merged with Meikles Africa Limited, Tanganda and Cotton Printers to form largest company on the ZSE
CBZ Holdings (Indigenous)	2007		Took over a controlling stake in Beverley Building Society after buying off majority shareholder UK based Andrew Weir & Co. In a deal worth £3.5million.	Took over the entire issued share capital of Datvest Asset Management.
Premier Finance Group (Indigenous Foreign takeover)	2009		Foreign Investor ADC took over 54 % of indigenous bank after investing US\$6 million.	
Interfin Holdings (indigenous)	2010			Took over 100 percent equity in a struggling indigenous bank CFX Bank
TN Holdings (Indigenous)	2010			Merged with Tedco Holdings a furniture company

Source: Author's compilation from Fieldwork data.

Besides the closing down of banks as a result of the 2003 financial sector crisis which are detailed in Table 2.5, the banking sector also went through several changes between 2004 and 2010 such as mergers and acquisitions and the takeover of local banks by foreign investors some of which resulted in ownership structure of the banks. Table 2.6 outlines some of the changes which were recorded in the banking sector through mergers, acquisitions or takeover by foreign investors.

Table 2.6 shows that all the banks affected by these changes were indigenous banks. Two of the three state banks, ZABG and ZB Holdings took over the assets of some liquidated private indigenous banks. ZABG Bank was established after the amalgamation of three indigenous banks placed under curatorship as a result of the financial sector crisis.³⁰ At least three of the banks which are now classified as foreign banks (Metropolitan Bank, BancABC and Premier Bank) were previously private indigenous banks which were taken over by foreign investors.

2.9 Conclusion.

This chapter has reviewed the relevant literature on corporate governance of firms in general and that of banks in particular. Although literature suggests the dominance of the agency theory which focuses on contracts involving the rules and incentives to align managerial behaviour with shareholders' goals, other theories such as the stakeholder theory, stewardship theory and the political model have also gained prominence. The stakeholder theory has challenged the focus on shareholders by the agency theory and recognised the importance of other stakeholders. The various theoretical incongruences within these theories have highlighted the need for a broader theoretical approach to corporate governance beyond the agency theory.

This chapter has also argued that adopting a generalised agency theory and combining it with the institutional perspective is a useful framework for this study. The goal of this conceptual framework

³⁰ Zimbabwe Allied Banking Group was established by the central bank after the amalgamation of the assets of Trust Bank, Royal Bank and Barbican Bank.

is to provide multi theoretical lenses to produce new knowledge on ownership structures and corporate governance of banks in Zimbabwe. The strength of this theoretical approach is that it attempts to capture the institutional realities within the banking sector to better understand ownership structure and corporate governance practices.

Lastly, a historical background of the evolution of ownership structure and corporate governance in Zimbabwe's banks was discussed. The current state of the banking sector has also been analysed to provide a better understanding of the current context of this research. The institutional settings such as the legal and regulatory systems and the other important institutions such as the central bank and the stock exchange have been discussed. These institutional settings are important in establishing the contextual setting in which the research questions are analysed. The purpose of the historical review was to provide a general picture of the historical development of the Zimbabwean banking sector and the institutional setting in which this occurred.

CHAPTER 3

METHODOLOGY

3.0 Introduction

The last chapter reviewed literature on corporate governance and set out the theoretical framework for this research. This chapter discusses the methodology employed in this study. The chapter is arranged as follows; after a discussion on the general research approach employed, the research methods are detailed. The data collection methods are also discussed. Thereafter, some challenges experienced by the researcher during fieldwork in collecting the data are discussed after which a summary of the discussions on methodology is made in the concluding section.

3.1 Research Approach

The central enquiry of this study is the effects of ownership structure on corporate governance in Zimbabwe's banking sector. This section discusses the research approach adopted to answer the research questions. The research approach connects the conceptual framework to the research methods and the data collection methods. The research approach is described in general as the overall plan for a research, which guides the collecting and analysing of data evidence in such a manner that makes it possible for the research questions to be answered (Bryman, 2004; Ragin, 1994; Punch, 1998).³¹

Having adopted the agency theory extended by the rational choice institutionalists approach as a conceptual framework in the previous chapter, this study also employs a positivist approach that emphasises a 'deductive' methodology. This means that explanations and working hypotheses are

³¹ Punch (2005) suggests that in considering the design, a researcher is moving from what data will be needed to how and from what strategy? Within what framework? From whom? How?

deduced from abstracted first principle assumptions about the motives and behaviour of actors. According to Bates et al, (1998), rational choice institutionalists subscribe to a positivist approach that emphasises on deducing hypotheses from theories based on the principles of methodological individualism and tests them by studying bargaining and exchange relations in order to develop general theories that hold across time and space.

A positivist deductive approach is aligned with the extended agency approach and the rational choice institutionalists which based on the assumptions in these complementary theories which suggests that actors transform institutions when material factors (such as prices or transaction costs) shift and they perceive that the benefits of doing so will exceed the costs. As a result, actors are said to build economic and political institutions to solve the problems of exchange and reducing transaction costs (North, 1990).

The research employs a combination of quantitative and qualitative approaches. The qualitative approach is employed to analyse data from the questionnaire survey and to conduct the case studies. The quantitative approach is used to analyse the performance of banks and to correlate corporate and bank performance.

3.1.1 Qualitative Approach.

Qualitative approach can be defined as a descriptive, non-numerical approach to collect and interpret information aimed at understanding a social phenomenon (Reaz, 2005). In social sciences, qualitative approach also entails alternative conceptions of social knowledge, of meaning, reality, and truth (Creswell, 1994). The Qualitative approach is believed to provide greater depth of understanding, producing a detailed discussion on the social settings being investigated.

A qualitative approach has been criticised as having a number of weaknesses. Lack of generalisability of results and difficulty in verifying information and influencing policy due to lack of precision of

numbers are often cited as weaknesses of a qualitative approach (Kanbur, 2005).³² Qualitative researches are seen as concerned with small-scale aspects of social reality whilst quantitative researchers are often depicted as being involved in uncovering large-scale social trends and connections between variables.

However, adopting a qualitative approach is expected to result in enhanced quality of data and a deeper understanding of the underlying subject (Berg, 2001). One of the advantages of the qualitative approach is its flexibility in supporting a 'non static' approach when analysing a phenomenon (Letza and Sun, 2002). As a general rule, qualitative research view the world as processual rather than static and as being dynamics of social relationships between social actors rather than the characteristics of individuals and the relationships between abstract concepts.³³

A qualitative approach is also believed to provide a means of accessing unquantifiable facts and seeks answers for questions by examining various social settings (Berg, 2001). Based on these justifications, a qualitative approach is appropriate to achieve a processual thinking of the corporate governance paradigm which encourages a multiplicity of corporate governance reality based on institutional contexts. In this approach, corporate governance is viewed as a social construct which represents or reflects the periodic patterns of continuously shifting ideas, paradigms, social norms, codes of behaviour, and modes of thinking.³⁴

3.1.2 Quantitative Approach

A quantitative approach employs quantitative measurement using different statistical tools (Gillham, 2000). The approach has been criticised as being too static, and concerned largely with the accumulation of facts and causes of behaviour through careful isolation, measurement and

³² Blaikie (2000) identifies two aspects to the problem of generalisation in qualitative research. First, probability sampling is uncommon and, is inappropriate in many instances. Second, qualitative data does not lend themselves to the kind of generalisation commonly used in quantitative research, such as using statistical techniques that are based on probability theory.

³³ Ibid.

³⁴ Ibid.

evaluation of variables (Collins, 1992). However, the approach has several advantages. A quantitative approach is believed to provide stronger forms of measurement and establish more reliability and the ability to generalise the results (Bryman, 2001). The approach can also deal with a large number of samples within a shorter period of time (Berg, 2001).

The quantitative approach is employed in this study to examine the performance of banks and correlate corporate governance and bank performance. Using a quantitative approach to explore this relationship provides a more explicit and stronger analysis of the relationship between the variables.

3.1.3 Triangulation of approaches

In light of their disadvantages and advantages, the research combines the qualitative and quantitative approaches. Combining qualitative and quantitative approach is referred to as triangulation of approaches (Glick, 1992; Maxwell, 1998; Hammersley and Atkinson, 1995; Olsen, 2004). A triangulation of approaches results in a stronger research design and produces more valid and reliable findings by minimising the inadequacies of individual methods and neutralising inherent bias in particular data sources (Jick, 1979).

It is expected that the triangulation of approaches in this study will be more effective in exploring ownership structure and corporate structure in a processual way whilst making the results more robust by using approaches which support stronger forms of measurement. The research questions for this study also require a multi-dimensional approach to addressing the subject. Punch (1998), has argued that different questions require different methods to answer them. This is also true of the research questions in this study.

3.2 Research Methods

Combining the quantitative and qualitative approaches, the research employed a questionnaire survey, case studies and statistical analysis of bank performance. Each of these research methods is detailed in this section.

3.2.1 Questionnaire Survey

This study used a questionnaire survey to obtain an overall picture of ownership structure and corporate governance of banks. A survey is described as a means of gathering information about a particular population by sampling some of its members usually through a system of standardized questions for purposes of eliciting information which, after evaluation, results in a profile or statistical characterisation of the population sampled (Punch, 2005).³⁵

There are two basic survey designs which use questionnaires to collect data; cross-sectional and longitudinal surveys (Babbie, 1990). Due to time and cost constraints, this study used a cross-sectional survey, where data was collected at one point in time from a sample selected to describe a larger population at that time. By asking the same or similar question to all respondents, the research method is said to be useful in describing the characteristics of a large population (Babbie, 2004).³⁶

In total, the questionnaire had forty two (42) factual and opinion based questions on ownership structure and corporate governance of Zimbabwean banks. These questions were grouped into five main sub-headings which are; general information on the banks, ownership structure, Board Structure, effects of the regulatory changes in ownership structure on corporate governance, and the effect of the regulatory changes regarding disclosure and transparency on corporate

³⁵ According to Punch (2005), the term survey has different meanings. It is sometimes used to describe any research which collects data (quantitative or qualitative) from a sample of people.

³⁶ Babbie (2004) also suggests that the method is said to be the most commonly used technique to collect data that are beyond the reach of the investigator.

governance. All the questions in the questionnaire were closed end questions to allow respondents to specify anything listed in the choices. An option of 'other' or 'neither agree nor disagree' was also added in the questionnaire to allow flexibility where respondents did not agree with the listed choices. The full questionnaire is produced as *Appendix 1*.

The total number of commercial banks operating in Zimbabwe is 17. Questionnaires were sent to all the banks. Sending out of the questionnaire was done in December 2009 and follow up e-mails and phone calls were made in January and February 2010. Out of the 17 questionnaires sent, 12 were received full completed, amounting to a response rate of 70.58 percent. Given the sensitivities of corporate governance issues and the busy schedule of banking officials, such a response rate is acceptable.

The questionnaire was made available online with the help of an IT expert and the link to the questionnaire was e-mailed to company secretaries of the surveyed banks and followed up by further e-mails, telephone calls and in some cases physical appointments during a fieldwork visit in January 2010. A more detailed discussion on how the questionnaire was administered is discussed in Chapter 5 where the survey results are analysed.

3.2.2 Case Studies

One of the limitations of the questionnaire survey employed by this research is that the questions are closed end. Whilst these questions are necessary to get specific responses on some of the research issues, it is difficult to get in-depth and context related information. To offset this limitation, the research uses case studies. Case studies are defined as an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident, and in which multiple sources of evidence are used (Yin, 1994). It is considered an appropriate method when the

investigator identifies cases within boundaries and seeks to provide an in-depth understanding of the cases or comparison of several cases (Creswell, 2007; Creswell and Clark, 2007 and Yin, 2003).

Stake (1994) has distinguished single and multiple case approaches within case study research. In a single case study, the focus is within a single case and analogous to a single experiment providing a critical test of a theory, to corroborate, challenge or extend it. In multiple case studies or comparative case studies, the focus is both between and across cases. Multiple case study design is said to be analogous to conducting a series of experiments. A well developed theory can be tested by carefully selecting a series of cases in the same way as theory can be tested experimentally.³⁷ The other argument in favour of multiple case studies is that it improves theory building. This is because by comparing two or more cases, the researcher is in a better position to establish the circumstances in which a theory will or will not hold (Yin, 1994).

In this research, case studies are used to explore, in detail, the ownership structure and corporate governance practices of selected banks before and after the 2003 financial sector crisis. Six (6) banks were selected as cases and analysed in two groups. The first three banks in group A are banks which were established before the 2003 financial sector crisis but which all collapsed before or as a result of the crisis. The three cases in group B are banks which either survived the 2003 banking crisis or were established after the 2004 regulation requiring a separation between ownership and control. By strategically choosing the cases in this way, the case studies are meant to establish similarities if any within and among groups and highlighting the differences if any, within and among the different groups. A more detailed description of the case selection criteria is discussed in Chapter 7.

Data Collection – Interviews

Semi-structured interviews were employed in this research to provide data for the case studies. Interviews are probably the most widely employed method in qualitative research. Numerous

³⁷ See Blaikie (2000:221).

studies recommend interviews for a number of reasons, Bryman (2004) suggests that it is the flexibility of interviews that makes it so attractive. Huysamen (1994:145) argues that semi structured and unstructured interviews provide an opportunity for interviewers to use probes with a view of clearing up vague responses, or elaborate on incomplete answers. Gillham (2000:62) also argues that 'interviews assist particularly where material is sensitive in character after trust has been developed—people will disclose things in a face to face interview than they will in an anonymous questionnaire'.

Semi-structured interviews give greater freedom to ask follow up questions that may arise in the course of the discussions. Creswell (2007:140) argues that, interviews, particularly the less structured ones, are more appropriate as they are more flexible and continuous. Using semi-structured interviews has several advantages. First, because semi-structured interviews give freedom for respondents to explore issues, they are useful for studying topics that are difficult to fit into existing categories or are undergoing change. The flexibility of semi structured interviews assisted in the extraction of deeper information regarding the issues being explored.

Semi-structured interviews are often seen as a particularly appropriate method for analysing issues that the respondents may consider to be sensitive, such as ownership stakes of banks, the arrest of bank owner managers after the 2003 crisis, corruption and the abuse of minority rights. Semi-structured interviews may be more likely to collect information about such potentially sensitive topics. By allowing the respondents to talk more freely about their experiences, semi structured interviews offer the possibility of uncovering casual relationships that were not previously apparent to the researchers.

Semi-structured interviews were conducted in the selected banks with chief executives, executive directors, company secretaries or top level managers. For some of the collapsed banks which are no longer in existence, interviews were done with former bank executives or senior managers. To

complement data on the collapsed banks, interviews were also done with central bank and stock exchange officials. These interviews were largely selected based on the suitability of the interviewees in enlightening the issues under study (Gerson and Horowitz, 2002).

Table 3.1: Details of the Interviewed Banks.

Name of Bank/Institution	Ownership Type/Description	Position	Informant
Century Bank	Private Indigenous	Executive Director	Interviewee 1
Barclays Bank	Foreign	Legal Executive	Interview 2
Barclays Bank	Foreign	Executive	Interviewee 3
TN Bank	Private Indigenous	Executive Director	Interviewee 4
Reserve Bank of Zimbabwe	Central Bank	Legal	Interviewee 5
NMB Bank	Private Indigenous	Executive Director	Interviewee 6
United Merchant Bank(UMB)	Private Indigenous	Legal Executive	Interviewee 7
United Merchant Bank(UMB)	Private Indigenous	Executive Director	Interviewee 8
Trust Banking Corporation	Private Indigenous	Executive Director	Interview 9
Zimbabwe Stock Exchange	Stock Exchange	Executive	Interview 10
Royal Bank Limited	Private Indigenous	Senior Manager	Interviewee 11
Royal Bank Limited	Private Indigenous	Executive	Interviewee 12
NMB Bank Limited	Private Indigenous	Executive Director	Interviewee 13
Kingdom Bank Limited	Private Indigenous	Executive Director	Interviewee 14
TN Bank Limited	Private Indigenous	Senior Manager	Interviewee 15
First Banking Corporation	Private Indigenous	Executive Director	Interviewee 16
TN Bank Limited	Private Indigenous	Non-Executive Director	Interviewee 17
Metropolitan Bank	Foreign Bank	Executive Director	Interviewee 18

Source: Author's compilation

A total of 18 interviews were carried out from 12 different banks. The details of the banks interviewed are shown in Table 3.1. For the sake of anonymity, the names of the interviewees and their exact positions are not given. This was required by the interviewees due to the sensitivities of the subject. Most of the interviewees are also still in their jobs, which could compromise their positions were they to be identified.

Data Collection –Other sources.

Secondary data was also used to address information gaps in the case studies. This is because the ownership structure and corporate governance of banks between 1991 and 2003 is analysed in a largely historical context compared to the period between 2004 and 2010 which is more recent.

Some of the secondary data that is used include monetary policy statements from the central bank,

press announcements, policy positions, bank annual reports, newspaper articles (print and electronic), ZSE regulations, Zimbabwean statutes and various legal frameworks and curator's reports on the failed banks.

3.2.3 Statistical Analysis of Bank Performance.

The research conducted a quantitative analysis as well. It compared the performance of banks over time, constructed corporate governance scores (CGS), and performed a correlation analysis between corporate governance and performance. The analysis of aggregate performance of the banks compared performance before and after the introduction of regulations on ownership in 2004. The data used were from the questionnaire survey. Secondary sources such as RBZ Annual reports, IMF country reports on the banking sector and the Global Rating Company (GRC) bank performance data on Zimbabwe were also used.

A Corporate governance scoring (CGS) was constructed based on the responses from 28 questions in the questionnaire. CGS is defined by Standard and Poor (2002) as an assessment of a company's corporate governance practices and policies and the extent to which these serve the interests of the company's stakeholders. The questions were separated into four categories each with different weights to construct the CGS index. The corporate governance scores were then used to relate corporate governance practices to ownership characteristics of banks.

To analyse the relation between corporate governance and performance, the study also conducted a correlation analysis between the performance ratios and corporate governance variables drawn from the questionnaire survey. In this regard, a correlation analysis is used to measure the degree of linear relationship between the performance indicators and the corporate governance variables.

3.2.4 Triangulation of research methods and data

In addition to the triangulation of research methods, the research employs a triangulation of data. Both first and second hand data were used. First data included the data from the questionnaire survey and interviews. Second hand data were from the different secondary data sources discussed earlier. According to Denzin (1970), data triangulation involves the gathering of data through several sampling strategies, from different populations, at different times and in different places. Data triangulation is believed to help in validating research findings (Olsen, 2004).

3.3 Fieldwork Difficulties.

Collecting the data required for this thesis was not without its challenges. Although the researcher overcame most of these difficulties, some of these challenges experienced are highlighted here. In most cases, banks were unwilling to provide data on their operations since most of the data is protected by banker-client confidentiality. Banks are also generally opaque and disclose only the minimum information as compelled by regulations. In Zimbabwe, acquiring data regarding ownership structure and corporate governance is particularly challenging since such information is considered as sensitive, following the arrest of a number of bank owners on allegations of corporate governance violations. In this polarised environment, gathering data from either the central bank or the banks themselves regarding corporate governance may be regarded by the respondents as being accusatorial. This could have created a problem in which respondents painted a positive picture of the corporate governance practices in their banks which could affect the reliability of the results.

In most banks, interview appointments were difficult to secure since most of them were with the CEOs of the banks or organisations interviewed. Some of the appointments were also postponed or cancelled and required rebooking. In total, 18 interview sessions were conducted, with each interview lasting between 30 to 40 minutes. These interviews were carried out over a period of

approximately two months. Most of the interviews were recorded after seeking consent from the interviewees. In some instances, some CEOs asked not to be recorded whilst in others a recorder resulted in guarded responses. Notes were taken in a fieldwork diary where an interviewee elected not to be recorded or appeared uncomfortable.

Collecting the performance data also presented several challenges. Bank performance data for the period between 1992 and 2003 was generally unavailable. No performance data was available for all the banks which collapsed as a result of the financial sector crisis in 2003 which limited the level of analysis. A significant number of the banks do not have websites on which annual reports are posted. The central bank was also not able to provide any of this crucial data either directly or through its bank's annual report which has not been consistently published or made available. A central bank official who was contacted referred the researcher to the central bank website which was down 90 percent of the time. When it was accessed, the website did not have complete and up-to-date bank performance data.

3.4 Limitations of the Research.

It is important to highlight that this research suffers from some possible limitations. Firstly, a survey which covers two different periods in time would ideally have needed to be conducted at the same bank twice (in the case of this study, before and after the crisis) to get a more balanced view of the changes over different periods. The survey analysis in Chapter 5 was only carried out once in 2010. A further survey at a later date would be able to extend and track the differences between the two time points.

Secondly, the empirical analysis in Chapter 6 suffered from limitations such as lack of complete bank performance data for the period between 1992 and 2003. Performance data for the banks which collapsed as a result of the financial sector crisis in 2003 was also unavailable. As a consequence, the limited data curtailed the scope of the empirical analysis. Third, the data used to compare

performance and corporate governance practices after the 2003 financial sector crisis involved only a short period of time between 2004 and 2010. This may be too short a period to observe the effects of the regulatory changes on ownership structure and corporate governance. Fourth, due to the small sample size, the statistical analysis was unable to perform a regression analysis, opting instead for a correlation analysis.

3.5 Summary

This chapter discussed the methodology adopted in this study to address the research questions. Triangulation of research approach, research methods and data is employed. Firstly, there is a triangulation of research approach in which qualitative and quantitative approaches have been combined. Second, the study employs a triangulation of research methods which includes a questionnaire survey, case studies and statistical analysis of bank performance. Third, the research also uses data triangulation by using both first and second hand data. In this regard, the study mixes approaches, methods and data to get more viewpoints regarding the subject being studied and make the research findings more valid, reliable and rigorous (Creswell, 2007).

The next 5 chapters in this study discuss the empirical results. Chapter 5 starts with the results from the questionnaire survey. Chapter 6 is based on the statistical analysis of the relationship between corporate governance and performance. Chapter 7-9 discusses the case study findings and Chapter 10 draws the study to a conclusion by summarising the main findings.

CHAPTER 4

CORPORATE GOVERNANCE IN ZIMBABWEAN BANKS: FINDINGS BASED ON QUESTIONNAIRE SURVEY.

4.0 Introduction

The importance of corporate governance within the banking sector has already been highlighted in the literature reviewed earlier in this study. In Zimbabwe, the 2003 financial sector crisis highlighted the need for good corporate governance as one of the mechanisms which can prevent bank collapse and protect stakeholder interests. After the crisis, the central bank introduced new corporate governance regulation through the Corporate Governance Manual in 2004 'to improve corporate governance practices within the banking sector' (RBZ, 2004).

This chapter reports the results of a survey conducted on the Zimbabwean banking sector in the first half of 2010. The main objective of the survey was to provide a general picture of the current state of ownership structure and corporate governance of banks. The opinions of the respondents on the effects of the 2004 regulatory changes on ownership and corporate governance have also been explored. Although largely subjective, these opinion based responses are used to corroborate the main survey results and to analyse the collective observations of the respondents on the effect of the changes.

This rest of this chapter is organised as follows, the next section looks at the design of the questionnaire and the administration of the survey. The following section presents the results of the survey on ownership structure, the board of directors and opinion based responses on the effect of the ownership changes on corporate governance. The last section concludes by summarising the

findings from the survey. This chapter makes a significant contribution to this thesis since it provides first-hand evidence on ownership and corporate governance structures of Zimbabwean banks. The results from this survey have also been used and referred to in several other chapters in this thesis.

4.1 Questionnaire Survey

4.1.1 Design of the Questionnaire

The questionnaire comprised of forty two (42) questions.³⁸ Two types of questions were used; the first type asked the respondents to give factual information on relevant corporate governance issues, the second were questions asking the respondents to provide their opinions. All the questions were closed-end questions, which asked respondents to choose from available options or to rank the options. An option of 'other' was used for the respondents to specify anything which was not listed.

However, the questionnaire design could have suffered from several limitations. First, in some of the questions, the respondents were required to remember factual information regarding events which occurred over a long period of time. This requires a good memory and may have affected the quality of the responses. Ideally, a survey which covers two different periods in time would have needed to be conducted at the same bank twice (in this case, before and after the crisis) to get a more balanced view of the changes over the different periods. This proved to be impractical for a PhD thesis due to time and resource constraints. The survey was undertaken during a field trip in 2010 and would not have been able to access the respondents before the 2003 crisis.

Second, although they only form a small portion of the questionnaire, using opinion based questions also has its limitations.

³⁸(The questionnaire is attached as Appendix 1).

This is because the answers provided by respondents are subjective and may sometimes be tempered with emotionalism which may affect their reliability.³⁹ To mitigate these limitations, the responses on factual questions were cross-checked with data collected from secondary sources and from interviews conducted at the banks. The opinion based responses were used largely to supplement the fact based survey results. No marked inconsistencies between the responses and data from the sources were found.

4.1.2 Administration of the Survey.

As at December 2009, the Zimbabwean banking sector had a total of 17 registered commercial banks.⁴⁰ Among these banks were foreign banks, state owned and private indigenous banks. Although the focus of this research is on private indigenous commercial banks, a survey of the entire commercial banking sector was conducted to allow for a comparison of the ownership structure and corporate governance practices across different banking types. The respondents to the questionnaire were senior executives of the commercial banks.

A pilot survey was conducted to check the wording and relevance of the questions, to ascertain the time taken by respondents to complete the questionnaire and to identify any problems which could have arisen in its completion and subsequent analysis of the results.⁴¹ After the pilot, amendments were made to the wording of some questions. The questionnaires were then distributed to all the 17 banks in the banking sector. With the help of an IT expert, an electronic version of the questionnaire was loaded on the internet.

³⁹ Where owner managers who were adversely affected by the central bank's ownership changes after the 2003 financial sector crisis answer the subjective question, their responses demonstrate a need to apportion blame for the distress on the central bank and a constant urge to dismiss the regulatory changes as ineffective and unnecessary.

⁴⁰ The entire banking sector has a population 27 banks constituted as follows; 17 Commercial banks, 5 Merchant Banks, 1 Discount House and 4 building societies.

⁴¹ The Pilot Survey was completed by a senior Executive Director in one of the leading private indigenous banks. The respondent was kind enough to provide feedback on the structure of the questions, the amount of time it took him to complete his responses and to advise on any questions which required rewording because they were ambiguous.

The respondents were directed to the web link through e-mails which allowed them to complete and send back the questionnaire electronically.⁴² Having the survey available online was helpful in minimising human contact through appointments and delays which could have resulted from posting the questionnaire. This approach significantly reduced the cost of administering the survey.

The link to the questionnaire was emailed to the informants by the researcher whilst still in the UK to allow the banks more time to complete them. Reminders were sent to the informants by e-mail in December 2009. The questionnaires were addressed to the chief executive officers or company secretaries of the banks since they are in a good position to know about corporate governance issues in the bank. The responses received indicate that most of the questionnaires were completed by the company secretaries. It is however possible that completion may have been delegated to subordinates. However, there is no indication that the data collected was less reliable because of this delegation. Whilst most of the questionnaires were e-mailed back, in a few cases, questionnaires were collected in the presence of the researcher during a field trip which was carried out in early 2010. Personal visits were made to some of the informants for follow ups.

4.1.3 Response Rate

Fully completed questionnaires were received from 12 banks. Of these, 10 were received electronically and two were collected by the researcher from the banks. This converts to a response rate of 70.58 percent, which is reasonably acceptable for a survey of this nature. In addition, three other banks sent back their responses which only answered questions regarding ownership and performance. Due to the incomplete data, the responses were excluded from the analysis in this chapter although the data were utilised in Chapter 6 to construct corporate governance scoring for all the banks.

⁴² The Survey Questionnaire was available at http://www.kayistudios.com/clients/banking_survey/

Caution should be taken when analysing the results of this survey. There is a potential bias that banks with better corporate governance are more likely to respond to the survey than those with poor corporate governance. As a result, the banks which did not respond may have been the ones which were poorer in corporate governance. Therefore, the results from the survey may present a brighter picture of corporate governance and related practices.

4.2 Analysis of Survey Responses

This section presents the results from the survey. Firstly, the general information about the banks is presented. This is followed by an analysis of the responses regarding ownership structure, board features and opinion based responses on the effect of the 2004 regulatory changes on corporate governance. Table 5.1 presents some background information on the respondent banks. The table shows that the respondents were across the three different ownership types, namely, state, private indigenous and foreign owned banks. Responses were received from two out of a total of three state banks. From the private indigenous banks, responses were received from five out of a total of eight banks. Five responses were received from foreign banks out of a total population of six. In total, twelve banks responded to the survey.

The general information in Table 4.1 shows that four of the respondents were established before 1991, seven were established after financial sector liberalisation but before the crisis (between 1991 and 2003), and one was established after the banking sector crisis in 2003. Seven out of the twelve banks surveyed operated as subsidiaries of a bank holding company. Eight respondent banks were listed on the Zimbabwe Stock Exchange (ZSE). Table 4.1 also indicates that private indigenous banks had the highest number of listed banks. All the five private indigenous banks which responded to the survey were listed on the ZSE.

Table 4.1: General Information on Respondent Banks*

Name of Bank	Period when Licensed			Whether listed or not		Stand alone or subsidiary of a Holding company.	
	Before 1991	Btwn1991-2003	After 2003	Yes	No	Standalone	Subsidiary of Holding Co.
State Owned							
Agribank	.				.	.	
ZB Bank	.			.			.
Sub-Total (2/3)**	2	0	0	1	1	1	1
Foreign Banks							
Stanchart	.				.	.	
Barclays	.			.		.	
Premier		.			.		.
BancABC		.		.			.
Metropolitan		.			.	.	
Sub-Total (5/6)	2	3	0	2	3	3	2
Private Indigenous							
CFX Bank		.		.			.
NMB Bank		.		.		.	
Kingdom Bank		.		.			.
TN Bank Limited			.	.			.
FBC Bank		.		.			.
Sub-Total (5/8)	0	4	1	5	0	1	4
Total (12/17)	4	7	1	8	4	5	7

Source: Author's own compilation from Survey data.

* General information on the surveyed banks regarding their structure and ownership type, state owned indigenous (private) owned and foreign owned banks.

** The number in brackets represents the total number of respondent banks in each ownership category out of the total number of banks in the sector.

4.2.1 Ownership Structure of Respondent Banks

Ownership structure of a firm is argued to have varying effects on corporate governance (Jensen and Meckling, 1976; Shleifer and Vishny, 1998; Claessens, 1999). The questionnaire asked questions on the ownership structure of the banks at the time the survey was conducted. There were also questions asked about the ownership structures of the banks at the time they were licensed. Some other questions regarding the effect of the 2004 regulatory changes introduced by the central bank on ownership structure were also asked.

A major issue that has received attention in literature is how ownership concentration impacts on corporate governance (Claessens, 1999). Questions were asked to find out to what extent the banks had concentrated ownership. Specifically, the questions asked about the level of CEO shareholding, executive directors' shareholding and shareholding by the largest shareholder, top five shareholders and institutional investors. In order to define the level of ownership concentration, this thesis uses 10 percent shareholding as a threshold. In this regard, a bank was considered to have ownership concentration if a shareholder owned more than 10 percent of the bank's shareholding. A bank was considered to have a separation between ownership and management if the CEO and executive directors owned less than 10 percent of the total shareholding.

The 10 percent threshold is adopted in this thesis for a number of reasons. Firstly, the same threshold has been used in a number of studies to indicate ownership concentration (La Porta *et al*, 1998). However, other studies by Jacquemin and de Ghellinck, 1980; Radice, 1971 used 5 percent as the threshold to indicate ownership concentration, whilst 10-25 percent is used by Grosfeld and Tressel, 2001; Bothwell, 1980.⁴³ Secondly, following the banking sector crisis in 2003, the Zimbabwean central bank introduced new ownership provisions through the Corporate Governance Manual (2004).⁴⁴ The provisions restricted any shareholder with 10 percent or more in a bank or bank holding company from being a part of management or from being a board chairman of the banking institution or bank holding company.⁴⁵ The objective of the new regulations was to enforce a separation between ownership and management. Whilst the 10 percent threshold is useful in determining insider ownership concentration, it does not show the shareholder with ultimate

⁴³ Examples are Monsen *et al*. (1968) and Boudreaux (1973) defined as OC those firms in which one party owned at least 10 percent of the voting stock and there was evidence of active control, or one party owned at least 20 percent of the voting stock. MC was defined as those firms in which no single party owned more than 5 percent of the voting stock.

⁴⁴ The Corporate Governance Manual introduced by the central bank after the 2004 banking sector crisis is discussed in the Historical Background Chapter.

⁴⁵ See section 2.3.1 and 2.3.2 of the Corporate Governance Manual (2004).

ownership control in the respondent banks since some of the shareholders exercise control as blockholders. However, the 10 percent limit adopted in this study to indicate ownership concentration has also been adopted by previous studies and is also in line with the Zimbabwean regulatory framework.

Questions 2.1 to 2.3 in the questionnaire asked the respondents whether the CEO was the founder and/or the majority shareholder when the bank was licensed, and at the time the questionnaire was completed. The objective was to examine the changes in the CEO shareholding between the two periods, particularly amongst private indigenous banks. It should be noted that this study had already taken into account the fact that CEOs of foreign and state banks would not have been the founders since these banks are sponsored by their foreign parent companies and by the government respectively.

The results from the survey show that all the five private indigenous banks surveyed had the main sponsor as the CEO when they were licensed. Most of the sponsors, who were the CEOs, had substantial shareholding, 44.26% in CFX Bank, 31.9 % in FBC Bank, 29.83% in NMB Bank and 26% in Kingdom Bank. Three of the five foreign banks, were private indigenous banks when they were licensed. Among the three former private indigenous banks, the sponsors controlled 25.82 percent in BancABC, 25 percent in Metropolitan Bank and 9 percent in Premier Bank.

Among the other foreign banks, foreign sponsors owned 100 percent in Standard chartered Bank and 67.7 percent in Barclays Bank with no equity participation by the CEOs in both banks when they were licensed. Within the state owned banks, the government as the main sponsor controlled 100 percent in Agribank and 62 percent in ZB Bank. These results indicate ownership concentration across all ownership types.⁴⁶ In all the five private indigenous banks and the three former private

⁴⁶ By classification, the government is the main sponsor and shareholder of state owned banks; and foreign investors (in some cases the foreign parent bank) are the main shareholders of foreign banks.

indigenous banks, the founder CEO and main sponsors had substantial shareholding when the banks were licensed.

i. Shares held by current CEOs and Executive Directors.

The questionnaire asked how much shareholding the current CEOs controlled in banks when the survey was conducted. The main objective of this question was to find out changes in CEO shareholding between the time when the banks were licensed and the time of the survey. The results on CEO shareholding when the survey was completed are presented in Table 4.2. They indicate that two of the twelve banks had CEOs with shareholding over 10 percent which, according to the definition discussed earlier indicates insider ownership. One of these banks was BancABC, a former private indigenous bank and the other is TNFH, a private indigenous bank.⁴⁷

An analysis of the shareholding structures provided by the banks in response to a question in the survey was used to establish the shareholding held by the bank's executive directors (excluding the CEO). The level of *executive ownership* is important in determining the level of inside ownership.⁴⁸ Whilst the results presented in Table 4.2 show that two banks still had CEOs with shareholding above 10 percent, when CEO shareholding is excluded, only one bank, Premier bank had executive directors owning more than 10 percent of the shareholding.⁴⁹ In total, the survey findings indicate that three banks had insiders (CEO and executive directors) owning more than 10 percent of the shareholding through related investment vehicles. The remaining nine banks had executive directors with no shareholding or with shareholding below 10 percent.

⁴⁷ BancABC started operation as African Banking Corporation (ABC) a private indigenous bank before its primary listing on the Botswana Stock Exchange which resulted in a significant foreign investment in the banking institution. CEO has a 13.41% shareholding in the bank.

⁴⁸ Executive Ownership is measured as a proportion of shares held by executive directors to the total shares outstanding at the end of the fiscal year. This is in line with the approach adopted by Datta et al (2005). Executive directors refer to those who are directly involved in the daily business of the firm and thus, make the financial decisions.

⁴⁹ The two banks are BancABC where the CEO, Mr Douglas Munatsi, one of the founders of the bank has a 13.41 percent shareholding in the bank and TN Bank in which the founder and CEO has a 18 percent shareholding.

Table 4.2: CEO & Executive Directors Shareholding in December 2009*

Name of Bank	CEO Shareholding as a Percentage		Executive Director Shareholding (%)		Executive Director's Shareholding less CEO shareholding.
	Shldng < 10%	Shldng > 10%	Shldng < 10%	Shldng > 10%	
State Owned					
Agribank	0	-	0	-	0
ZB Bank	0	-	0	-	0
ZABG Bank	0	-	0	-	0
Foreign Banks					
MBCA Bank	0	-	0	0	0
Standard Chartered	0	-	0	0	0
Barclays	0	-	0	0	0
Foreign Banks- Former Private indigenous					
Premier	0	-	-	28	28
BancABC		13.41		13.41	0
Metropolitan	0	-	0	-	0
Private Indigenous					
CFX Bank	0	-	0	-	0
NMB Bank	-	0	-	0	0
CBZ	1.69	-	1.93	-	0.24
Kingdom Bank	0	-	5.80	-	0
TNFH	-	18	-	21.68	3.68
FBC Bank	4.4	-	9.09	-	4.69
Average(All Banks) Total**		2.21	6.1	-	3.89

Source: Authors compilation from Survey and Secondary Data.

*Table shows the percentage shareholding by Bank CEO and Executive Directors in all the surveyed banks at < (less than) 10 percent and > (more than) 10 percent to highlight level of insider ownership. 10 percent is the maximum shareholding allowable for a single shareholder within management in accordance with the regulations.

** The Average in this section is a cumulative average of the two sections (e.g. Total CEO Shareholding for all banks combining those with less, and more than 10 percent shareholding).

These results in Table 4.2 indicate a marked change from the period when the banks were licensed.

A total of seven banks responded that they had CEOs as majority shareholders with more than 10 percent of the shareholding. Table 4.3 reveals a reduction in CEO shareholding in the private indigenous banks. This may have been due to the central bank regulations which introduced a

separation between ownership and management after the 2003 crisis which led to a mandatory rationalisation of CEO shareholding.⁵⁰

Table 4.3: Percentage responses on founder CEO participation in banks*

Name of Bank	Whether Founder was CEO. (Y-Yes, N-No)	CEO Shareholding when bank was licensed %	CEO Shareholding when Survey was completed. %
State Owned			
Agribank	N	0	0
ZB Bank	N	0	0
ZABG Bank	N	0	0
Foreign Banks			
MBCA Bank	N	0	0
Standard Chartered	N	0	0
Barclays	N	0	0
Foreign Banks- Former Private indigenous			
Premier	Y	12.11	0
BancABC	Y	13.41	13.41
Metropolitan	Y	25.00	0
Private Indigenous			
CFX Bank	Y	15.4	0
NMB Bank	Y	10.54	0
Kingdom Bank	Y	26.00	0
TN Bank Limited	Y	18.00	18.00
FBC Bank	N	2.3	4.4

Source: Authors compilation from Survey and Secondary Data.

Table 4.3 also indicates that the foreign banks in which the founders were the CEOs with significant shareholding were former private indigenous banks. The results reveal a reduction in CEO shareholding in these banks at the time the survey was completed. Although the findings indicate that only two banks had CEOs with over 10 percent of the shareholding, NMB Bank came under owner management soon after the survey was completed after one of the former executives who own 10.41 percent of the shareholding returned to the bank as CEO.

⁵⁰ The percentage shareholding for bank CEOs within the indigenous banks surveyed is as follows, CFX Bank: 0%, NMB: 0%, CBZ Bank: 1.69, Kingdom Bank: 0%, TN Bank: 18%.

ii. Ownership concentration by blockholders

Another objective of this section is to analyse the results regarding ownership of banks by blockholders such as majority shareholders, top 5 shareholders and institutional shareholders. A key issue in corporate governance is whether large owners contribute to the solution of the agency problems or whether they exacerbate them (Shleifer and Vishny, 1997). Besides the shareholding which is controlled by the largest shareholder, the level of shareholder concentration can also be highlighted by an analysis of the amount of shares held by the top five Shareholders (Demsetz and Lehn, 1985).

Institutional investors are believed to play an important role in the corporate governance of banks and in determining bank ownership structure due to their information advantage by directing the firm and management activities towards the best interests of all parties and deterring managerial opportunism (Franks and Meyer, 1994; Gorton and Schmidt, 1996). The definition of an institutional investor adopted in this study relates to various types of collective share holding for which professional fund managers try to make optimal portfolio investments such as private pension funds, state and local retirement funds, mutual funds, life insurance companies, property and casualty insurance companies (Gorton and Schmidt, 1996).

In this analysis, the definition of institutional investors has been restricted to exclude non pension fund institutions to avoid results bias due to the high participation of corporate investors within the surveyed banks with only a few investments in individual names. The government as an investor and the parent companies of foreign banks have also been excluded in the definition of institutional investors. In this regard, banks such as Standard Chartered Bank and Agribank which are 100 percent owned by the foreign parent company and the government are considered as having no institutional shareholding.

The questionnaire asked the respondents in *Question 2.7* to provide a list of their current shareholders from which an analysis of the shareholders was made. The shareholding structure was useful in establishing concentration by blockholders and distinguishing blockholders by their identity such as institutional shareholders, largest shareholder and the total shareholding of the top 5 shareholders within the banks.⁵¹

Table 4.4: Ownership concentration by blockholders within surveyed banks

Name of Bank	Shares held by Largest Shareholder (%).	Total shares held by Institutional Shareholders	Total shares by Top 5 Shareholders %
State Owned			
Agribank	100	0	100
ZB Bank	41.58	49.73	78.37
Average	70.79	24.86	89.18
Foreign Banks			
Standard Chartered	100	0	100
Barclays	67.7	13.79	84.17
Foreign Banks- Previously Private indigenous			
Premier	54	54	82
BancABC	13.41	49.39	55.26
Metropolitan	60	3	83
Average	59.02	24.03	80.88
Private Indigenous			
CFX Bank	16.46	11.56	58.55
NMB Bank	21.11	23.89	57.76
Kingdom Bank	10.56	10.56	44.9
TN Bank Limited	13.32	17	41.2
FBC Bank	22.44	29.74	52.93
Average (Private indig)	16.77	18.55	51.06
Average(All Banks)	43.38	30.21	69.84

Source: Authors own compilation from Survey Data.

Table 4.4 displays the results on the shareholding controlled by the majority shareholder, top five shareholders and institutional owners within the banks to determine the level of ownership concentration. The responses regarding the ownership by these shareholders are analysed in turn.

⁵¹ A blockholder is defined as any shareholder owning more than 10 percent of the bank's equity.

The previous sections have already highlighted that the largest shareholder within state and foreign owned banks were the government and the foreign parent companies. Table 4.4 indicates that in state owned banks, the government controlled 100 percent in Agribank and was the largest shareholder in ZB bank where it owned 41.58 percent of the shareholding.⁵² The conventional foreign banks, Barclays Bank and Standard Chartered Bank were owned 67 percent and 100 percent respectively by their London based parent company.⁵³ In the remaining three foreign banks which were previously indigenous banks, a foreign investor, Loita Capital which acquired 60% in Metropolitan bank was the bank's largest shareholder. In Premier Bank another foreign investor, African Development Corporation (ADC) acquired 54 percent of the shares to become the largest shareholder. However, as previously noted, the largest shareholder in BancABC was the current CEO who owned 13.41 percent of the bank's shareholding.

In the three foreign banks that were previously private indigenous banks, the top five shareholders controlled a total of 82 percent of the shareholding in Premier Bank indicating a high degree of concentration. Of this total, 28 percent of the shareholding was controlled by bank executives whilst 54 percent was controlled by a foreign investor. In Banc ABC, the top five shareholders controlled a total of 55.26 percent shareholding and of this total, connected directors including the CEO controlled 25.82 percent of the shareholding. In the third bank, Metropolitan bank, the top five shareholders controlled 83 percent of the shareholding and the executive directors had no shareholding in the bank.

In the private indigenous banks, it has also been noted earlier that one bank, TNFH had the current CEO as the largest shareholder. Table 4.5 shows that when the survey was conducted, institutional

⁵² The State controls 100 percent of Agribank, through the Ministry of Agriculture which owns 50 percent whilst the Ministry of Finance owns the remaining 50 percent stake.

⁵³ Of the six foreign banks surveyed, 3 are controlled by parent companies outside the country, MBCA Bank is controlled 70.85% by Nedbank, SA. Standard Bank is wholly owned by Standard Chartered PLC (UK), whilst Barclays Bank is owned 67.7 percent by Barclays Bank PLC in the UK. The other two became foreign banks after acquisitions by foreign investors;

shareholders were the largest shareholders in NMB Bank, FBC Bank and Kingdom Bank whilst the largest shareholder in CFX Bank was a corporate investor.

Table 4.5: Largest Shareholder within Private Indigenous Banks

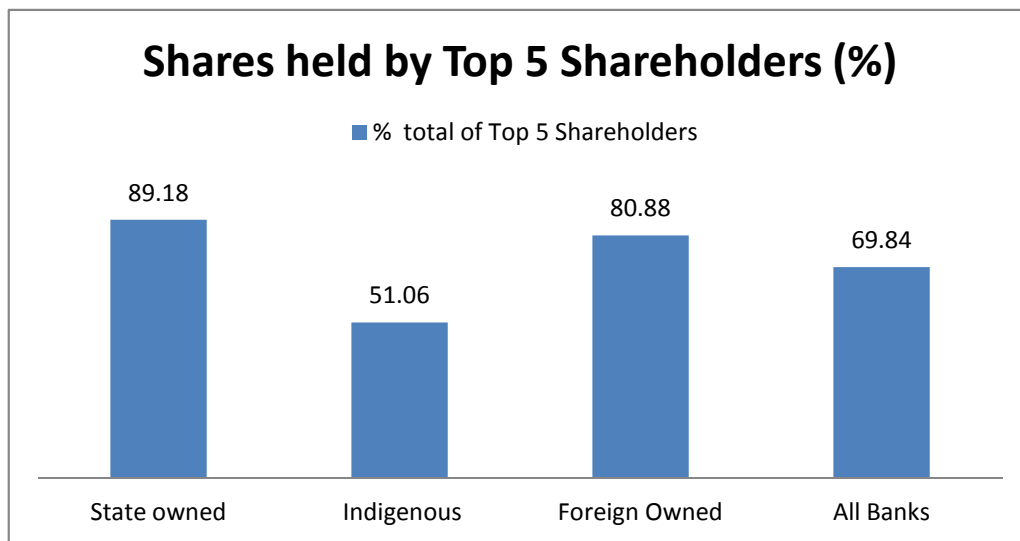
Name of Bank	Largest Shareholder	% Shareholding	Description of Shareholder
CFX Bank	APS	16.46	Corporate investor
NMB Bank	Old Mutual	21.55	Institutional
Kingdom Bank	EWI	10.56	Institutional
TN Bank Limited	T Nyambirai	18.32	Current CEO
FBC Bank	NASSA	22.44	Institutional

Source: Author's compilation.

The results also indicate high concentration of shares within the top 5 shareholders in the private indigenous banks. The identities of the top five shareholders in these banks indicate that the only bank in which the executive directors controlled more than 10 percent of the shareholding was in the newly established TN Bank. Former executive directors in the banks controlled 16.46 percent in CFX Bank and 29.13 percent in NMB Bank. The results in the previous section on CEO shareholding and those on block shareholders indicate that the CEOs in TNFH and BancABC, who controlled more than 10 percent of the shareholding, were also the majority shareholders. The survey results on TNFH indicate that although none of the executive directors were the biggest shareholder, they controlled more than 10 percent of the shareholding.

Figure 4.1 highlights that when taken as averages; state banks had the highest concentration of shares by the top 5 shareholders constituting an average of 89.18 percent. Foreign banks had an average of 80.88 percent shareholding by top 5 shareholders, whilst the average was lower in private indigenous banks at 51.06 percent. The high concentration of shareholding in the top 5 shareholders in state and foreign banks is largely a result of the large shareholding by the government and foreign investors which has been observed in the previous section. In the banks which are private indigenous banks or were previously private indigenous, current executives are among the top five shareholders in BancABC, Premier and TN Bank. Former executive directors are also among the top 5 shareholders in CFX, NMB and Kingdom Bank.

Figure 4.1: Total Shares held by Top 5 Shareholders (As a Percentage).



Source: Author's compilation from Questionnaire Survey data.

The results in Table 4.4 indicate that all the banks surveyed had an institutional investor as one of the top 5 shareholders. When taken as averages, the level of institutional investors across the three ownership types were largely similar ranging between 18 percent in private indigenous banks to 24 percent in state and foreign banks. However, as noted earlier, the private indigenous banks appear to have the highest number of institutional shareholders compared to the other banking types. The results indicate significant institutional participation in private indigenous banks such as FBC where institutional investors controlled a total of 29.74 percent, 23.89 percent in NMB Bank and 11.56 percent in CFX Bank.

4.3.2 Summary of Key findings on Ownership Structure

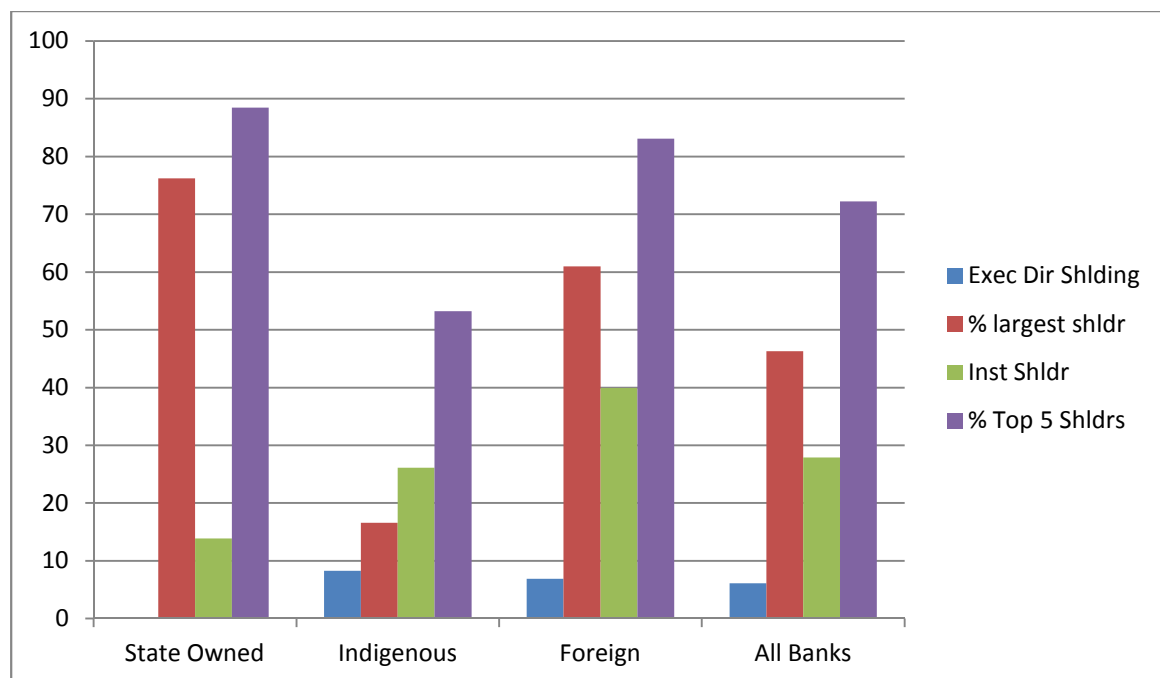
This section has discussed the survey results regarding the ownership structure of the surveyed banks. In general, the survey results show a high concentration of shareholding across the three ownership types. When the banks were licensed, the sponsor CEOs and/or the executive directors controlled more than 10 percent of the shareholding in all the eight banks which were licensed as

private indigenous banks. In this regard, the survey findings indicate that all the private indigenous banks had ownership concentration by insider blockholders.

However, at the time the survey was conducted only two banks, one private indigenous and a former private indigenous bank still had CEOs with shareholding above 10 percent. These CEOs were also the largest shareholders in the banks. These results indicate a reduction in CEO shareholding among the private indigenous banks as well as the banking sector as a whole.

The amount of shareholding by executive directors within the banks has also been used to determine the level of insider ownership concentration at the time the survey was conducted. Besides the two banks in which the CEOs owned more than 10 percent of the shareholding, one other bank was observed to have executive directors owning more than 10 percent. In total, three banks out of the twelve surveyed were classified as being under inside ownership based on CEO and/or executive director shareholding. All the three banks were private indigenous banks in origin.

Figure 4.2: Comparative analysis of ownership structure patterns across banks.



Source: Author's compilation from Survey data.

The results regarding blockholder ownership by the largest shareholders, top five shareholders and institutional investors which are summarised graphically in Figure 4.2 indicate a high degree of ownership concentration across all ownership types with the only difference being in the identity of the blockholder.

The high ownership concentration in the state and foreign banks was a result of ownership by the government and foreign investors respectively that controlled significant shareholding in the banks. In private indigenous banks, the results indicate that CEOs were the majority shareholders in two of the banks whilst a total of three banks which were private indigenous in origin had insider ownership concentration in which the CEO and/or the executive directors controlled more than 10 percent of the shareholding. In the rest of the banks, the largest shareholder was either a corporate or institutional investor. In the banks that are private indigenous or former private indigenous, current executive directors were among the significant top 5 shareholders in BancABC, Premier Bank and TN Bank whilst former executive directors were also noted among the significant top 5 shareholders in NMB Bank, Kingdom Bank, CFX and Metropolitan Bank.

4.4 Board of Directors.

The board of directors is considered one of the key internal corporate governance mechanisms of a corporation given its role as an intermediate between managers and shareholders. Fama (1980) has argued that the composition of the board is important because the presence of non-executive directors represents a means of monitoring the actions of executive directors.⁵⁴ The survey asked questions regarding board structure, independence and the functions of the board and its committees. Other questions asked the respondents to list the current directors in the banks

⁵⁴ An alternative perspective is presented by the resource dependency theory which argues that good governance is achieved when board members are appointed for their expertise to help firms successfully cope with environmental uncertainties (See Bhagat and Black, 1999). Corporate governance literature has also linked board features such as board size, composition, meetings and independence with firm performance and good governance (Hertig, 2005; Hussain and Maillin, 2002; Fama and Jensen, 1998; Hawley and Williams, 1996).

indicating their qualifications and whether they are executive or non executive. The results on these board features are presented in Table 4.6.

4.4.1 Board Size.

The size of the board is considered an important factor in controlling management (Jensen, 1993). The size should be large enough to secure sufficient expertise on the board but not so large that productive discussion becomes impossible.⁵⁵ The Companies Act 1996 (Chapter 24:03) requires that all companies registered in Zimbabwe should have a minimum of two directors, one of whom should be resident in Zimbabwe. The Corporate Governance Guideline (2004) issued by the central bank which relates specifically to banks makes it a requirement that each banking institution should have a minimum of *five* directors with the majority being non-executive directors such that no individual or group of individuals or interests can dominate the board's decision making process. There is no prescription on the maximum number of directors who can serve on Zimbabwean companies.

Table 4.6 summarises the responses to the questions on the board. It shows that one of the foreign banks, Standard Chartered Bank had the largest board with 16 board members. Another foreign bank, BancABC has the smallest board, with seven board members. When analysed as averages, the results in Table 4.6 shows that bank boards had an average of ten board members.⁵⁶ The private Indigenous banks and the foreign owned banks had the same average of eleven board members, with the average within state owned banks slightly lower at nine board members. What can be concluded from this data is that the board size in all the banks is above the minimum requirement of the 2004 corporate governance guidelines.

⁵⁵ Salmon (2000) suggests that the optimum size of the board is between 8 and 15 people for large, publicly traded companies. With fewer than eight members, a board is likely to have difficulty staffing its committees such as audit, compensation, and others. Salmon also suggests that in relation to inside directors, only three executives be members of the board: the CEO, the chief operating officer, and possibly the chief financial officer.

⁵⁶ The number of board members within the banks ranged from 7 board members to a maximum of 16. The total number of directors were as follows; State banks (Agribank, 9; ZB Bank, 8 and ZABG, 11), Foreign Banks (MBCA, 11; Stanchart, 16; Barclays, 11; Premier, 9; BancABC, 7. Private Indigenous (CFX, 9; NMB, 12; CBZ, 13; Kingdom, 12; TN Bank, 10; FBC, 11).

Table 4.6: Composition of Boards of Directors within Banks.

Name of Bank	Board Size	No of Ex. Dir	No of Non Exec	% of Non Exec	No of non execs Connected to Mgt	Status of Chairman*
State Owned Banks						
Agribank	9	2	7	77.7	0	Ind. Non Exec**
ZB Bank	8	2	6	75	0	Ind. Non Exec
Average	9	2	7	75	0	100
Foreign Owned						
Barclays Bank	11	3	8	72	0	Ind. Non Exec.
Standard Chartered	16	6	10	62.5	0 ⁵⁷	Ind. Non Exec.
Foreign Banks – Former Pvt Indigenous Banks						
Metropolitan Bank	11	4	7	63.63	0	Ind. Non Exec
Premier Banking Corp	9	4	5	55.5	6	Ind. Non Exec.
Banc ABC	7	1	6 ⁵⁸	85.71	3	Connected Non Exec
Average	11	3	7	69	2	80
Private Indigenous						
TN Bank	10	2	8	80	4	Ind. Non Exec
CFX Bank	9	2	7	77.7	2	Ind. Non Exec
NMB Bank	12	2	10	83.33	1	Ind. Non Exec
Kingdom Bank	12	2	10	83.33	2	Ind. Non Exec
FBC Bank	11	5	6	54.54	0	Ind. Non Exec.
Average	11	4	8	76	2	100
AVERAGE (ALL BANKS)	10	2	8	73	2	12.5/87.5

Source: Author's own compilation from Questionnaire Survey data.

*This column presents data on whether the Chairman of the board is a Non Executive, Connected non executive or part of the executive team.

** Ind. Non Exec – Refers to Independent Non Executive Director.

A follow up question in the questionnaire asked about the number of directors when the respondent banks were licensed to assess whether there was a change over time. It is reported that the average number of directors was five and six in state and private indigenous banks respectively. The average number of directors in foreign banks was nine, relatively high compared to the other two types. In comparison, at the time the survey was conducted, the average number of directors was nine and

⁵⁷ Ibid.

eleven in state and private indigenous banks respectively. The number of directors in foreign banks was eleven, similar to those in private indigenous banks.

4.4.2 Board Composition

The composition of boards has generated considerable debate among corporate governance researchers such as Bhagat and Black (2000); Mehran,(1995). This is because the expertise, motivation and objectives of executive and non executive directors may vary considerably. The primary concern with board composition is the board's control role and whether the composition provides directors with sufficient independence to protect the interests of stakeholders (Johnson et al, 1996). Ownership structure has a direct relationship with board composition in that *for example*, owner managers can exercise ultimate control of the board by appointing a significant number of non-executive directors who rarely question their decisions (Hawley and Williams, 1996; Agrawal and Knoeber, 1996; Weisbach, 1988).

The questionnaire asked the banks to indicate whether directors were executive or non executive and whether the CEO of the bank served as the Board Chairman. Columns 2-4 of Table 4.6 summarises the responses on these questions. It shows that that the number of non-executive directors in all the banks outnumber executive directors. In this regard, the proportion of non executive directors was revealed to be above the minimum requirements of the 2004 guidelines. Another question asked whether non executive directors had any significant shareholding or business relations with the management or with controlling owners. The objective was to find out the independence of the directors and whether or not they were connected to top management. The results are summarised in column 5 of Table 4.6. In general, the results indicate that private

indigenous banks had more connected non-executive directors than the other two ownership types.⁵⁹

4.4.3 Separation of the Roles of CEO and Board Chairman

When the role of the CEO and Chairman of the board are combined, literature suggests that this structure breaks the balance of power between executive directors and the board, potentially restricting board effectiveness in controlling managerial initiatives and actions (Boyd et al, 2005). Combining the two roles reduces information asymmetry between the CEO and the board (Eisenhardt, 1989).⁶⁰ One of the questions in the questionnaire asked the banks to indicate whether there was a connection between the CEO of the bank and the board Chairman. The results on this are summarised in the last column of Table 5.6. They show that all the twelve banks surveyed had a separate CEO and board chairman. In all the cases, the chairman was non executive. All but one bank reported that the chairman was not connected to top management.

4.4.4 Board Committees

Board committees are fundamental in assisting the board to discharge their duties and responsibilities based on the expertise of the individual directors within clearly defined mandates (Eisenhardt, 1989). The Corporate Governance guidelines compelled banks to establish board sub-

⁵⁹ There were some individual banks with a high number of connected outside directors such as BancABC (3); Premier Bank (6) and TN Bank (4). Literature argues that independent directors should not have any significant family or business relationship with the management or with controlling owners that might interfere with the exercise of independent judgement. Employees or representatives of affiliated companies, suppliers, providers of professional services, and important customers should also be disqualified on the grounds of conflict of interest (Salmon, 2000). However, according to OECD (2003), they note that 'however precise the definition of 'independence', or rigorous its enforcement, legal norms by themselves cannot ensure that 'independent' directors will act independently.' (p.50).

⁶⁰ Some literature has argued that the mandatory separation of the CEO and the chairperson's position might undermine the strategic leadership and accountability of corporations and might trigger damaging power struggles with top executives (OECD, 2003). The Stewardship theorists argue that managers are the stewards of a company's assets, not an agent of shareholders, and that the economic performance of a firm increases when power and authority are concentrated in the same person acting as CEO and chairperson, whose depth of knowledge, information, and technical expertise as well as commitment are critical requirements for a successful firm (Davis, Shoorman and Donaldson, 1997).

committees and introduced a requirement for formally determined terms of reference for the committees in regard to their life span, role and function. One of the questions asked the banks to indicate whether they had the following sub committees: Audit, Remuneration and Investment committees.

The results indicate that all the banks surveyed had all the three committees, even though only the Audit Committee is mandatory according to the guidelines.⁶¹ Rules regarding the composition of the committees are much simpler, the only mandatory requirement being that all board committees should be chaired by an independent non-executive director except for committees fulfilling an executive function. The responses from the banks also indicate that all the banks complied with this requirement.

4.4.5 Board Meetings

When boards meet more frequently, they are more likely to remain informed and are given more time to confer, set strategy and to execute their monitoring role effectively (Vafeas, 1999; Abbott, et al, 2003). The number of times the main board and the sub-committees meet may therefore be an important indicator of them exercising this monitoring function.

Table 4.7: Average Number of Board Meetings within Surveyed Banks. (2009).

Board Unit	Average Number of Meetings	Board Attendance %
Main Board	5	95
Human Resources Related Committee(s) Incl. Nomination and Remunerations	3	75
Risk Committee	6	93
Credit Committee	6	95
Audit Committee	5	90

Source: Author's own compilation from Survey data.

⁶¹ The role of independent directors is deemed especially important in such committees as audit, compensation and nomination committees that deal with conflicts of interest. It is advisable that all board committees include at least one or a majority independent directors in the expectation that this would enhance the objectivity and transparency of committee decision making and enable the independent directors to develop expertise in technical aspects of corporate management that will help them perform their overall oversight functions better (Nam and Nam (2004).

The survey asked the banks to indicate how many times the main board and the committees met within an accounting year. According to the responses presented in Table 4.7, in all the surveyed banks, the main boards met at least four times within the 2009 financial calendar. The number of meeting across all ownership types ranged from four to six meetings a year. The results on the number of meetings by board subcommittees indicate that committees such as the Risk, Credit, Audit and Assets and Liabilities committees recorded the highest meeting ratios during the same period meeting an average 5 times. In contrast, the Human Resources related committees met the least (an average of 3 times), which may suggest that risk related issues were slightly more prominent compared to HR related issues within the surveyed banks.⁶²

In terms of individual board attendance of the board members, the Corporate Governance Manual (2004) requires every board member to attend at least 75 percent of the board meetings of a banking institution. There is also a requirement for the banks to review the suitability of Non-Executive directors who fail to comply with the 75 percent attendance rule without valid reason at the bank's AGMs. Further, banks are required to disclose board meeting attendance by directors in their Annual Reports. This extra disclosure requirement has made access to information regarding board meeting attendance easier.

Since it is now mandatory for banks to publish information regarding board attendance in their annual reports, board attendance figures in Table 4.7 was acquired from the annual reports provided by banks. The data indicates that attendance in the main board and financial risk oversight committee recorded turn-out rates above 95 percent, whilst HR related committees ranged from 0 to 100 percent, with an average attendance rate of 75 percent. To complement these results, the

⁶² One of the reasons why there could have been more meetings in these committees may have been that the central bank increased the minimum capital requirements for commercial banks and merchant banks to US\$12, 5 million and US\$10 million for building societies. The compliance deadline was staggered into two. Banks needed to raise half the capital by September 30, 2009 and the remainder by March 31, 2010 Zimbabwe uses two statutory regimes to regulate bank capital – Minimum capital requirements and the Capital Adequacy Ratio, technically known as the reserve ratio requirement. This is expressed as a ratio of total deposits held by a financial institution, currently 10 percent. This proportion of deposits constitutes non-lonable funds deposited with the central bank as deposit cover. The current average CAR for local banks is about 40 percent.

questionnaire also asked if board attendance had improved since 2004. Eleven of the twelve banks surveyed reported that board attendance had increased significantly. These results indicate that the majority of the surveyed banks now hold regular board meetings.

4.4.6 Board Qualifications

The qualification of directors is critical for the board to be effective in performing its key responsibilities.⁶³ In the Zimbabwean context, the Corporate Governance Manual (2004) sets out the roles and responsibilities of directors to include monitoring the CEO and key executives, reviewing risk management and internal control systems, setting performance objectives and monitoring business operations, disclosures, related party transactions and self dealing. To effectively discharge these functions, the board needs to appoint members with relevant experience and expertise.⁶⁴ The guidelines also outline strict guidelines for appointing properly qualified directors. Specifically, they recommend the appointment of practising lawyers and Accountants to the boards of banking institutions.

One of the questions in the questionnaire asked the banks to provide the qualifications of the serving directors. The results on this are presented in Table 4.8 and were supplemented by data from the banks' Annual Reports. The results indicate a high proportion of directors with a university degree in most banks.⁶⁵ All the banks but two had at least one lawyer and all but one had an accountant on the board.⁶⁶ The high percentage of board members with university qualifications may have been a result of regulatory change and the introduction of the *Fit and Proper Person Test* by the central bank as part of the board requirements. The test requires that anyone nominated to a bank board be properly qualified and approved by the central bank before taking office. However,

⁶³ The management oversight includes maintaining the integrity of the corporate assets by ensuring the continued competence of management.

⁶⁴ See Corporate Governance Manual (2004)

⁶⁵ The average for directors with University education or higher for all indigenous banks surveyed is 85.83 percent which is still quite high.

⁶⁶ Agribank, which is a state owned bank did not have a lawyer or accountant serving as a board member. The bank is the only one within the surveyed banks without these professionals.

data were not available from the survey to indicate the number of directors with banking or financial experience, which is a more relevant issue to banks.

Table 4.8: Board member qualifications in selected Banks*

Banks by Ownership Type	Board Total	No of Directors with University education	% of Total	Lawyers on Board	Accountants on Board
State Owned					
Agribank	9	8	88	0	0
Foreign Owned					
Banc ABC	7	7	100	1	2
Premier Bank	9	9	100	1	1
Average	8	8	100	1	1.5
Private Indigenous					
CFX Bank	9	7	77	2	1
NMB Bank	11	10	90	2	3
TN Bank	9	9	100	2	5
FBC Bank	11	11	100	0	3
Average	9.6	8.3	85.83	1.5	2.5
Average (All Banks)	9.4	8	84.1	1.2	1.9

Source: Author's own compilation from Survey data and individual bank annual reports.

*In this analysis, we have omitted banks where we received no responses or acquired insufficient information from the QS on the question.

4.4.7. Arrest of board members

One of the questions in the questionnaire asked the respondent whether any CEOs or executive directors had been arrested or removed from their post due to allegations relating to corruption, violation of the Banking Act or for externalisation. A follow up question, asked whether any of the board members had ever been asked to resign from the board by the central bank, the board or by shareholders as a result of issues relating to the violation of the Banking Act.⁶⁷ The objective of these questions was to find out whether there were allegations of corporate governance violations issued by the authorities in the period between 2003 and the time the survey was conducted.

⁶⁷ Question 2.6 also asks the Respondent Banks to indicate the category of the any member (s) who were removed or forced to resign, whilst Question 2.6.1 asks the respondent banks to indicate the reasons for the removal.

The responses for these questions are reported in Table 4.9. It shows that none of the state and foreign owned banks had cases of CEOs being arrested. Among the indigenous banks, executive directors of CFX Bank and NMB Bank were arrested on allegations relating to fraud, externalisation and/or violation of the Banking Act.⁶⁸ It is also reported that the directors of NMB and Metropolitan Bank left the country in fear of arrest regarding these allegations.⁶⁹

Table 4.9: Bank Executives who were arrested.*

Name of Bank	Arrested		Convicted		Left the Country		Forced to resign	
State Owned								
Agribank	No		No		No		No	
ZB Bank	No		No		No		No	
Average	Yes(0) No (100)		Yes(0) No (100)		Yes(0) No (100)		Yes(0) No (100)	
Foreign Owned								
Banc ABC	No		No		No		No	
Stanchart	No		No		No		No	
Barclays Bank	No		No		No		No	
Premier Bank	No		No		No		Yes	
Met Bank	No		No		Yes		Yes	
Average	Yes(0)		No(100)		Yes(16.6)	No(83.34)	No(66.67)	Yes(33.33)
Private/Indig								
TN Bank	No		No		No		No	
CFX Bank	Yes		No		No		Yes	
NMB Bank	Yes		No		Yes		No	
Kingdom Bank	No		No		No		No	
FBC Bank	No		No		No		No	
Av(Indigenous)	Yes(33.33)		No(66.67)		Yes(0)		No(100)	
AVERAGE (ALL BANKS)	Yes(13.33)	No(86.66)	Yes (0)	No(100)	Yes(16.6)	No(83.34)	Yes(16.6)	No(83.4)

Source: Author's own compilation from Questionnaire Survey data.

*Results in Table 4.9 are responses to Questions 2.5 and 2.6 in which respondent banks were asked to respond by giving a Yes or No answer. The average figures indicate the average No or Yes responses (as a percentage) within each bank type surveyed.

⁶⁸ The percentage of the Executives who were arrested refers only to the existing banks which were surveyed. The results do not include the executives of banks which were liquidated or merged with other entities as a result of the banking sector crisis. If this were considered, results show that between 10-12 directors were either arrested or skipped the country fearing arrest.

⁶⁹ This constitutes 16.6 percent of directors leaving the country in both foreign and private/Indigenous banks.

In CFX Bank, two of the directors were forced to resign and later arrested whilst in NMB Bank, all four executive directors fled the country. One of the NMB directors was subsequently arrested on his return. The executive directors who were either arrested, forced to resign, or who fled the country were all from private indigenous banks.⁷⁰ However, the respondents reported that none of the executives who stood trial for the alleged improprieties were convicted of any of the offences.

4.4.8 Board of directors and Related Party transactions.

The questionnaire asked questions relating to insider loans to directors before and after the 2003 banking crisis. The purpose of this was to assess the extent of related party transactions in the surveyed banks and whether there had been a change in the practice since the 2004 regulation was introduced. Respondents were asked whether *any member of the board had borrowed or attempted to borrow money from the bank to fund their personal business ventures.*⁷¹ Other questions required the respondents to specify the category of the directors who had borrowed from the bank, and whether the bank ever extended a loan or financial support to the bank holding company or any of the subsidiaries within the group.

The responses are presented in Table 4.10 and indicate that eight of the twelve surveyed banks responded that they had extended loans to board members before and after 2003. Among private indigenous banks four of the five banks surveyed reported that they had extended loans to the directors. The results also show that five banks had issued loans to their holding company or other subsidiaries within the group. The banks which reported extending loans to directors were state bank, private indigenous banks or foreign banks that were previously private indigenous banks. Regarding the period when the loans were extended, seven respondents indicated that the insider loans were made before 2004 whilst three respondents indicated that the insider loans were

⁷⁰ Metropolitan Bank and Premier Bank were indigenous banks at the time of the banking crisis and only became foreign after takeover by foreign investors.

⁷¹ The question required the respondent banks to answer either Yes or No.

extended after 2004. This seems to indicate a reduction in the number of banks which made loans to directors at the time the survey was conducted.

Table 4.10: Responses on Related Party Transactions within Surveyed Banks*

Responses	When bank was licensed	Borrowing by BoD	Period ⁷² when borrowing made	Category of BoD member ⁷³	Borrowing by Holding Co.
State Owned					
Agribank		Y	Both Period	Non Execs	N
ZB Bank		Y	1991-2003	Exe Director	N
Foreign Banks					
Stanchart Bank		N	-		N
Barclays Bank		N	-		N
Foreign Banks – Previously Pvt Indig					
Premier Bank		Y	2004-2009	Exec Directors	Y
Met Bank		Y	1991-2003	Exec Directors	N
Banc ABC		N	-		Y
Private Indigenous					
TN Bank		N	-	-	N
CFX Bank		Y	1991-2003	Exec/Non Exec	Y
NMB Bank		Y	1991-2003	Exec Directors	Y
Kingdom Bank		Y	Both Periods	Exec/Non Exec	Y
FBC Bank		Y	1991-2003	Non Execs	N

Source: Author's own compilation from Questionnaire Survey data.

*Y-Yes, N-No in respect to related party transactions by members of the board of directors within surveyed banks between 1991 and 2010. The numbers in brackets are the total number of banks within each category that answered Yes or No.

4.4.9 Sub-summary of the results on the board.

The results in this section have highlighted an increase in the size of boards from an average of six board members when the banks were licensed to ten when the survey was conducted. The composition of the boards across all banks indicates that non executive directors on average constituted 70 percent of the boards with little differences across ownership types. However, the results regarding whether the non executive directors were independent of management have

⁷² The periods have been separated into two, before the banking sector crisis (1991-2003) and after the crisis and the implementation of the corporate governance changes (2003-2010).

⁷³ The ratio of executives to non executives (as a percentage) who accessed loans from the banks.

highlighted that in four of the five surveyed private indigenous banks, some non executive directors were connected to management. In eleven of the twelve banks surveyed, it was observed that there was a separation between the duties of the chairman and the CEO. The exceptional bank is a foreign bank which was previously private indigenous, where the board chairman was one of the bank's founders with significant shareholding.

It has also been noted that the banks with executive directors who were either arrested forced to resign or who fled the country fearing arrest on various allegations of corporate governance violations were from private indigenous banks or foreign banks that were previously private indigenous. These banks CFX, NMB Bank, Premier Bank and Met Bank which reported arrests or directors fleeing the country or being forced to resign had the founders as the CEOs and had insider ownership concentration. All these banks also reported in the survey results that they had issued loans to executive directors. However, the results also indicate that none of the directors who were arrested were convicted on any of the charges. The results have also highlighted the prevalence of loans to the board before 2004 and a reduction at the time the survey was conducted. It has also been observed that indigenous banks, particularly private indigenous banks were largely affected by the related party transactions before or after 2004.

The survey results regarding other board issues such as board size, composition, the number of board meetings and board qualifications indicate that all the surveyed banks met the minimum requirements of the 2004 corporate governance guidelines. Before 2004, the survey findings indicate that private indigenous banks had an average of six board members. The survey findings regarding sponsor shareholders revealed an average of three sponsor executive directors in most private indigenous bank. This suggests a high proportion of executive directors compared to non executives. The large percentage of the executive directors who had significant shareholding in the banks may have affected the independence of the board in the execution of its duties.

4.5 Opinions on effect of ownership changes on corporate governance

The Zimbabwean central bank premised that a separation between ownership and management within banks would lead to increased efficiency, monitoring function of the board and the protection of depositors. It was also argued that the separation would reduce related party transactions (RBZ, 2004). Opinion based questions were asked in the questionnaire to establish how the respondent banks perceived the 2004 regulatory changes.⁷⁴

Since the opinions of the respondents were subjective, the results presented in this section were treated with caution. They are used in this study to supplement the findings in the questionnaire survey. The results discussed in this section are only from private indigenous banks and foreign banks which were previously private indigenous banks.

Table 4.11: Effect of change in Ownership on corporate governance.*

Name of Bank	Increased Efficiency	Reduced related party transactions	Increased monitoring by BOD	Reduced fraudulent transactions	Increased depositor protection	Whether separation has been beneficial
Foreign Owned - Previously Pvt Indig.						
Banc ABC	Y+	Y	Y	Y	O	NO
Premier Bank	O	N	Y	O	Y	YES
Met Bank	Y	Y	Y+	O	Y	YES
Private/Indig						
CFX Bank	N	Y	O	N	Y	YES
NMB Bank	Y	Y	Y+	O	Y	NO
Kingdom Bank	Y+	Y	Y+	Y	Y	YES
FBC Bank	O	O	Y	O	Y	NO

Source: Author's own compilation from fieldwork data

*In this regard, the respondents were asked to express the extent to which they agree or disagree on a given statement from Y+ (strongly agree); Y (agree); O (neither agree nor disagree); N (disagree) and N+ (strongly disagree). The banks which were not affected by the crisis (Agribank, ZB Bank, Barclays, Standard Chartered Bank, TN Bank) have been excluded from this analysis.

⁷⁴ See questions 4.2 to 4.6 in Part 4 of the Questionnaire Survey. The questions measure the respondent bank's views on how the ownership changes impacted on some operational and internal governance issues within their banks.

This is because other banking types experienced little or no change in ownership even after the introduction of the 2004 regulation. In most cases, this was because the banks already had an ownership structure which complied with the new regulations.

The opinion based responses on the effect of changes relating to ownership structure on corporate governance are presented in Table 4.11 and 4.12.⁷⁵ The majority of the banks in these two categories agreed that the ownership changes had led to some positive outcomes in the various corporate governance issues. Only two banks, Premier and CFX Bank disagreed that ownership changes had led to increased efficiency, reduced related party transactions and fraudulent transaction or increased the protection of depositors. Table 5.11 also indicate that opinions on the effects of the regulatory changes relating to ownership structure on frauds was least agreed by the banks whilst a majority indicated that they strongly agreed (Y+) that the changes had led to increased monitoring by the board.

When asked whether the ownership and board changes introduced by the central bank in 2004 increased efficiency within the banks, four banks either strongly agreed (Y+) or agreed (Y) whilst the remaining three banks either had no opinion (two banks) or disagreed (one bank). The results show a similar trend on whether the separation of ownership and management led to the reduction of related party transaction. Five banks of the seven which were affected by the ownership changes agreed that the changes had a positive effect. Six of the seven banks also agreed that the changes had led to increased board monitoring. Another high rating was regarding whether the separation had led to increased protection of depositors and other stakeholders with six banks agreeing (Y).

When the results in Table 4.11 are interpreted together, they show that the majority of the banks believed that the regulatory changes relating to ownership and the board, introduced by the central

⁷⁵ The question in this section asked the respondents to express the extent to which they agree or disagree on a given statement from Y+ (strongly agree); Y (agree); 0 (neither agree nor disagree); N (disagree) and N+ (strongly disagree).

bank in 2004 had had a positive effect on board effectiveness, stakeholder protection and reduction of related party transactions.

The respondents were also asked questions regarding whether the changes in the composition of the board introduced by the central bank in 2004 had an effect on selected corporate governance issues. One of the questions asked whether these changes had led to *(a) Increased participation of board members in supervising banks (b) Increased stakeholder protection and (c) reduced related party trading, theft or corruption by senior management*. In the previous section where opinion based responses on the effect of ownership changes on corporate governance were analysed, only seven banks which were affected by the ownership changes were included to avoid a corruption of the results by the responses of the banks that were not affected. In this section, indications are that all the surveyed banks were affected by the regulatory changes on the board of directors. As a result, all the banks were included in the analysis on board arrangements.

The results on the effect of the board changes on corporate governance are presented in Table 4.12. They show that most banks agreed that board responsibilities and effectiveness had improved since the changes were implemented. Only one respondent did not agree (N).⁷⁶ When all banks are considered, regarding whether the regulatory changes had led to increased board participation, four banks strongly agreed, seven banks agreed, whilst one bank neither agreed nor disagreed. When the responses for strongly agree (Y+) and agree (Y) results are compounded, the results shows that eleven banks of the twelve surveyed agreed that the 2004 regulatory changes have led to increased board participation. These results on increased participation are in line with the findings in the previous section which suggest an increase in the number of meetings by the main board and its committees.

⁷⁶ TN Bank indicated that it did not agree that board changes had led to increased stakeholder protection. The only other exception was with Standard Chartered Bank; a foreign bank neither agreed nor disagreed with the assertion. This may be because the foreign bank was not affected by most of the regulatory changes since it already complied with UK Best practice where its parent company was based.

Table 4.12: Opinions on effect of board changes on corporate governance.*

Name of Bank	Increased Participation		Inc stakeholder protection		Reduced related party transactions and frauds		Has director's duty of care increased? ⁷⁷	
State Owned								
Agribank	Y		Y		_**		Very Much So	
ZB Bank	Y+		O		_**		Very Much So	
ZABG Bank	Y		Y		_**		Very Much So.	
Average	Y+(33.33) Y (66.67)		Y(66.67) O(33.33)		Y+(33.33) Y(66.67)		VMS(100)	
Foreign Owned								
Barclays Bank	Y		Y		_**		Somewhat	
Stanchart Bank	O		Y		_**		Very Much So.	
Foreign Banks that were Previously Pvt Indigenous.								
Premier Bank	Y		O		Y+		Very Much So	
Met Bank	Y		Y		Y+		Very Much So	
Banc ABC	Y+		O		Y		Very Much So.	
Average	Y+(20),Y(60)		O(20)		Y(60)		O(40)	
Private/Indig								
TN Bank	Y		N		Y		Very Much So.	
CFX Bank	Y		Y		O		Somewhat	
NMB Bank	Y+		Y		Y		Somewhat	
Kingdom Bank	Y		Y		Y		Somewhat	
FBC Bank	Y+		Y		O		Somewhat	
Average (Indigenous)	Y+(40)		Y(60)		Y(80)		N(20)	
Average All Banks	Y+ (4) 33.33		Y+ (0) 0		Y+ (2) 16.67		Very Much So (7) 58.33	
	Y (7) 58.33		Y (8) 66.67		Y (7) 58.33		Somewhat (5) 41.67	
	O (1) 8.33		O (3) 25		O (3) 25			
			N (1) 8.33					

Source: Author's own compilation from Questionnaire Survey data.

*Table presents the responses by bank where Y+ is strongly agree; Y (Agree); O (Neither agree nor disagree, N (Disagree) and N+ (strongly disagree). The figures in brackets are the percentage responses per bank type for each response on the strength of response. In the last column, VMS represents Very Much So as a response, whilst SWT represents somewhat as a response.

** Opinion results excluded as surveyed banks were not affected by related party transaction.

⁷⁷ In Question 5.5 of the Survey, we asked 'Do you think the duty of care of Management and Directors to bank shareholders have increased since the changes introduced by the Reserve Bank after the 2003 financial sector crisis. The possible answers to this question in the QS were (a) Very Much So; (b) have increased somewhat; (c) have not changed.

Another question asked whether the changes to the board arrangements had led to increased stakeholder protection in banks. The results on this question show that eight banks agreed that it had, three banks neither agreed nor disagreed whilst one bank disagreed.⁷⁸ A related question was whether the duty of care of management and directors had increased since the changes indicate that five banks believed that it had increased 'somewhat' whilst seven banks indicated that it had increased 'very much so'.

Table: 4.13: Responses on effect of ownership changes on supervision & surveillance*

	Bank Supervision	Onsite Surveillance	Offsite Surveillance	Internal controls	Enabling environment	Helped the most**	Most damaging
State Owned							
Agribank	2	2	3	2	5	Board req	Liquidity Ratios
ZB Bank	2	2	2	1	4	Compl req	Liquidity Ratios
Foreign Owned							
Barclays Bank	3	3	3	4	3	none helpful	Neutral impact
Stanchart	2	2	3	3	3	Compl req	-
Previously Private Indigenous							
Banc ABC	1	1	3	2	2	Board req	Compliance req
Premier Bank	3	2	3	3	2	Board req	Liquidity Ratios
Met Bank	3	2	5	2	4	Board req	Liquidity Ratios
Private/Indig							
TN Bank	2	2	3	4	6	Board req	Ownership chng
CFX Bank	2	2	3	2	2	Board req	Liquidity Ratios
NMB Bank	2	3	2	1	4	Board req	Liquidity Ratios
Kingdom Bank	1	2	2	2	3	Board req	Liquidity Ratios
FBC Bank	2	2	3	2	4	Board req	Liquidity Ratios

Source: Author's own compilation from fieldwork data.

*Question 5.1 in the QS asked; To what extent have the measures introduced by the central bank after the 2003 banking sector crisis been helpful to your bank in each of the following; 5.1.1, improving bank supervision and surveillance; 5.1.2, Increasing on-site surveillance by RBZ Inspectors; 5.1.3, Increased off-site surveillance by Bank supervisors; 5.1.4, Improved Internal controls; 5.1.5, Creating an environment for banking sector development. On the responses: 1. Indicates to a very great extent, 2. to a great extent, 3. to some extent, 4. to a little extent, 5. not at all, 6. no idea.

**Board reg denotes board requirements, Compl req denotes compliance requirements.

⁷⁸ Within individual banks, the responses were either Agree or neither agree nor disagree, whilst one bank completely disagreed that the changes had led to an increase in stakeholder protection.

The two state banks surveyed expressed the view that directors' duties had increased significantly ('very much so'). Four of the five surveyed foreign owned banks and one private indigenous bank also expressed the same view using the same response (VMS). The questionnaire also asked questions regarding the effect of the ownership changes introduced in 2004 on supervision and surveillance, internal controls and creating a conducive banking environment. The opinion based responses on these questions are presented in Table 4.13. They generally indicate that most of the banks agreed that the reforms have had a positive effect on these measures.

Most of the surveyed banks expressed the opinion that the regulatory changes which were most effective were those relating to bank supervision and onsite surveillance. When asked to indicate the regulatory changes which helped or caused the most damage to their bank, the results show that nine banks indicated that the new board requirements had been the most effective.⁷⁹ Eight of the twelve banks surveyed cited the new liquidity requirements as having had the most negative effect on their banks.

4.6 CONCLUSIONS

This chapter has analysed the survey results and provides a broad picture of the banking sector on ownership, board features and other corporate governance practices. The results on ownership structure have shown a high concentration of shareholding across the three ownership types. When the banks were licensed, the sponsor CEOs and/or the executive directors controlled more than 10 percent of the shareholding in all the eight banks which were licensed as private indigenous banks. In this regard, the survey findings indicate that all the private indigenous banks had insider ownership concentration when they were established.

⁷⁹ See questions 5.2 and 5.3 of the Questionnaire Survey. The responses to question 5.2 regarding which policies have helped the bank the most were (a) revised liquidity requirements, (b) new compliance requirements, (c) board requirements, (d) changes to ownership structure and (e) other.

When the survey was conducted, the results still reported high ownership concentration in all the surveyed banks. However, the survey findings indicate a reduction in CEOs with more than 10 percent of the shareholding. Of the twelve banks surveyed, three banks, all of which were either private indigenous banks or foreign banks which were previously private indigenous banks, had a CEO and/or executive directors controlling more than 10 percent of the shareholding. The rest of the banks had a separation between ownership and management, with executives owning less than 10 percent of the shareholding.

The findings regarding ownership by the biggest shareholder, top five shareholder and institutional shareholders highlighted significant ownership concentration by these blockholders particularly the top 5 shareholders who controlled significant shareholding in all the banks. The survey findings also show the identities of the blockholders with ownership concentration. Whilst CEOs and/or executive directors were the majority shareholders in three of the banks which were private indigenous or previously private indigenous banks, the top five shareholders in the rest of the banks which were private indigenous in origin indicate a domination by corporate, institutional shareholders and former executives shareholding. The former executive directors had significant shareholding in at least four of the eight banks which were private indigenous in origin.

The survey findings regarding ownership structure in general indicate ownership concentration. The results also indicate insider ownership concentration among private indigenous banks when the banks were licensed. At the time the survey was conducted, the survey findings indicate that some banks of a private indigenous origin still recorded high shareholding by insiders with executive directors owning more than 10 percent of the shareholding.

The findings regarding board arrangements have highlighted that board issues such as board size, composition, the number of board meetings and board qualifications show that all the surveyed banks met the minimum requirements of the 2004 corporate governance guidelines. The opinion

based responses on board features have also supported these findings, suggesting that board size and participation had increased since the regulatory changes were introduced in 2004.

The survey findings also show that all the banks with executives who were arrested, fled the country in fear of arrest or who were forced to resign were private indigenous banks or previously private indigenous in origin. The survey results also indicate that all the banks in this classification reported issuing related party loans to executive directors. All these banks also had insider ownership concentration and had the founders as CEOs at the time. The survey results have also highlighted that more banks reported issuing related party loans between 1991 and 2003. However, the results indicate that despite a significant reduction, some private indigenous banks have reported extending related party loans to directors between 2004 and the time the survey was conducted.

Although all banks across ownership types had significant ownership concentration, the prevalence of related party transactions and allegations of expropriation in private indigenous banks or foreign banks which were previously private indigenous banks suggests that the identity of the blockholders with concentrated ownership may be an important determining factor. Banks which were private indigenous in origin, with insider ownership concentration were the only banks which reported issuing related party loans to executives or had directors arrested or fleeing the country fearing arrest. In comparison, state and foreign banks with outsider ownership concentration were unaffected.

The survey findings also indicate that some private indigenous banks still had insider ownership concentration despite the 2004 regulations which limit shareholding by management to 10 percent. This could indicate that executives or insider owners could use other ways to get around the regulations and by doing so, still control the banks despite the regulations requiring a separation between ownership and management.

The opinion based responses in this section have been used to corroborate the main survey findings. These opinion based responses indicate that most banks generally believed that the ownership and board changes introduced in 2004 had led to positive corporate governance outcomes such as the role of the board, related party lending, disclosure and transparency and protection of stakeholders. However, ownership structure changes relating to separation between ownership and control did not receive much support from banks of a private indigenous origin. Changes relating to the board of directors were viewed as having had the most positive impact. In this regard, the opinion based responses are in line with the findings from the main survey which indicate a reduction in related party transactions and that the current board arrangement in the surveyed banks meet the minimum requirements of the 2004 guidelines.

CHAPTER 5

THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND BANK PERFORMANCE

5.0 Introduction

In the previous Questionnaire Survey chapter, this thesis has obtained a broad picture of the ownership structures and corporate governance practices within the Zimbabwean banking sector. The purpose of this chapter is to explore the relationship between corporate governance and bank performance. Specifically, this chapter relates ownership structure, board features, audit and disclosure arrangements to the performance of banking firms.

Across literature, studies analysing the relationship between corporate governance and firm performance have yielded mixed results (Reaz, 2005). There are studies which found that corporate governance has a significant impact on the performance of corporations while others found no such evidence. The link between corporate governance and performance is premised on the argument that much of the driving force behind how a firm performs is based on the monitoring and financial incentive structures that are in place for managers, stockholders, and directors. Stock ownership will therefore determine who has the most to gain and the greatest incentive to lead a firm to improve performance (Spong and Sullivan, 2007).

Despite the mixed results, some studies have established a positive relationship between Corporate Governance and performance (e.g. Zingales, 1998; Shleifer and Vishny, 1998; Weiss and Nikitim, 1998). When it comes to banks, literature suggests differences in performance across bank ownership types. Claessens *et al* (2001) find that foreign banks are more profitable than domestic

ones in developing countries although it is the other way round in developed countries. A study by Dermirguc-Kunt and Huizinga (1999) finds that foreign banks have higher margins and profits than domestic banks in developing countries. Evidence also suggests that state owned banks typically have larger NPLs than private banks and that countries with the largest share of state-owned banks, on average, have the highest percentage of NPLs and operating costs (Mishkin, 2005).

When bank performance is analysed by ownership structure, a number of studies seem to support the managerial hypothesis that owner controlled (OC) firms report higher profitability measures than manager controlled firms (MC).⁸⁰ Most of the studies on the effect of corporate governance on firm performance however, focus on developed countries (e.g Agrawal and Knoeber, 1996, Bhagat and Black, 1998; 2000; Weir et al, 2002). Only a few studies have analysed the relationship between corporate governance and bank performance in developing countries. There are even fewer studies which look at this relationship in African countries.

The only known study which analyses the relationship between corporate governance and performance in Zimbabwean firms is by Mangena and Tauringana (2006). The study looks at the relationship between corporate governance and performance in respect to all the 157 companies listed on the ZSE for the period between 2001-2003. The results from the regression analysis performed in the study suggest that companies with effective corporate governance mechanisms perform better than those with weak corporate governance. Specifically, the cross-firm regression analysis finds that performance is positively associated with a higher proportion of non-executive directors and the frequency of board meetings and negatively associated with board size.

Whilst the Mangena and Tauringana study focuses on the relationship between corporate governance and performance of companies listed on the ZSE, no study has so far been undertaken to analyse the relationship between corporate governance and performance of the Zimbabwean

⁸⁰ See Short, H (1994).

banking sector. This chapter attempts to make an empirical analysis of the relationship between ownership structure, board issues, audit and disclosure and the performance of banks.

The rest of this chapter is organised as follows, the next section makes an analysis of performance of the Zimbabwean banking sector between 1999 and 2003, using accounting measures. The following section constructs a Corporate Governance Scoring (CGS) grid by using the results from the questionnaire survey to obtain a view of the corporate governance practices of individual banks. The next section makes a correlation analysis between corporate governance scores and bank performance. The last section discusses the results.

5.1 Performance of the banking sector.

The objective of this section is to illustrate the performance of the banking sector using key financial ratios. Statistical analysis is used to see whether there were significant differences in the financial performance of banks before and after the 2004 ownership reforms. A study by Antwi-Asare and Addison (2000) use this approach to analyse bank performance in Ghana before and after liberalisation of the financial markets and banking sector reforms. In a study on corporate governance of banks in Bangladesh, Reaz (2005) also uses a similar approach to analyse the relationship between corporate governance and bank performance. The analysis in this section adopts a similar approach to that in Antwi-Asare and Addison (2000) and uses accounting indicators to analyse performance.

The performance of the banking sector is measured by profitability, asset quality and liquidity ratios. To measure profitability, the study uses Return on Asset (ROA) and Return on Equity (ROE) ratios.⁸¹ The profitability ratios will be complemented by ratios which assess operational efficiency of banks, namely Net Interest Margin (NIM) and Cost to Income ratio (CIM). To measure asset quality, Non

⁸¹ A number of banking and Corporate Governance studies have used accounting and profitability measures such as ROA and ROE to measure bank performance (Hassan and Bashir, 2003; Antwi-Asare and Addison, 2000; Bothwell, 1980; Demsetz and Lehn, 1985; Joh, 2003).

Performing loans (NPL) and Loan Loss Reserves (LLR) ratios are used.⁸² The analysis also uses the ratio on advances to total assets to measure liquidity. All the variables which have been utilised in this analysis are defined in **Appendix 2**.

The profitability, asset quality and liquidity ratios in this section were calculated using data on the Zimbabwean Banking Industry for a ten year period between 1999 and 2008. This data were sourced from the Global Credit Rating Company (2009) and from the IMF (2005). These were the only sources where complete data for all the relevant years analysed in this thesis were available. The notional data acquired from these sources has been transformed to real terms for the benefit of the thesis. The performance data for this period was available in two formats; the data between 1999 and 2003 were for the banking sector aggregate whilst data for individual banks was only available between 2004 and 2008.

This performance data has been organised into two significant periods in the Zimbabwean banking sector. That is, the period (1999-2003) from the financial sector liberalisation to the banking sector crisis in 2003 and then the period (2004-2008) after the banking sector crisis and the introduction of regulatory changes by the central bank in 2004. In addition to analysing the aggregate performance data for the two periods, a performance trend analysis of individual banks between 2004 and 2008 is also made with the objective of observing the performance measures of these individual banks after the introduction of the 2004 regulatory changes.

5.1.1 Profitability and operational efficiency of the banking sector (1999 to 2008).

Changes in the profitability of the banking sector can indicate whether the performance of the sector as a whole has improved or not after the 2004 regulatory reforms. A paired *t test* was carried out to see whether there is significant difference in the sector's profitability between the two

⁸² Non Performing loans are based on a complex set of guidelines by the central bank, and include loans with problems and deficient coverage, loans with high risk of borrower insolvency and recovery difficulty, and loans deemed unrecoverable.

periods (1999-2003 and 2004-2008). The results are summarised in Table 5.1 indicating a positive change in the ROA ratio which moved upward from 5.31 percent to 18.11 percent, whilst ROE indicators also showed an upward movement from 49.38 percent to 92.80 percent. Over the 8 years, both ROA and ROE variables shows a continuous increase year on year (y-o-y) except for a decline in both indicators between 2003 and 2004. This decline may have been a result of the banking sector crisis.⁸³

In view of the regulatory reforms introduced in 2004, both ROA and ROE ratios are expected to rise. When tested for significance, the results in Table 5.1 show that the changes in both ROA and ROE between the two periods are statistically significant at 1 percent and at 5 percent respectively. This means that there is a statistically significant increase in ROA and ROE over time.⁸⁴ ROA shows how well a bank is performing using the resources at its disposal to generate additional resources for the bank and ROE measures how much profit a bank generates with the money shareholders have invested. Positive growth in these indicators is considered to be necessary for the viability of any bank (Dziobek and Pazarbasioglu, 1977:8-9). Good earnings performance enables a bank to fund its expansion, remain competitive and replenish or increase its capital.

When the Cost to Income Ratio (CIR) and net interest margin (NIM) ratios are considered, literature suggests that the lower the CIR, and the higher the NIM ratio, the more profitable a bank will be (Reaz, 2005). The results in Table 5.1 indicate an increase in the CIR ratio from a mean of 18.24 percent in the first period to 57.74 percent in the second period, whilst the NIM mean decreased from 236.33 percent to 66.1 percent in the second period. In both cases, the results show negative signs from expected outcomes.

⁸³ Between 2003 and 2004, ROA fell from 15.58 % to 10.94, whilst ROE also retreated from 72.33% to 59.28% indicating the severity of the banking sector crisis.

⁸⁴ The significance level used in this analysis is .05 which is the level used in social science studies.

However, the p values for the paired t test on CIR and NIM ratios show that the differences in the means for both ratios over the two periods were not statistically significant. One of the reasons for the reduction in the NIM ratio over the two periods may have been due to negative real interest rates and a decline in interest bearing assets following the deterioration of the Zimbabwean economy between 1999 to 2003 which was discussed in the historical Background in Chapter 2.

Table 5.1: Paired t test for Profitability Ratios of All Zimbabwean banks (1999-2008). *

Variable	Obs.	Mean	Std. Error.	Stnd. Dev.	[95% Conf]	t-statistic.
ROA	5(1999-2003)	5.316	2.599588	5.812855	-1.901612	
	5(2004-2008)	18.11	3.363914	7.521941	8.770276	-8.8026.
		Ha:mean (diff)<0 Pr(T<t)=0.0005	Ha:mean(diff)!=0 Pr(T>t)=0.0009			
ROE	5(1999-2003)	49.386	9.179717	20.52647	23.89902	
	5(2004-2008)	92.806	10.86921	24.30429	62.62824	-3.0767
		Ha:mean (diff)<0 Pr(T<t)=0.0185	Ha:mean(diff)!=0 Pr(T>t)=0.0370			
CIR	5(1999-2003)	18.24	3.010581	6.731865	9.881286	
	5(2004-2008)	57.742	27.5706	61.64974	-18.80627	-1.3337
		Ha:mean (diff)<0 Pr(T<t)=0.1266	Ha:mean(diff)!=0 Pr(T>t)=0.2532			
NIM	5(1999-2003)	236.33	96.82188	216.5003	-32.49065	
	5(2004-2008)	66.1	30.14519	67.40668	-17.59645	+1.6191
		Ha:mean (diff)<0 Pr(T<t)=0.9096	Ha:mean(diff)!=0 Pr(T>t)=0.1807			

Source: Statistical Analysis based on RBZ Annual Reports.

*Profitability data is for all banks for two periods (between 1999-2003 and 2004-2008). T-statistic is for the difference in means between pre-regulatory reform and post regulatory reforms. Under one tailed test, significance at 0.5% level. CIR, refers to Cost to Income Ratio. The observation refers to the total number of years in each period whilst the particular period is indicated in brackets.

5.1.2 Profitability Ratios by bank ownership types (2003-2008).

This section makes a trend analysis of the profitability ratios between 2004 and 2008 the period after the introduction of regulatory reforms by using data at bank level. The purpose of this analysis is to examine the performance of the individual banks, and by bank ownership type. The expectation is that after reforms, profitability indicators should improve (Reaz, 2005).

Since most of the corporate governance and ownership reform measures were implemented in 2004, the expectation is that banks would record performance improvement thereafter. The full consolidated results for all banks in respect of these profitability indicators between 2004 and 2008 are summarised in Table 5.2 and Figure 5.1 below. The results show that private indigenous banks recorded the lowest ratios in ROA and ROE between 2004 and 2005 compared to foreign banks with the highest ratios and state banks with the second highest.

Figure 6.1 highlights the results of a trend analysis for the ROA ratio between 2004 and 2008. The results highlight that indigenous banks were outperformed by state banks between 2004 and 2005, followed by a trend reversal between 2006 and 2008. The lower profitability of private indigenous banks may be due to poor performance of some particular banks (NMB, Kingdom and Interfin) which reported negative ratio in this period.

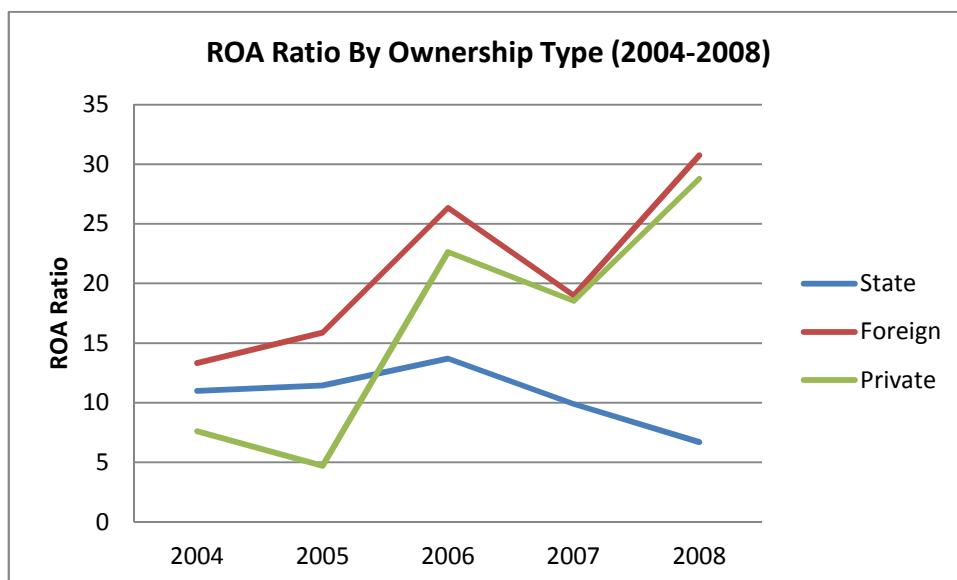
Table 5.2: Measures of Bank Profitability by Ownership Type (2003-2008).

Bank Type	2004		2005		2006		2007		2008	
	ROA	ROE	ROA	ROE	ROA	ROE	ROA	ROE	ROA	ROE
State owned	11	117	11.45	116.45	13.7	106.43	9.9	58.5	6.7	19.03
Foreign	13.33	109.48	15.88	123.45	26.35	114.45	19	69	30.76	94.81
Pvt Indig.	7.6	-17.2	4.7	93.37	22.65	118.03	18.53	88.07	28.8	173.77
All Banks	10.94	59.28	13.86	110.58	16.25	99.46	19.04	76.99	30.46	117.93

Source: Bank Annual Reports and Global Credit Rating, GRC (2009).

Foreign banks remained top performers throughout the whole period between 2004 and 2008. The results for NIM and CIR ratios between 2004 and 2005 show a similar pattern, with indigenous banks reporting the lowest NIM ratio in 2004 of 35.7 percent, compared to foreign banks (45.28 percent) and state banks (63.95 percent). The same pattern was repeated in 2005. Between 2006 and 2007 there was a slight improvement in the NIM ratios for all banks, although the ratio retreated to -10.7 percent in 2008. This may have been a result of a reduction in bank deposits as depositors avoided putting their money in banks due to uncertainties caused by the dollarization of the economy.

Figure 5.1: Trend Analysis – ROA Ratio by Ownership Type (2004-2008)



Source: Author's own compilation

One of the reasons why private indigenous banks had the lowest ratios may be attributable to the reconstruction of the sector through mergers and acquisitions. Another could have been the introduction of the regulatory changes in 2004 which only affected indigenous banks. The observation made in the questionnaire survey chapter suggests that a number of private indigenous banks were placed under curatorship, closed or forced to change their ownership structures as a result of the regulatory changes. None of the state or foreign owned banks were affected.

A further analysis of the cost to income ratio (CIR) provides an insight into the cost efficiencies of the different bank ownership types. The cost efficiency of banking firms is predicted to be positively associated with bank performance and specifically with bank profitability. The standard analysis of cost to income ratio, which is employed in other studies such as Pasiouras and Kosmidou (2006), reflects the ability of bank's management to cover operating expenses by the generated bank income.

Table 5.3: Measures of operational efficiency by Ownership Type (2004-2008).

Bank Type	2004		2005		2006		2007		2008*	
	CIR	NIM	CIR	NIM	CIR	NIM	CIR	NIM	CIR	NIM
State owned	48.2	63.95	42.7	44	38.15	53.4	49.55	27.73	-	10.4
Foreign	39.53	45.28	32.61	32.8	26.21	84.1	23.16	33.71	-	10.55
Pvt Indig.	65.92	35.7	70.3	31.74	39.92	71.97	36.87	49.83	-	-10.7
All Banks	53	43.67	52.71	33.46	35.79	76.62	33.54	42.92	-	0.9

Source: Bank Annual Reports and Global Credit Rating, GRC (2009).

*CIR data for 2008 were not available.

The results in Table 5.3 show that foreign banks with an average cost to income ratio of 24.89 percent were the most cost efficient whilst indigenous banks with an average ratio of 41.80 percent outperformed state owned banks. The high CIR ratio of state banks may be attributed to a proportionately large branch network in the rural areas due to the government's desire to provide banking facilities to the rural population. The high average CIR for state banks is also a result of a high CIR of 2,683 percent in 2007 reported in Agribank, one of the state banks.⁸⁵

Demirguc-Kunt and Huizinga (1999) who analysed the determinants of commercial bank interest margins and profitability for 80 countries between 1988-1995 period show that, in developing countries, foreign banks have higher net interest margins (NIM) and profits than domestic banks, while the opposite is true for developed countries. The reasons noted for this superior performance

⁸⁵ Agribank is a state owned bank which is 100 percent controlled by the government.

of foreign banks is their technological edge which is relatively strong to overcome any informational disadvantages.⁸⁶ Macroeconomic factors are also found to explain variations in interest margins across countries since Inflation is believed to be associated with higher realised interest margins and higher profitability.⁸⁷

The aggregate profitability ratios for the banking sector before and after the introduction of the 2004 regulatory changes as analysed in 5.1.1 show an upward movement in ROA and ROE. This improvement was found to be statistically significant. There is also indication of a general increase in the CIR and a reduction in the NIM ratio over the same period although this was statistically insignificant. The trend analysis between 2004 and 2008 in 5.1.2 suggest that foreign banks performed better than both indigenous and state owned banks during this period. The results also indicate poor performance by indigenous banks between 2004 and 2005 which may have been the result of the 2003 banking crisis.

5.1.3 Asset Quality Ratios (1999-2008).

Credit risk exposure is used across literature as an indicator of asset quality, which can be measured by the ratio of non performing loans (NLPs) to loan-loss provisions (Demirguc-Kunt and Huizinga (1999). Since loan-loss provisions indicate the probability of loans to become non-performing, higher provisions are taken to be negatively related to bank profitability. Different authors capture this effect by using different indicators. A study by Athanasoglu *et al* (2006) use loan-loss provisions to non performing loans ratio, whilst Kosmidou *et al.* (2006) use loan-loss provisions to total assets

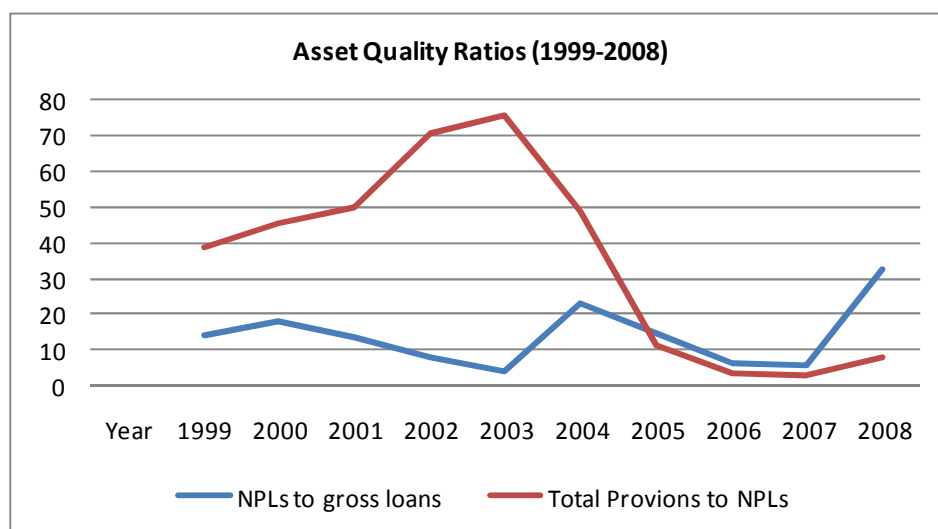
⁸⁶ See Demirguc-Kunt and Huizinga (1999)

⁸⁷ Ibid. (The positive relationship between inflation and bank profitability implies that bank income increases more with inflation than bank costs. Further, high real interest rates are associated with higher interest margins and profitability, especially in developing countries)

ratio as an indicator.⁸⁸ This study uses loan loss provisions to non performing loans ratio to measure credit risk exposure of Zimbabwean banks.

Asset quality is an important performance measure since the solvency of banks is at risk when their assets become impaired due to over exposure to non-performing loans. Non Performing loans (NPLs) have been identified in literature as one of the primary causes of bank collapses (Llewellyn, 1998; Brownbridge, 1998).⁸⁹ The banking sector reforms, introduced by the central bank in 2004, were expected to enhance the efficiency of banks and strengthen their profitability and solvency by reducing the NPL ratio.⁹⁰ The data used to analyse NPL ratio and loan loss provisions are aggregate data for the banking sector as a whole. Figure 5.2 shows the changes in the two indicators for the banking sector over the period between 1999 and 2008.

Figure 5.2: Aggregate asset quality of the banking sector (1999-2008)*



Source: Author’s own compilation

*Figures in the vertical Axis are in percentages.

⁸⁸ Regardless of the indicator used, the relationship between loan loss provisions with bank profitability is expected to be negative.

⁸⁹ According to Brownbridge (1998), the single biggest contributor to the bad loans of many of the failed local banks was insider lending. In at least half of the bank failures, insider loans accounted for a substantial proportion of the bad debts

⁹⁰ In this case, higher NPL would be associated with less efficient banks.

The results indicate the peaking of total provisions to NPLs ratio in 2003, whilst the NPLs to gross loans ratio recorded the lowest result in the same year. A possible explanation for this may be that since 2003 was the height of the banking sector crisis, this could have led to higher provisioning as banks feared defaults. After 2003, both ratios indicate a downwards movement although they start to move upwards again after 2007.

Table 5.4 below analyses the results of a paired t test for NPLs to gross loans and loan loss to gross loans provisions ratios between the two periods (1999-2003 and 2004-2008).

Table 5.4: Paired t test for Asset Quality Ratios of All Zimbabwean banks (1999-2008). *

Variable	Obs.	Mean	Std. Error.	Std. Dev.	[95% Conf]	t-statistic.
NPLs	5(1999-2003)	11.62	2.47657	5.5377	4.743939	
	5(2004-2008)	16.452	5.098978	11.40166	2.294968	-0.7491.
		Ha:mean (diff)<0 Pr(T<t)=0.2477		Ha:mean(diff)!=0 Pr(T>t)=0.4954		
LLR	5(1999-2003)	56.06	7.18071	16.05656	36.12315	
	5(2004-2008)	14.762	8.594926	19.21884	-9.101341	2.8985
		Ha:mean (diff)<0 Pr(T<t)=0.9779		Ha:mean(diff)!=0 Pr(T>t)=0.0442		

Source: Statistical Analysis based on RBZ Annual Reports.

*Profitability data is for all banks for two periods (between 1999-2003 and 2004-2008). T-statistic is for the difference in means between pre-regulatory reform and post regulatory reforms. Using a one tailed test at 5 percent significance level. NPLs, refers to Non Performing Loans Ratio, whilst LLR refers to Loan Loss Provisions. The observation refers to the total number of years in each period whilst the particular period is indicated in brackets.

The purpose of this analysis is to assess whether there is a significant change between the two periods. When the means for the two periods are compared, the results show a decline in loan loss provisions from 56.06 to 14.76 percent although the NPL ratio records a marginal increase over the same period, from 11.62 percent to 16.34 percent between the two periods. However, the Paired t

test for both ratios shows that the changes over the two periods were not statistical significant. This means that there is no significant change in the two indicators over the two periods.

5.1.4 Asset Quality Ratios by Ownership type (2004-2008).

Data on asset quality ratios at the bank level are used to make a trend analysis from 2004 and 2008 and the full results are presented in **Appendix 3**. Table 5.5 summarises the results by ownership types.

Table 5.5: Asset Quality Ratios by Ownership Type (Average, 2004-2008). *

Bank Type	2004		2005		2006		2007		2008	
	NPL	LLR	NPL	LLR	NPL	LLR	NPL	LLR	NPL	LLR
State owned	25.95	8.3	22.7	17.15	5.2	2.83	0.83	1.73	14.3	3.12
Foreign	16.87	15.96	12.01	11.53	9.80	5.31	4.93	2.60	3.93	3.12
Pvt Indig.	20.23	17.4	16.92	10.75	4.85	1.65	9.86	4.21	62.21	15.55
All Banks	18.41	11.94	14.75	11.17	6.45	3.14	5.94	3.14	34.36	7.81

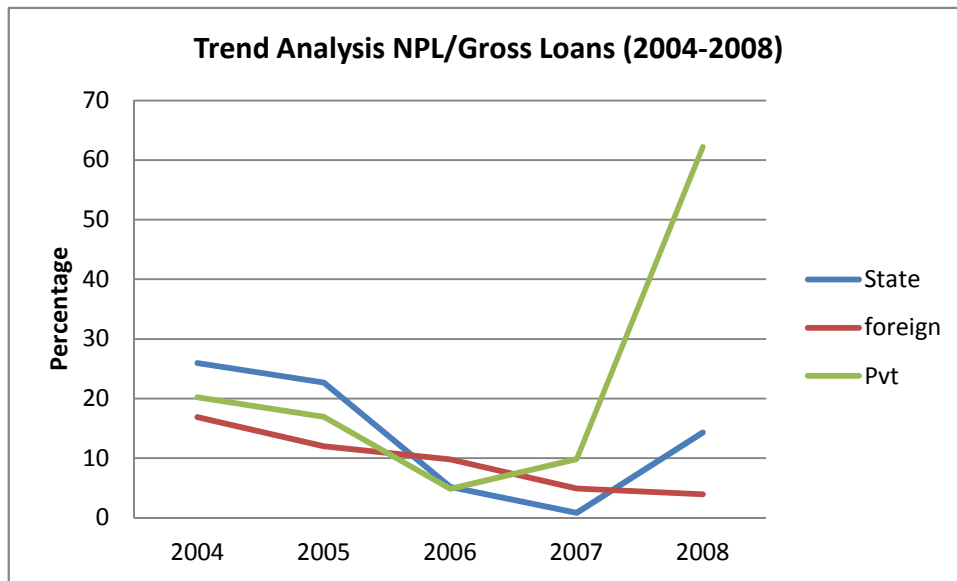
Source: Researcher's compilation from fieldwork data.

*The figures in this analysis are the averages for each ownership type over the five year period.

The results indicate that NPLs had been declining across different ownership types before making a sharp increase in 2008. In general, the results reveal that foreign banks had lower NPLs and LLRs ratios compared to other bank types. It is difficult however to conclude whether private indigenous banks were better than state banks or not. The high NPL and LLRs averages among indigenous banks should however take into consideration the results in a few indigenous banks such as FBC, CFX and NMB Bank which had higher NPL ratios compared to others.⁹¹ The high level of NPLs in indigenous banks in this analysis may be explained by the findings in the questionnaire survey chapter which suggests a high percentage of insider loans within the sector before and after the 2003 bank crisis.

⁹¹ For example, CFX Bank had an NPL ratio of 462.7 percent in 2007 when the rest of the indigenous banks in the same sector had NPL ratios below 10 percent. In 2004-5, FBC Bank had higher NPL ratios of 64.9 percent and 44.8 percent respectively compared to other banks which averaged 15 percent NPLs.

Figure 5.3: Trend Analysis of NPL/Gross Loans by ownership type (2004-2008)



Source: Author's own compilation

Another explanation could have been the poor quality of loans within indigenous banks compared to foreign banks since private indigenous banks attracted high default risk clients at the bottom of the chain due to their comparatively small sizes. Loan Loss Reserve/Gross loans ratio suggests that indigenous banks also had higher provisions (12.05 percent) compared to other bank types. Interestingly, in 2008 there was a sharp increase among private indigenous banks in both NPL and LLR indicators which may have been a result of the panic and apprehension initially caused by the dollarization of the economy which resulted in increased loan defaults.

5.1.5 Liquidity Ratios by ownership type (2004-2008)

Liquidity management is another important dimension of banks and one that is closely related to corporate governance. This is because solvent financial institutions may be driven towards insolvency by poor management of short-term liquidity. Chapter 2 which discusses the *Historical Background* revealed that most banks which collapsed during the 2003 banking crisis suffered a liquidity crisis which forced them to approach the central bank for liquidity support through the

Troubled Bank Fund (TBF).⁹² Generally, the liquidity of banks is a necessary condition for ongoing banking operations and any severe liquidity challenges can lead to a bank failure.⁹³

One of the ratios used to measure liquidity is loan to asset ratio defined as a ratio of the total outstanding loans to total assets. A high ratio indicates that a bank is loaned up and its liquidity is low which exposes the bank to possibly higher defaults. Another ratio which can measure liquidity is the loan to deposit ratio (LTD). This is the percentage of a bank's loans against its deposits which is used as a gauge of a bank's solvency. The higher the ratio, the more the bank is relying on borrowed funds which are generally more costly than deposits. By international standards, healthy LTD ratios typically fall between 95 percent to 105 percent.

There are two opposing considerations when determining any bank's LTD ratio. First, there is the risk element arising from issues such as economic performance, quality of bank management, the deposit base and lending opportunities (Aryeetey, 1994). Zimbabwe's general economic decline and the liquidity crisis in the banking sector in 2003 may be due to some reason that banks were sceptical to increase borrowing. The effect of these combined factors would lower the LTD ratio. Secondly, banks have to consider the earnings factor, which would result in a higher ratio.⁹⁴ Financial reforms tend to focus banks on increasing their earnings potential, thereby expecting a higher LTD ratio.

A trend analysis of the loan to total asset ratio by ownership type between 2004 and 2008 is undertaken at bank level. The data on individual banks was presented in **Appendix 4**. Table 5.6 reports the results by ownership type.

⁹² The Troubled Financial Institutions (Resolution) Act, Chapter 24:28, Act 31/2004 enacted on January 14, 2005 allowed the Reserve Bank of Zimbabwe to establish the Troubled Bank Fund for the purpose of providing financial assistance to financial institutions in distress.

⁹³ Conversely, maintenance of superfluous liquidity can lead to the underperformance of banking assets and thus to lower profitability of banking firms. However, an unmatched position potentially enhances profitability but also increases the risk of losses.

⁹⁴ McNaughton and Barltrop (1992:13) argue that 'though the appropriate level varies by country. 70-80 percent would represent a reasonable balance between liquidity and earnings' concerns.

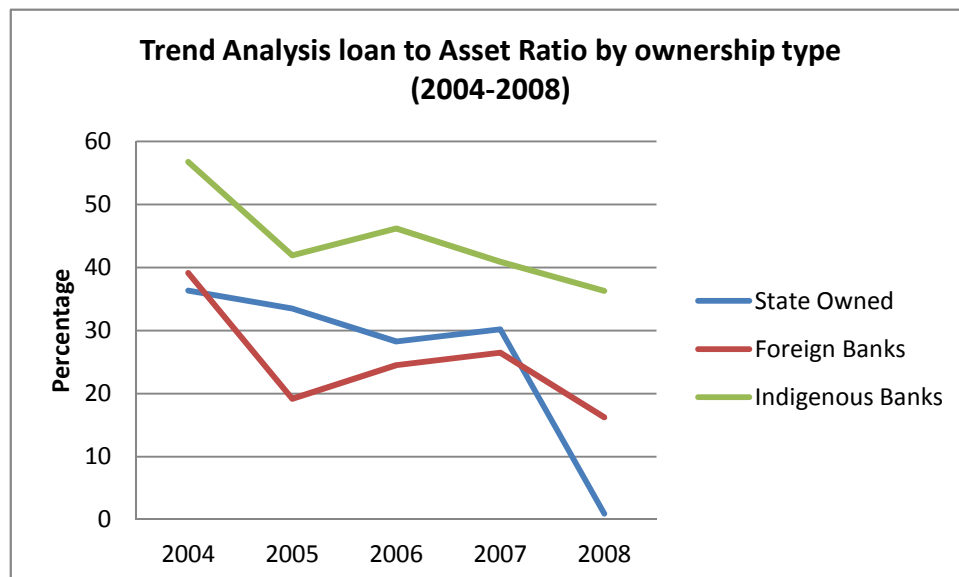
Table 5.6: Loan to Asset Ratio by ownership type (2004-2008)

	2004	2005	2006	2007	2008	Average
Ownership Type						
State Owned	36.35	33.5	28.25	30.20	0.95	25.85
Foreign Banks	39.14	19.15	24.50	26.5	16.20	25.25
Indigenous Banks	56.73	41.91	46.16	40.87	36.25	44.38
All Banks	47.42	31.55	35.13	33.7	23.84	34.32

Source: Researcher's compilation from fieldwork data

On average, there seemed to be a decrease in the loan to asset ratio for the whole banking sector from 47.42 percent in 2004 to 34.32 percent in 2008. It appears that indigenous banks reported loan to asset ratios above the banking sector averages.⁹⁵

Figure 5.4: Trend Analysis of loan to Asset Ratio by ownership type (2004-2008)



Source: Author's own compilation.

Both Table 5.6 and Figure 5.4 show that over the 5 years, private indigenous banks had the highest loan to asset ratio. The trend analysis indicates that indigenous banks had higher liquidity ratios between 2004 and 2005 compared to other banking sectors which may imply poor liquidity within

⁹⁵ ReNnaissance Bank had a high loan to asset ratio of 102.6 % in 2004 and 128.2 in 2006 whilst CBZ Bank reported 73.2 % in 2004. This could have been responsible for the high averages within the private indigenous banks.

the banks. However, there was a general decline in the ratio recorded in the private indigenous banks.

The reduction of the loan to asset ratio between 2004 and 2008 in figure 5.4 could have been a result of reduced lending by most banks. This was due to increased liquidity constraints imposed upon the banking sector over the period. Another possible reason for the more conservative credit practices over this period could be the rigorous lending guidelines introduced in 2004 which resulted in a cautious approach to avoid liquidity problems. The results also indicate a sharp fall in the ratio in 2008. This may have been because of low deposits into banks following the dollarisation of the economy as bank customers unsure of the currency changes, preferred to keep their money outside the banking system.

5.1.6 Sub-summary.

This section analysed the performance indicators of commercial banks in Zimbabwe. Aggregate data on the banking sector as a whole were used to see whether there was significant change in performance the 1999-2003 and 2004-2008 periods. Data at bank level were used to draw a trend analysis over the period from 2004 to 2008.

The findings suggest a positive growth of profitability ratios such as ROA and ROE between the two periods analysed with the differences in the ratios between the two periods being statistically significant using a paired t test. The results also indicate that CIR increased over the same period whilst the NIM ratio reduced but both statistically insignificant. The Asset quality ratios show a marginal increase in the NPL ratio and a decrease in the LLR ratio. However, the paired t test for these two ratios showed no statistical significance over the two periods. The trend analysis of all the performance indicators show that private indigenous banks were outperformed by foreign banks as well as by state owned banks in most of the indicators and in most of the years.

5.2 SCORING CORPORATE GOVERNANCE PRACTISES IN ZIMBABWEAN BANKS

The previous section looked at the performance indicators of banks between 1999 and 2008. In this section, a scoring of corporate governance practices in the Zimbabwean banks is constructed. Corporate governance scoring has been used in literature to assess corporate governance practices in firms (Nam and Nam, 2004). Rating agencies have developed different indices to measure corporate governance practices. Some of the well known indices are FTSE-Institutional Shareholder Services (ISS) Corporate Governance Index, Standard & Poor's Corporate Governance Scores, Dow Jones Sustainability Index and Business in the Community Corporate Responsibility Index. In this section, corporate governance scoring is constructed based on the responses from the questionnaire survey discussed in the previous chapter.

5.2.1 Method of Corporate governance scoring.

Corporate governance scoring is defined by Standard and Poor (2002) as an assessment of a company's corporate governance practices and policies and the extent to which they serve the interests of the company's stakeholders. A corporate governance scorecard has been used in several studies to test for overall quality of corporate governance and firm performance in emerging markets.

Different corporate governance studies have used different methods of scoring. The scoring method used by Black (2000) is based on eight corporate governance elements with different weights, namely, disclosure and transparency, dilution through share issuance, asset stripping and transfer pricing, dilution through merger or restructuring, bankruptcy, limits on foreign ownership, management attitudes towards shareholders and registrar risk. A study by Black, Jang and Kim (2003) chose 42 items from 123 survey questions and classified them into four categories, each with an equal weight of 0.25. The scores by Campos et al (2002) are based on 15 elements of good corporate governance derived from the OECD's principles of corporate governance (OECD, 1999).

The study by Gompers et al. (2003) developed a governance index that was based on 24 firm specific characteristics around shareholder rights. Brown and Caylor (2004) also developed a governance index based on 51 governance factors which finds that higher governance scores drive return on equity and profit margins. The FTSE Research and Institutional Shareholder Service (ISS) which was referred to earlier on produced a joint research report in 2005 about their corporate governance Index (CGI). In their report, they identified five governance areas; ownership, compensation, audit, board and equity structure, on which they based their index calculations.

The CGS method in this chapter will use four corporate governance categories, each with different weights to construct a CGS index. The four categories are ownership structure and influence (OWNS), corporate governance reported problems (CGRP), board structure and Effectiveness (BE) and Disclosure of Information and Transparency (DT). These categories have been used by Cheung and Jang (2004) to construct CGS in Asia.

The data used to construct the scores are obtained from the responses from the Questionnaire Survey discussed in the previous chapter. A total of 28 questions from the questionnaire survey in which the responses required yes or no answers have been classified into the four categories defined earlier. Table 5.7 below details the number of questions and the assigned weights in each category. The scoring model applied the same weight of 20 percent to three of the categories OWNS, BE and DT. A higher weight of 40 percent is applied to the CGRP on reported corporate governance problems. This is because the issues in the CGRP category are of higher significance to this study and may result in distinguishable corporate practices within the banks. The questions in the CGRP category related to placing of banks under curatorships, mergers and acquisitions, whether a respondent bank was fined or censured for corporate governance violations or whether board members were arrested or removed from their positions as a result of corporate governance violations or problems.

Table 5.7: Number of Questions in CGS subcategory and weighting of score.

Subcategory (Area of Corporate Governance).	No. of Questions	Weight %
Ownership and Influence (OWNS)	6	20 % (1)
Corporate Governance Reported Problems (CGRP).	10	40% (2)
Board Structure & Effectiveness (BE)	7	20% (1)
Disclosure of Information and Transparency (DT)	5	20% (1)
Total	28	100%

Source: Author's own compilation.

The 28 questions in the questionnaire were of two types, the first type were those where a 'Yes' response would be desirable in ensuring better corporate governance. For such a question, a value of 1 is assigned if the answer is 'Yes' and zero if the answer is 'No'. The second question type is where a 'Yes' answer is considered undesirable. Accordingly, a value of 1 is assigned if the answer is 'No' and a zero if the answer is a 'Yes'. The same approach is adopted in the scoring model by Cheung and Jang (2004).

After the responses to the questions were converted to numeric values, a final score for individual banks was calculated by using the assigned weights. First, the value of 1 was assigned to each question. For example, each of the seven sub-questions under OWNS were allocated a value of 1/7 (if the answer is 'yes' for desirable questions). Second, the total value earned by the sub-questions was calculated to give a score for that particular category. Third, the total value for each of the four categories of corporate governance (OWNS, CGRP, BE and DT) was calculated for each bank. Fourth, using the assigned category weightings and each bank's category scores the aggregate corporate governance score for each bank was calculated by simply totalling the bank's OWNS, CGRP, BE and DT scores so that each bank is scored out of a full score of 100. Finally, each surveyed bank was ranked using the scores acquired to achieve a more comparative picture. (See **Appendix 5**).

However, corporate governance scoring itself has several limitations. One of the limitations is in regard to converting survey questionnaire responses into numeric values based on whether a

response is desirable or not is a subjective deduction. Whilst there are some questions which can easily be converted into corporate governance scores using the classification above, there are some questions where whether a 'Yes' or 'No' would be desirable may not be as clear-cut.⁹⁶ This is particularly the case in the Ownership Structure (OWNS) category where questions regarding whether ownership concentration is desirable are asked.⁹⁷ Another limitation is that the four categories may not be adequate to cover each dimension of corporate governance which requires examination. With each category, the questions asked may also not cover every bit of the aspects which are intended to be covered. The outcomes of the scoring depend heavily on which questions from the questionnaire survey were included in the scoring.

Scoring the quality of corporate governance practices in banks is subjective and can be controversial. It is unlikely that analysts will agree on whether or not particular aspects of corporate governance should be included within a scoring system, the weight that should be given to each aspect and what scores to give to responses to individual questions. The CGS that has been constructed for Zimbabwean banks in this chapter is a pioneering approach which has not been adopted in any known previous studies. In this study, these limitations may have been mitigated by the broad base from which the survey questions used in the scoring are drawn. The questions cover various elements of corporate governance practices which are particularly important for this analysis.

5.2.2 The Corporate Governance Scoring Results for individual banks.

A CGS is constructed for the 12 banks which responded to the related questions in the survey. The results are summarised in Table 5.8. They indicate that out of a total of 12 banks ranked, the banks with the best CGS rankings are foreign banks, namely Barclays and Stanchart. However, the results

⁹⁶ An example of this could be that the first question in the CGRC section asks whether any of the CEOs of the respondent banks were ever arrested for fraud or corporate governance related issues. In this regard, the arrest would not be desirable, as a result, we award 1 to a "No" response and a 0 to a "Yes" response.

⁹⁷ In this case, the researcher is guided by findings in all other analytical chapters which suggest problems between ownership concentration and corporate governance.

also show that the worst ranked banks Premier ranked 11th and Met Bank ranked 12th were also foreign owned although both banks were previously private indigenous banks until they were taken over by foreign investors following the 2003 financial sector crisis.

Table 5.8: Corporate Governance Score of Individual banks

Bank	OWNS Weight 20% (6)*	Score %	CGRP Weight 40% (10)	Score %	BE Weight 20% (7)	Score %	DT Weight 20%(5)	Score %	Total CGS** (weighted)	Total Score %
State										
Agribank	6	20	7	28	5	14.29	4	16	29	78.29
ZB	6	20	8	32	5	14.29	4	16	31	82.29
Average	6	20	7.5	30	5	14.29	4	16	30	80.29
Foreign										
Stanchart	6	20	10	40	7	20	3	12	36	92
Barclays	6	20	10	40	6	17.14	5	20	37	97.14
Premier	3	10	4	16	6	17.14	3	12	20	55.14
BancABC	0***	0	7	28	6	17.14	5	20	25	65.14
Met Bank	2	6.67	5	20	4	11.43	3	12	19	50.1
Average	3.4	11.33	7.2	28.8	5.8	16.57	3.8	15.2	30.73	71.9
Indigenous										
CFX	3	10	3	12	7	20	5	20	21	62
NMB	4	13.33	5	20	5	14.29	4	16	23	63.62
Kingdom	4	13.33	7	28	7	20	5	20	30	81.33
TN Bank	0	0	10	40	7	20	3	12	30	72
FBC	6	20	7	28	5	14.29	5	20	30	82.28
Average	3.4	11.33	6.4	25.6	6.2	17.71	4.4	17.6	27.58	72.24

Source: Author's own compilation from fieldwork data.

*Percentage is the total weight assigned to the sub category whilst the figures in brackets are the total number of questions in that subcategory.

**CGS (Corporate Governance Scoring) is the total of all the scores for the four categories, OWNS, CGRC, BE and DT.

*** A zero (0) score indicates that the bank did not score any points in the particular category based on all the questions asked.

In general, there is no marked difference in the corporate governance scores across different ownership types with the scores for most banks ranging between 31 and 29 across all banking types.

The results also show that a number of foreign banks (Barclays and Standard Chartered Bank) and some state owned banks (Agribank and ZB Bank) had full scores under the OWNS and CGRP

categories. This may be because none of the foreign and state owned banks were affected by ownership changes and corporate governance violations as was established in the questionnaire survey chapter. The results also indicate that two banks (BancABC and TN Bank) recorded zero scores under the OWNS category which may indicate poor ownership structure within these banks.

When analysed by ownership type, the results show similar average scores for the three ownership types. Private indigenous banks score slightly lower within the CGRP category compared to other bank types. When the scores are averaged, there was little difference in the average scores across the three banking types. Foreign banks had the highest scores (30.73) although this is only marginal to that of state banks (30) whilst private indigenous banks had a slightly lower average score of 27.58. However, the scores for foreign banks could have been higher without Metropolitan Bank and Premier Bank which recorded the lowest scores since these banks were previously indigenous banks recently taken over by foreign investors.

Analysis is made to relate CGS to different classifications of banks. More specifically, analysis is carried out to see whether CGS differs between listed and non listed banks, between stand alone banks and banks as part of a holding company, and between foreign owned domestic banks, and between banks in which CEOs and executive directors control more than 10 percent of the shareholding and those in which they control less. The results in this regard are presented in Table 5.9 alongside the ROE means.

Though statistically insignificant, the comparative results show that banks listed on the Zimbabwe Stock Exchange have higher average CGS (28.5) compared to unlisted banks (26.5). When the means for the ROE ratio for the two are compared unlisted banks have a higher average ROE average (143.71%) which is almost double that of unlisted banks (87.63 %). A possible explanation for the higher CGS among listed banks may be that listed banks have extra corporate governance

compliance procedures which require stringent standards to be observed for the protection of minority investors (Mangena and Tauringana, 2005).

Table 5.9: Corporate Governance Scores (CGS) by Ownership Structure

Ownership Structure	No of Banks	CGS/Mean	P-Values**	ROE/Mean*
Listed Banks.	9	28.5		143.71
Unlisted Banks	3	26.5		87.63
			Pr ([T]>[t])=0.6996	
Stand-alone-Banks	5	28.4		151.02
Part of a Group or Holdings	7	25.8		96.07
			Pr ([T] >[t])=0.6192	
Substantially owned by foreigners	5	27.41		80.06
Others	7	27.71		75.02
			Pr ([T] >[t])=0.9100	
CEO >10 % shares.	3	26.80		117.13
CEO<10 % shares	9	32.33		128.92
			Pr ([T] >[t])=0.0351	
Concentrated ownership Executive >10 % shares	5	25.60		107.43
Diffuse Executive Directors <10% shares.	7	32.63		142.88
			Pr ([T] >[t])=0.0743	

Source: Author's own compilation from fieldwork data.

*Return on Equity (ROE) as at year ending 2008.

** The p-Values in this table relates to a paired t test for the corporate governance score between the two contrasting ownership types.

The results show that stand-alone-banks have higher CGS (28.41) and higher ROE ratios (151.02) compared to those which are part of a group or holding company with lower score CGS (25.8) and ROE ratios (96.07%). However, the difference in CGS was statistically insignificant. Banks that are substantially owned by foreigners seem to have marginally lower CGS compared to local banks.⁹⁸ The difference is however statistically insignificant. It also appears that foreign banks were more

⁹⁸ In this analysis, indigenous banks include state and privately owned indigenous banks.

profitable than locally owned banks.⁹⁹ This is at large consistent with the results presented in the earlier sections of this chapter.

The results in Table 5.9 also reveal that that owner managed banks in which the CEO controls 10 percent or more of the bank's shareholding have lower CGS (26.80) and lower ROE ratios (117.13 %) compared to banks in which the CEO owns less than 10 percent of the shareholding with higher CGS (32.33) and higher ROE (128.92). The difference in the CGS in this regard is statistically significant at 5 percent. The last set of results indicate that banks with diffuse ownership in which executive directors own less than 10 percent of the issued share capital, have higher CGS (32.63) and higher ROE ratio (142.88%) compared to banks with concentrated ownership in which executive directors control more than 10 percent of the shareholding with a lower CGS (25.60) and lower ROE ratios (107.43). The difference in the CGS between these two groups is also statistically significant at 10 percent.

5.3 CORRELATION BETWEEN CORPORATE GOVERNANCE AND BANK PERFORMANCE

The previous section has constructed corporate governance scores using the responses from the survey. This section analyses the correlation between the performance indicators and corporate governance variables drawn from the questionnaire survey. The *Pearson Product-Moment Correlation Coefficient* (r), or correlation coefficient for short is a measure of the degree of linear relationship between two variables, usually labelled X and Y. In this study, the correlation analysis is used to measure the degree of linear relationship between the performance variables and the corporate governance variables. Further, an analysis of the correlation between the corporate governance scores (CGS) discussed in the previous chapter and performance ratios is also made.

⁹⁹ It should be noted, however, that foreign banks in this analysis includes weak indigenous banks which were taken over by foreign investors after the 2003 financial sector crisis.

While in a regression the emphasis is on predicting one variable from the other, in a correlation analysis, the emphasis is on the degree to which a linear model may describe the relationship between the performance and corporate governance variables. In a regression analysis, the interest is directional in that one variable is predicated and the other is the predictor whilst in correlation the interest is non-directional. The only critical aspect in a correlation analysis is the relationship between the variables. Many studies which analyse the relationship between corporate governance and performance often perform a regression analysis since a regression can explain causality (Reaz, 2005).

There are, however a number of reasons why a correlation analysis is conducted in this study. The Zimbabwe banking sector consists of 17 commercial banks and only 12 banks responded to the questionnaire survey from which the data on corporate governance is drawn. In econometrics studies, such a sample size is too small to perform a regression analysis in light of the number of independent variables considered.¹⁰⁰ There was also a limitation in conducting a panel data analysis, although this could have led to an increase in sample size it was difficult to obtain data on corporate governance variables for each year in the time period covered.

5.3.1 Data and variables for the correlation analysis.

The data on performance used in this analysis is the same as that in the previous sections; this was extracted from the Global Credit Rating Company (2009) report. This performance data used in the correlation analysis is for 2009 whilst the data for the corporate governance variables was obtained in January 2010 making the two data sets approximately of the same period. The corporate governance data was obtained from the questionnaire Survey discussed in the previous chapter.

¹⁰⁰ This is because for an equation with one exogenous (or independent) variable, a regression analysis may give poor results with just a few observations, e.g. with less than six, and meaningless results with less than four observation. See A Goldberger (1991). A Course in Econometrics, Harvard University Press, Cambridge, Mass. p.249.

Table 5.10: Definition of Corporate Governance Variables

Board, Ownership and Disclosure Variables		Description
Ownership Variables		
OWTF		Banks in which a foreign shareholder or investor is the majority shareholder.
OWTP		Banks in which the majority shares are held by Private Indigenous investors or owner managers.
PUB		Banks with a public listing on the Zimbabwe Stock Exchange
EXEOWN		Executive Director's share ownership, measured as a percentage of shares owned or controlled by executive directors at the end of the financial year.
LCON5		Level of ownership concentration, measured as the total sum of shares owned by the bank's top five shareholders.
INSTOWN		Institutional share ownership. Measured as the percentage of shares owned or controlled by institutional shareholders, excluding government or governmental owned bodies such as the National Investment Trust.
OCON		Percentage of shares held by the inside board members including executive directors and CEO.
Board Variables		
PROPND		Proportion of Non-Executive directors, measured as the number of non-executive directors on the board divided by the total number of directors on the company's board as at annual report date.
LBQL		Proportion of directors with degree qualifications or above measured as the number of directors with a university degree or above as a percent of the total board.
BDSZ		Board Size, measured as the total number of directors on the board as at the annual report date.
BODBOR		Number of directors who borrowed from the bank as a percentage of the total number of directors as at annual report date.
Disclosure Variables		
LDSC		Voluntary disclosure by banks, measured as an index.

Source: Author's own compilation.

Corporate Governance variables are classified into three categories, namely ownership structure and the control of firms (top ten shareholders as a measure of ownership concentration), board mechanisms (board size and composition), and transparency variables based on level of disclosure by banks. Since the performance variables have already been defined in the previous section, this section discusses the corporate governance variables used in the correlation analysis. These corporate governance variables are also outlined in Table 5.10.

i. Ownership Variables

The ownership type of a bank is believed to have a significant effect on corporate governance (Grosfeld and Tressel, 2001 and Januszewski *et al*, 2002). A study by Mitton (2002) finds that ownership structure related differences of five East Asian countries had a significant impact during the 1997-1998 financial crises. Mitton observes that the differences in corporate governance across firms were a result of variations in ownership structure. In this analysis, the relationship between ownership type and ownership structure variables with the corporate governance variables is explored. The variables **OWTF**, **OWP** are used to denote foreign banks and private indigenous banks respectively.

Whether a bank is listed or not is considered to be an important determinant of a firm's governance as it affects the shareholding concentration as well as creating the opportunity to improve governance through market discipline (Joh, 2003). The variable **PUB** is used for public listed bank. The level of ownership by insiders/executive ownership of banks has been identified as one of the most central issue in this analysis. Many studies have also analysed the impact of insider or outsider ownership of bank on performance.¹⁰¹ The variable **EXEOWN** is used to represent the percentage of shares owned and controlled by the bank's executive directors. The level of ownership concentration within the bank can have negative impact due to potential of expropriation and a positive impact

¹⁰¹ See Agrawal and Knoeber, 1996; Morck et al., 1988; McConnel and Servaes, 1990).

due to better monitoring of executive behaviour. To denote concentration, the study uses the variable **LCONS5** to denote the total shareholding held by the bank's top 5 shareholders.

Institutional ownership is also considered important in analysing ownership structure of banks. Institutional shareholders are believed to make a significant difference in the quality of corporate governance due to their monitoring capacity (Agrawal and Knoeber, 1996; Grosfeld and Tressel, 2001; Learmount, 2002; Black, 1992; Shleifer and Vishny, 1997). The study uses the variable **INSTOWN** to represent the proportion of shares owned by institutional investors. Based on the criteria set in the previous Questionnaire Survey chapter, a bank is defined as owner controlled if any or all of the executive directors control 10 percent of the bank's shares and to be under management control if executive directors control less than 10 percent of the shareholding. The variable **OCON** is used to denote owner concentration.

ii. Board Variables

Board variables are also used as part of the corporate governance variables. Studies by Hawley and Williams (1996), Donaldson and Davis (1994), Trickler (1996) and Turnbull (1995) suggest that board composition and proportion of non executive to executive directors have varying implications on bank performance. The variable **PROPNEED** is used to indicate the percentage of non executive directors to executive directors within the banks.

Banking business is also a highly specialised business requiring the expertise of properly qualified board members to exercise control over management and improve bank performance. The variable **LEBQL** is used to indicate the percentage of directors with a university degree or above on the board. The size of the board is also believed to influence the subsequent monitoring of board activities and performance of firms (Reaz, 2005). The variable **BDSZ** is used to denote board size. To measure inside lending to the board of directors by the banks, the variable **BODBOR** is used.

iii. Disclosure Variables.

During the post-crisis period, Zimbabwe's central bank has given high priority to regulatory changes which encourage disclosure of relevant information in the banking industry. The Corporate Governance Manual (2004) introduced stringent regulations regarding the disclosure of information to stakeholders. To analyse the relationship between disclosure and performance, the variable **LDSC** is used.

5.3.2 Results of the correlation analysis between corporate governance and performance.

Having specified the variables used in the correlation analysis, this section analyses the results of the correlation between corporate governance and performance. The *Pearson Product-Moment Correlation Coefficient* (r) or *correlation coefficient* is interpreted using the established procedure. Firstly, the sign of the correlation (+, -) is interpreted to define the direction of the relationship between the variables. Based on the general statistical interpretation of correlation coefficients, a positive correlation coefficient is interpreted to mean that as the value of one variable increases, the value of the other variable increases whilst a negative correlation indicates that as one variable increases the other one decreases (Lomax, 2007). Second, the absolute value of the correlation coefficient is taken to measure the strength of the relationship between the variables. A correlation coefficient of $r=0.50$ or greater is taken to indicate a stronger degree of linear relationship than one below 0.50 .¹⁰² Lastly, the analysis tests whether the correlation coefficient is statistically significant by interpreting the *p-values*.

The correlation table is presented in Table 5.11 and shows the relationship between the corporate governance variables and the performance variables separately. The results show that a number of ownership variables such as OWF, OWTP, OCON and EXECOWN have a positive relationship with

¹⁰² Likewise, a correlation coefficient of $r=-50$ shows a greater degree of relationship than one of $r=-40$. A correlation coefficient of zero ($r=0.0$) indicates the absence of a linear relationship and correlation coefficient of $r=+1.0$ and $r=1.0$ indicate a perfect linear relationship.

ROA. However, a significant number of the ownership variables show a negative relationship with ROE. In comparison, the results show that most of the board and disclosure variables with the exception of the proportion of non executive directors (PROPNEED) show an expected positive relationship with both ROA and ROE.

When analysed by ownership type, the results indicate that Foreign banks (OWTF) have an expected positive relationship with ROA and an unexpected negative relationship with ROE, whilst private indigenous banks (OWP) have a positive relationship with both ROA and ROE. A further analysis of the correlation matrix between corporate governance and performance shows that only one of the relationships between private indigenous banks (OWTP) and ROE ($r = 0.5641$) is strong and statistically significant.

Table 5.11: Correlation Analysis Results.

CG Variables	ROA			ROE		
	Coeff	P-Value	N (Sample)	Coeff	P-Value	N (Sample)
Ownership Variables						
OWTF	.1271	.6518	12	-.1854	-.5084	12
OWTP	.0441	.8761	12	.5641	.0285*	12
Pub	-.0721	.7985	12	.3351	.2222	12
Execown	.1606	.5674	12	-.2076	.4578	12
LCON10	-.1104	.6953	12	-.4820	.0688	12
INSTOWN	-.1938	.4889	12	-.2982	.2803	12
OCON	.1519	.5890	12	-.1214	.665	12
Board Variables						
PROPNEED	-.0385	.8915	12	.2122	.4476	12
LBQL	.1792	.5227	12	-.0514	.8557	12
BDSZ	.3210	.2434	12	.0343	.9034	12
BBORR	0.546	.8469	12	.1528	.5867	12
Disclosure Variables						
LDSC	.0909	.7474	12	.3793	.1633	12

Source: Author's own compilation.

* Results show a strong relationship between the variables. p-Value statistically significant at 5 percent.

The positive correlation in this regard suggests higher ROE ratios within private indigenous banks. All the other variables show no observable strong relationship between them and are not statistically significant. In general, the results in Table 5.11 indicate that the correlation between corporate governance and performance within the analysed banks is weak and not statistically significant.

Although the results indicate no correlation between corporate governance and performance, the absence of conclusive evidence establishing this relationship does not disprove the claim that good governance leads to good performance. Besides the fact that some studies do not find this relationship to be robust, there are a number of reasons which could explain or may have influenced the findings from this study.

First, most research supports the positive correlation between firm-level corporate governance practices and different measures of firm performance. The link is stronger with market-based measures of performance (that is firm valuation) and weaker with accounting measures (Lomax, 2007). One of the reasons for a weaker relationship when using accounting figures might be explained by the allowed discretion in accounting reporting and the fact that better governance might reduce such discretion (Dedman, 2002). This study uses accounting measures, instead of stock returns, which could explain the weak relationship between corporate governance and performance.

Second, a weak relationship between corporate governance and performance could result from a financial crisis or poor macroeconomic conditions. The findings in some studies suggest that during a financial crisis, best governance practices are actually associated with poorer performance. A study by 3 USC business school professors of 296 financial institutions in 30 countries found that board independence and high institutional investor ownership, which are usually assumed to be good practices, were associated with poor stock performance during the crisis (Erkens et al., 2010). They

further found that financial institutions with more independent boards were more likely to raise equity capital during the crisis, which ultimately resulted in a wealth transfer from shareholders to creditors. The deteriorating macroeconomic climate in Zimbabwe at the time of this study may have contributed to operational inefficiency within banks as a result of the financial crisis.

Third, the findings could also indicate that besides corporate governance, there may be other institutional factors which can affect performance (Rajan and Zingales, 1999; Brownbridge, 1998). In particular, the background section and the survey chapter analysed the effect of regulatory and political factors on banks particularly in developing countries such as Zimbabwe. These include the central bank regulatory policies, the existence of special interest groups and political interference in banks as some of factors which can affect the relationship between corporate governance and performance.

5.3.3 Correlation analysis between CGS and performance.

A correlation analysis between the corporate governance scores acquired in section 5.2 and the performance indicators is also performed. The results for this are presented in Table 5.12.

Table 5.12: Correlation Analysis between CGS and Performance

CG Variables	ROA			ROE		
	Coeff	P-Value	N (Sample)	Coeff	P-Value	N (Sample)
CGS	-.1628	0.6133	12	-.3526	0.2609	12

Source: Author's own compilation

The correlation coefficients show that the relationship between CGS and both ROA and ROE is negative. Both relationships are below the .5 level and both are not statistically significant. This finding is consistent with those in the correlation analysis between performance and other corporate governance variables.

The correlation results in this section must take into consideration some potential limitations. First, correlation analysis in this study seeks to analyse as many corporate governance variables as possible which can affect performance outcomes. It has been observed that if researchers examine the relations among enough variables, then certainly some variables will be significantly related (Lomax, 2007). A large number of corporate governance variables which are analysed in this correlation may have influenced the outcome.

Second, the correlation results show a weak relationship in most of the variables with only a few of the results being statistically significant which may indicate that there is a non linear relationship between the variables. Despite these limitations, in the absence of a regression analysis, correlation results are useful in examining the relationship between the corporate governance and performance variables and establishing whether this relationship is statistically significant or not.

5.4 Conclusion.

This chapter has quantitatively analysed the relationship between corporate governance and bank performance. The analysis has been conducted in three parts, these were; an analysis of aggregate performance of the banking sector, corporate governance scoring, and a correlation analysis between corporate governance variables and bank performance.

The analysis of aggregate performance of the banking sector compared the performance indicators between 1999 to 2003 and 2004 to 2008. A trend analysis of performance by ownership type for the period between 2004 and 2008 was also made by using data at bank level. The results show improvement of profitability ratios (ROA and ROE) between the two periods. The differences in the profitability variables (ROA and ROE) between the two periods were statistically significant whilst the differences in the CIR and NIM ratios were not.

The asset quality ratios indicated an unexpected deterioration in the NPL ratio and a decrease in LLR ratio. The trend analysis between 2004 and 2008 shows that foreign banks reported the highest

profitability, asset quality and liquidity ratios, followed by state banks, with private indigenous banks reporting the lowest average ratios in the same period. None of the changes in relation to the Asset quality ratios were found to be statistically significant.

The second part of the analysis in this chapter constructed corporate governance scores (CGS) for the banking sector based in the responses from the questionnaire survey. It is found that among the 12 banks rated, the two banks with the highest ratings are foreign banks. When the scores are analysed by ownership type, the results indicate that private indigenous banks score only marginally lower than foreign and state banks.

It has been found that banks listed on the ZSE scored higher than non listed ones, but that the difference was statistically insignificant. It has also been established that stand alone banks have higher corporate governance scores and ROE ratios compared to those which are part of a holding group. Banks with professional CEOs have also been found to have higher corporate governance scores and ROE ratios compared to banks with CEOs owning more than 10 percent of the shareholding. The results also indicate that banks with diffuse ownership structures have higher corporate governance scores compared to banks with concentrated shareholding. The performance differences regarding different CEO shareholding and different executive director shareholding were statistically significant at 5 and 10 percent respectively.

The analysis of the correlation between corporate governance variables and performance shows that the relationship between most of the variables is positive as expected although only fewer of the observed relationships were statistically significant. When the relationship between corporate governance and performance variables was analysed by ownership type, the coefficients showed that private indigenous banks had lower ROA coefficient (0.0441) compared to foreign banks (0.1271) although almost all of the relationships between corporate governance and performance variables were found to be weak and not statistically significant. The correlation analysis between

CGS and performance ratios also indicates no statistically significant correlation between the variables.

The results from the three different approaches are largely complementary and consistent. The findings indicate that private indigenous banks had slightly higher performance compared to state banks although foreign banks perform better with regards to aggregate performance and CGS. However, the results indicate no major distinction in corporate governance practices across banks regardless of ownership type. Despite a relationship in the expected positive direction between corporate governance variables and performance indicators, the association is neither strong nor statistically significant.

CHAPTER 6

‘THE BEST WAY TO ROB A BANK IS TO OWN ONE’¹⁰³: CASE STUDIES ON SELECTED BANKS.

6.0. INTRODUCTION

The previous questionnaire survey chapter presented a broad picture of the ownership structures and corporate governance practices in the Zimbabwean banking sector. This chapter use case studies in selected banks to explore the effects of ownership changes on corporate governance. According to the theoretical framework discussed in Chapter 2, the ownership structure and behaviour of bank owners may be shaped by the institutional environment in which they exist and in reaction to the constraints and incentives they face (Zhang, 2002).¹⁰⁴

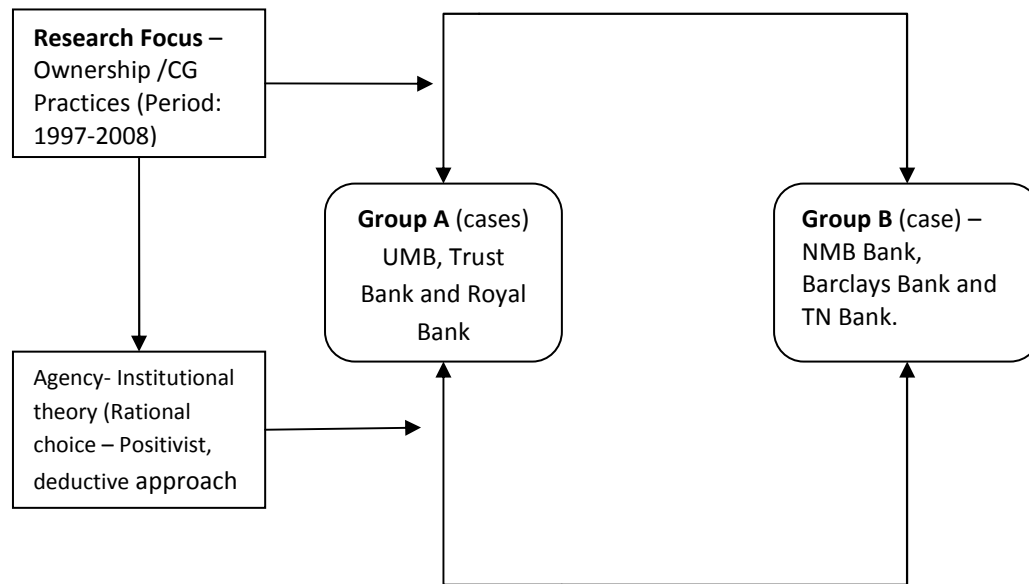
Besides analysing the ownership and corporate governance practices in different banks, the case studies will also explore the impact of the institutional environment such as the legal and regulatory measures and the macroeconomic environment on these practices. In total, six case studies, highlighted in Figure 6.1 are analysed. Cases are grouped into two categories based on whether the banks collapsed or survived the 2003 financial sector crisis. The first section analyse three case studies in Group A, which includes banks that collapsed before or during the 2003 financial sector

¹⁰³ Adapted from William Black’s (2005) *The Best Way to Rob a Bank is to Own One: How Corporate Executives and Politicians Looted the S&L Industry*. In book, William Black lays bare the strategies that corrupt CEOs and CFOs – in collusion with those who have regulatory oversight of their industries-use to defraud companies for their personal gain. Recounting the investigations he conducted as Director of litigation for the Federal Home Loan Bank Board, Black reveal how Charles Keating and hundreds of other S&L owners took advantage of a weak regulatory environment to penetrate accounting fraud on a massive scale. Similarities are drawn in this chapter between Black’s findings and the conduct of some of the CEOs and Executive directors of the banks analysed in some of the case studies.

¹⁰⁴ See also Scott, 2001: 45 who says “from an institutional perspective, legitimacy is not a commodity to be possessed or exchanged but a condition reflecting cultural alignments, normative support, or consonance with the relevant rules”

crisis. These banks were licensed before the regulatory changes which introduced a separation between ownership and control.

Figure 6.1: Case Study design using Multiple Cases



Source: Adapted from Flick, 1998 and author’s modifications

The second section presents evidence from three banks, classified as Group B, which either survived the crisis or were licensed after 2004. The last section concludes the case study analysis by making a comparative analysis of the banks in the two groups.

6.1 Selection of cases

The six banks used as case studies in this thesis were selected using a criterion based on the different fates of the banks following the 2003 financial sector crisis. The selection criterion is detailed in Table 7.1. By strategically choosing the cases in this way, the case studies are to

establish similarities and differences if any, within and among the groups.¹⁰⁵ This cross analysis of multiple case studies is important in theory building and in establishing the circumstances in which a theory will or will not hold (Yin, 1984). This multi-case approach is important in analysing the theoretical assumptions regarding coercive and mimetic isomorphism discussed in the *Theoretical Framework* in which one unit in a population is forced to resemble or has similar characteristics with other units which face the same environmental conditions causing similarity of structure, thought, and action.

Table 6.1: Selection of cases

GROUP	Case Banks	Selection Criteria	Analysis Period
Group A Banks licensed before separation of ownership and control regulations introduced in 2004. (All banks in this category collapsed before or as a result of the 2003 crisis).	United Merchant Bank (UMB)	Private Indigenous bank licensed after deregulation. Liquidated before the 2003 crisis. No ownership limitation when bank was licensed.	Licensed in 1995 after deregulation, collapsed before 2003 crisis.
	Trust Bank	Private Indigenous bank. Collapsed as a result of the crisis and amalgamated into a new state bank ZABG. Listed on ZSE.	Established 1996 after deregulation collapsed as a result of crisis.
	Royal Bank	Private Indigenous bank. Collapsed as a result of the crisis and amalgamated into a new state bank ZABG. Listed on ZSE	Established 2002 collapsed in 2003 as a result of crisis.
Group B Banks which either survived the 2003 crisis or established after the regulations requiring separation between ownership and control.	NMB Bank	Private Indigenous licensed after deregulation, licensed before 2004 but survived the crisis. Listed on ZSE and LSE.	Established 1993 Operated before and after the crisis
	Barclays Bank	Foreign owned bank, established before deregulation. Survived the crisis. Listed on ZSE. Foreign bank was chosen for comparative purposes with private indigenous banks.	Operated before and after the crisis
	TN Bank	Private Indigenous Bank. Listed on ZSE.	Established after the 2003 crisis.

Source: Author's compilation from fieldwork data.

¹⁰⁵ Mitchell, 1983:199-200 argues that case studies can be used to generalize based on ...logical inference, which is the process by which the analyst draws conclusions about the essential linkages between two or more characteristics in terms of some systematic explanatory schema – some sort of theoretical proposition.

The next section examines the three banks in Group A, namely UMB Bank, Trust and Royal Bank. United Merchant Bank (UMB,) was the first bank to collapse since the liberalisation of the financial sector. The second and third case studies present Trust Banking Corporation (“Trust Bank”) and Royal Banking Corporation (“Royal Bank”).¹⁰⁶ The cases in this group are used to explore the ownership structure and corporate governance practices of banks, and any similarities among the banks which collapsed before, or as a result of the 2003 financial sector crisis.

6.2 GROUP A CASES – UMB Bank, Trust Bank and Royal Bank

6.2.1 Background of the cases

The first case study, United Merchant Bank (“UMB”), was established in 1995 by a flamboyant businessman called Roger Boka. The bank was among the first to be granted a license soon after financial sector liberalisation in 1991. The bank was established and managed by its founding CEO, a larger than life figure with political connections and somewhat controversial economic empowerment proponent with no previous experience or qualification in banking. UMB was never listed on the Zimbabwe stock exchange, remaining largely under the control of its founder with no other known shareholders.

As one of the early banks to be established after liberalisation, founded on an indigenisation policy, UMB was active in extending loans to indigenous businesses, politicians and the local market which had previously struggled to access credit from foreign banks. In 1997, two years after it was licensed, UMB suffered a liquidity crisis which crippled its operations. The bank was subsequently closed down after the owner manager skipped the country to the USA fearing arrest. The collapse of UMB had a contagion effect on other financial institutions and some parastatals doing business with the bank.

¹⁰⁶ At the time of its collapse, Trust Banking Corporation (“Trust Bank”) was the biggest bank in Zimbabwe in terms of assets.

Trust Bank, which is analysed as the second case study was registered during the same period as UMB Bank when there was no limitation on the amount of shareholding that individuals could take in banks. The rise and fall of Trust Bank is one of the most debated financial scandals in the history of Zimbabwe's banking sector. The problems at the bank showed how quickly a liquidity crisis could spiral out of control and contaminate the entire sector. The bank was established in 1996, at the height of financial sector liberalisation, by a highly aggressive entrepreneur who was previously responsible for the set-up of NMB Bank, the country's first indigenous owned bank. The bank founder Mr William Nyemba, was previously instrumental in the formation of CAL Merchant Bank in Ghana and National Merchant Bank (NMB Bank) in Zimbabwe.

When it collapsed, Trust was Zimbabwe's biggest bank in terms of assets. As at 26 March 2004, the holding company, Trust Holdings which was capitalised to the tune of Z\$73 billion had also become the second largest company and best performing financial counter on the stock market for the year up to March 2004. The perception was that the central bank would not allow the bank to fail because of its size. Nonetheless, the banking giant collapsed and was placed under curatorship following a liquidity crisis and several allegations of fraud and corporate governance violations against the bank's founder and the executive directors.

Unlike Trust Bank which at the time of its collapse had become Zimbabwe's biggest bank in terms of assets, Royal Bank of Zimbabwe ("Royal Bank") analysed in this chapter as the third case study was a relatively small indigenous bank which collapsed within a very short period from the time it opened its doors to the public. Like UMB and Trust Bank, the bank was established in 2002, before the regulations which required the separation between management and control were introduced. Before Royal bank was licensed, an amendment had been made to the Banking Act to limit ownership by individual investors in banks to 25 percent.¹⁰⁷

¹⁰⁷ Royal Bank of Zimbabwe commenced operations as a fully licensed commercial bank on the 8th of May 2002.

At the time Royal bank was licensed, the economic conditions in the country had started to worsen. A year after its launch, the bank suffered a liquidity crisis in 2003 similar to that in Trust Bank. The bank was then placed under curatorship and later merged into ZABG in 2004. The executive directors of Royal were arrested on fraud charges relating to abuse of depositor's funds. Following protracted negotiations with the central bank, the bank's license was restored and the bank resumed operations in September 2010.

6.2.2 Shareholding Structure of Group A Cases.

The shareholding structure of the three Group A cases shows some similarities. Evidence suggests that Roger Boka owned 100 percent of UMB (Chikuhwa, 2004). The ownership structure of UMB was unique in that the founder's concentrated shareholding and complete control of the bank was the only such recorded case in the Zimbabwean banking sector. An analysis by Chikuhwa (2004) suggests that the owner's ultimate shareholding and control allowed him to use the bank to fund his ambitions to construct the world's largest tobacco auction floors.

When UMB was licensed in January 1995, the banking regulations did not impose a limitation on shareholding by private individuals within the banks. This may have been a significant factor in the ultimate ownership structure in UMB. Based on this assessment, UMB had insider ownership concentration in which the founder and Chief Executive had ultimate control, with 100 percent of the bank's shareholding.

The shareholding of Trust Bank is presented in Table 6.2. The bank's founder and CEO, Mr Nyemba owned 8.64 percent equity in Trust Bank as an individual shareholder whilst the other three founding executive directors controlled a total of 14.12 percent of the banking subsidiary at the time.¹⁰⁸ However, Trust Bank was a subsidiary of Trust Holdings Limited ("THL") in which Mr Nyemba

¹⁰⁸ Besides Nyemba, the other co-sponsors, C Goromonzi, controlled 3.38 percent in the bank whilst the other P, Dhlwayo owned 2.14 percent.

controlled 47 percent of the equity.¹⁰⁹ The CEO's co-sponsors were equally prominent as executive directors since the bank's formative years. One of them headed Trust Merchant Bank (TMB), another subsidiary of the THL, whilst another co-sponsor was the group finance director.

Table 6.2: Director's interests in Trust Bank (2001).

Name of Director	Director Type	Total	% of issued shares
Masaya, TR	Board Chairman- Non Exec	379 807	0.10
Sachikonye, JHK	Deputy Chairman – Non Exec	9 296 363	2.6
Nyemba, TW (Main Sponsor)	Chief Executive Officer	30 767 633	8.6
Chitiga, E	Non Executive Director	3 109 004	0.87
Dhliwayo, P (Co-sponsor)	Executive Director	7 635 712	2.14
Goromonzi, CP (Co-sponsor)	Executive Director	12 072 995	3.38
McDonald, NJ	Non Executive Director	329 807	0.09
Mlotshwa,R	Non Executive Director	50 000	0.014
Total		63 641 321	17.85

Source: Prospectus for Trust Bank (2001).

The co-sponsors also controlled significant shareholding in the holding company as well as in Trust bank itself in their personal capacities. The bank's shareholding structure in Table 6.2 which is based on the prospectus published before the bank was listed in 2001 indicates that of the 356 497 550 issued shares, the total controlled by the bank's executive directors was a total of 63 641 321 shares, which constituted 17.85 percent of the total.¹¹⁰ After, the bank's listing on the stock exchange in 2001, the changes in the shareholding structure shows that the bank's top ten shareholders presented in **Appendix 6** had an even higher concentration of shareholding within the management following the allocation of shareholding to staff. The bank also had a number of institutional shareholders in its top ten shareholder list.¹¹¹

¹⁰⁹ Trust Holdings Limited was the holding company for the bank's subsidiaries such as the Commercial Bank, the Merchant Bank, Asset Management Company and an equities firm

¹¹⁰ According to the Prospectus, direct shareholding was defined as shareholding in the director's individual capacities whilst indirect was shareholding through companies or nominees.

¹¹¹ The Key informant for Trust Bank, who served in a senior capacity in the bank's legal department before the closure of the bank in 2004 indicated that there was no evidence to suggest that any of the institutional investors challenged or questioned the executive directors regarding their expansion plans. The other limitation was that institutional shareholders controlled rather small pockets of shares, with the largest institutional shareholder, NRZ Contributory Pension Funds controlling 8.73 percent. The total shareholding of

Following the collapse of UMB and another bank called Prime Bank in 1998, the central bank decided to update the Banking Act, enacting a new statutory instrument called the Banking Regulations. The new regulatory requirements placed restrictions on the shareholding of banks and limited individuals to holding a maximum of 25% of the equity within a financial institution. The third case study, Royal Bank was licensed in 2002 under this new regulatory framework.¹¹² Table 6.3 lists the initial shareholding structure when Royal Bank was granted a license. The four executive directors who founded the bank (Jeffrey Mzwimbi, Victor Chando, Durajadi Simba and Hardwork Pemhiwa) controlled 90 percent of the shareholding in the bank.

Table 6.3: Royal Bank Initial Shareholding Structure

Name of Shareholder	% Shareholding
Jeffrey Mzwimbi (CEO)	25 %
Victor Chando (Executive)	25%
Durajadi Simba (Executive)	20%
Hardwork Pemhiwa (Executive)	20%
Intermarket Unit Trusts	2%
Michael Tapera	2%
CG Karase	2%
Nomsa Yehudah	2%
Other	2%
TOTAL	100%

Source: Researcher's own compilation from fieldwork data.

The shareholding structure of Royal bank indicates a high concentration of the bank's shareholding by insiders. The sponsors initially sought advice from the Reserve Bank on how to structure the bank's shareholding since they wanted a holding company to be the majority shareholder of the bank following the structure adopted by banks which had been licensed earlier. This was refused by the registrar of banks based on the restrictions in the new regulations which limited non financial institutions to holding a maximum of 25 percent of a bank's equity. Although the central bank

the institutional shareholders within the bank was at 23.05 percent compared to the executive management's voting block of approximately 30 percent.

¹¹² The Banking Regulations required that before being licensed as a bank, the sponsors should have the shareholders, the premises and equipment all in place. Previously one needed only to set up an office and hire a secretary to acquire a banking license. In this case, it was now required that one should bear the risk of setting up and purchasing the IT infrastructure, hire personnel and lease premises without any assurances that they would be granted the license (Makoni, 2010).

expressed its reservations to this new ownership structure, it advised the sponsors to take up shareholding in their personal capacities to satisfy the new requirements (Makoni, 2010).¹¹³ As a result, when Royal bank was licensed, 90 percent of the ownership was concentrated within the four sponsor shareholders in their individual capacities.

Similar to UMB and Trust Bank, the Royal Bank shareholding structure indicates significant ownership concentration. The bank's main sponsor and CEO together with the other co-sponsors who were the executive directors controlled a total of 90 percent of the bank's shareholding which indicates high ownership concentration. In this regard, Royal Bank also had insider ownership concentration similar to that observed in the other case study banks.

6.2.3 Board Structure of Group A Cases

The board structure of UMB Bank indicates that besides being the bank's only sponsor and CEO, Mr Boka was also the bank's Executive Chairman. The profile of the bank's founder discussed earlier indicates that although he was a successful indigenous businessman who was well connected to the political establishment, Mr Boka may not have had the requisite academic qualifications or experience to run a bank as the CEO. A former senior employee in the bank's legal department suggested that, besides Mr Boka, the bank had no other substantive executive directors.

Table 6.4 outlines the profile of the directors who were known to have been associated with UMB. According to the key informant, these directors are said to have left the bank a year after the bank was licensed due to disagreements with the CEO.¹¹⁴ The key informant for this case study noted that at any given time, UMB never had more than three non-executive directors. The key informant indicated that the owner made unilateral appointment decisions in most cases without referring to the board or to management.

¹¹³ When Royal Bank was licensed, the responsibility for registering bank was with the Registrar of Banks in the Ministry of finance office. The central bank in this case was acting in an advisory capacity.

¹¹⁴ Comments attributed to *Interviewee No.8*.

Table 6.4: Profile of the UMB's Directors

Name of Director	Profession	Educational Background	Experience Record
Chairman & Chief Executive Officer Roger Boka	Teacher and Businessman	Teacher training	Farming, paper salesman and Tobacco merchant.
Director 2 Jeffrey Mzwimbi Managing Director Designate.	Career Banker	Diploma in Business Administration Institute of Bankers (SA) International Executive Management.	Involved in senior management positions at a number of banks.
Director 3 Durajadi Simba, consultant and later MD.	Banker	Institute of Bankers (IOBZ) Diploma.	Linked to two collapsed financial institutions UMB and Unibank at senior level.

Source: Author's own compilation from Fieldwork data

In contrast to UMB, when Trust Bank was listed on the stock exchange in 2001, the bank had a board which seemed fairly compliant with international best practice. According to Table 6.5, the board consisted of eight board members of which three were executive directors. Taken as a percentage, non executive directors constituted 62.5 percent of the board. All the founding directors had some banking experience at a senior level as highlighted

Table 6.5: Trust Bank Board of Directors as at June 2001.

Name of Director	Qualification/Experience	Type of Director	%Shareholding
Masaya, Tichaendepi Robert	Senior Lecturer in Economic, served on several boards such as Astra, ZDB.	Chairman and Non Executive Director.	0.10
Sachikonye, Josephat Hatidikani, Kevin	Chartered Management Accountant, several other board appointments.	Deputy Chairman and Non Executive Director.	2.6
Nyemba, Tapera William.	25 years banking experience at senior level, hand in establishment of other banks.	CEO – Executive Director	8.6
Chitiga, Elizabeth	Several other board appointments mainly on parastatals.	Non Executive	0.87
Dhliwayo, Philip Pishai.	Chartered Institute of Secretaries, fellow of Institute of bankers. 25 banking years experience.	Executive Director – Retail Banking.	2.14
Goromonzi, Christopher.	13 years banking experience.	Executive Director-Merchant Banking	3.38
Macdonald, Neville James	Accountant, Partner with Barbour Robb and O'Connor chartered accountants.	Non Executive.	0.09
Mlotshwa Raymond	CEO of a clothing chain Edgars Stores Limited.	Non Executive.	0.014

Source: Prospectus for Trust Holdings Limited (2001).

However, according to a former executive in the bank, most of the bank's non-executive directors were handpicked or connected to the bank's founders and co-sponsors. Although the chairman and deputy chairman of board were non-executives, they both owned shares in the bank.¹¹⁵ Both were said to have been close acquaintances of the CEO and evidence suggests that the Chairman and the CEO were business partners in other ventures (Muranda, 2006). As shown in Table 6.5, all the directors had some shareholding in the bank and therefore none of them were independent. The deputy chairman was a significant shareholder in the bank, owning 2.14 percent of the bank's shareholding which could have impacted adversely on his impartiality.

Royal Bank board had a similar structure with 10 board members two of which were executive directors whilst the rest were non executives. However, only two of the non executive directors qualified as independent directors. The remainder had some ownership interest in the bank or connected to the executives. According to a former senior manager in the bank, the Royal Bank board consisted largely of board members appointed by the bank's founder and CEO. This board structure in which the board members were appointed by the bank's founder and with significant shareholding, mirrors case study findings in UMB and Trust Bank. The directors' association with management and shareholding in the bank may have compromised their independence and capacity to perform their duties of monitoring management decisions.

6.2.4 Corporate Governance Weaknesses in Group A Cases

The ownership concentration in UMB Bank, Trust Bank and Royal Bank and issues such as lack of board independence, lack of core competencies and weaknesses in the internal controls appear to have contributed to poor corporate governance in the banks which may in turn have contributed to their collapse. Some practices which may have been a result of corporate governance weakness are discussed below.

¹¹⁵ The chairman, TR Masaya had a nominal shareholding of 0.10 percent, whilst the Deputy Chairman, Mr J Sachikonye had a substantial shareholding of 2.6 percent in the bank.

The UMB bank owner, Roger Boka sought to live his life as a champion of black empowerment and as an example of the success of the indigenisation policy. Before its collapse, his bank helped many indigenous business people to access loans to start their business ventures under the nationalist exuberance of black empowerments. These loans were often extended without collateral.¹¹⁶ The loans were inefficiently managed and most of those who borrowed from the bank never repaid them. The bank owner was also prone to manipulation by politicians. Evidence suggests that Mr Boka extended loans and financed some politicians from the ruling ZANU PF party using depositor's funds.

An official from the Reserve Bank of Zimbabwe who led an investigation into the collapse of UMB made the comments that in an attempt to buy support, the owner manager would approach cabinet ministers to ask if they needed any financial assistance.¹¹⁷ An example of these unsecured loans to politicians was disclosed by Edgar Tekere, a former Minister of Manpower Planning. He revealed in his biography how he had received substantial financial assistance from Mr Boka in the form of a new car and large sums of money.¹¹⁸

The case study findings discussed in UMB highlighted an extreme case of ownership concentration in the bank. The case study highlighted how the owner manager used his ultimate shareholding to make all the major decisions in the bank without the involvement of the bank's management. Besides being the sole shareholder, the founder was also the bank's CEO and Executive Chairman.

¹¹⁶ It was customary of course for the established banks to demand collateral for loan applications as international best practise, most of the indigenous borrowers who could not provide this collateral were denied credit. Part of the primary objective of UMB was to fill this financing gap which was perceived to exist as a result of the prejudice of foreign banks against local borrowers. One of the reasons why the government could have supported UMB when it was initially established was its willingness to support Zimbabweans and Zimbabwean-owned business who were largely excluded from bank borrowing of all types with the foreign banks preferring to lend to companies owned from abroad or to non-indigenous clients who could provide the collateral required.

¹¹⁷ Reserve Bank of Zimbabwe Report on the collapse of UMB (1998).

¹¹⁸ Edgar Tekere: A Lifetime of Struggle (2007). See **Appendix 7** for an Extract from his book on the loans he received.

As a result, a weakened management and board failed to impose constraints on the owner regarding related party transactions, frauds and patronage loans made to politicians without the knowledge or approval of the board or the management committees. The case study evidence suggests that regulatory weaknesses may have contributed to corporate governance weaknesses in UMB. As noted earlier, the ownership concentration in the bank was partly a result of the lack of ownership restrictions by the regulations at the time the bank was licensed. The bank was awarded a banking license under the euphoria of financial liberalisation. Ordinarily, the bank's sponsor, Mr Roger Boka who seemed to lack the requisite qualifications or experience to run a bank would not have qualified for a banking license had he been subjected to a more rigorous screening process. The case of UMB highlights the contradiction between the government's zeal to open up the financial sector to indigenous ownership and the need to maintain a stable banking sector. Indigenous banks such as UMB were faced with the pressure to increase access to credit to the locals with little or no collateral and at the same time remain commercially viable.¹¹⁹

The bank owner's connectedness to the political establishment may have contributed to acute moral hazards. Firstly, UMB was a beneficiary of significant government deposits which reduced the bank's need to mobilize funds from the public. Secondly, the regulator's failure to take prompt corrective action in the bank is indicative of regulatory forbearance. Third, the evidence from the case study suggests that several of the insider loans made by the bank owner were to prominent politicians which could have increased moral hazards.

The collapse of the bank highlights potential problems with concentrated ownership and related weaknesses in corporate governance. The findings discussed in this case indicate that the problem of related party transactions within UMB can be linked to the bank's concentrated ownership, a more diversified ownership structure and an independent management may have been able to impose at

¹¹⁹ In particular, the government was pleased with UMB's support for local farmers since the government had just announced plans to compulsorily acquire land from white farmers for redistribution to locals.

least some restriction on the owner manager and impose greater constraints on insider lending. In summary, the evidence discussed in this case highlights how an owner manager with concentrated ownership and little if any regulatory and board oversight can exercise dominance within a bank which can result in the abuse of depositor's funds and compromise corporate governance practices.

The case study findings in Trust Bank indicate that that bank had significant ownership concentration. Trust was established and run by the main sponsor who became the CEO, and the other two co-sponsors who were executive directors. The executive directors directly controlled a total of 14.21 percent of the shareholding in the bank. However, the sponsors also indirectly controlled the bank through their significant shareholding in Trust Holdings Limited. The bank's shareholding structure indicates insider ownership concentration in which the executive directors controlled more than 10 percent of the bank's shareholding.

Unlike the UMB case which has been analysed previously, Trust Bank had a board with a non executive chairman and the majority of the directors were non executive directors. However, the board's independence may have been compromised since the chairman and the deputy chairman were close business partners of the CEO and beneficiaries of insider loans from the bank. It has also been noted that all the bank's board members had shareholding in the bank including the chairman and deputy chairman, which could have affected their independence.

Case study evidence in Trust Bank highlighted abuse of depositor's funds by the bank's executive directors, poor internal control systems and allegations of asset stripping. It also revealed the prevalence of related party lending to the directors and to subsidiaries within Trust Holdings. The bank is said to have engaged in highly speculative transactions in an attempt to hedge against rampant inflation and deteriorating macroeconomic conditions. The findings by various investigators into Trust Bank's failure suggests that the executive directors who controlled significant

shareholding in the bank together with non-executive directors, generated or authorised related party transactions for their own benefit (*See Appendix 8*).

This case study suggests that inside ownership concentration and resultant weaknesses in corporate governance such as poor internal control mechanism and lack of board independence may have contributed to the practices which finally led to the collapse of the bank. The case study also shows evidence of regulatory weaknesses by the central bank in the manner in which it addressed corporate governance weaknesses in the bank.

Royal Bank was another case of a bank under the control of its founders who had had concentrated shareholding in their individual capacities. The findings in this case study show similarities in Royal bank, UMB and Trust Bank cases studies in that all these banks had significant ownership concentration with the founding CEOs and executive directors controlling significant shareholding in the banks.

The case study findings suggest that ownership concentration and resultant weakness in corporate governance resulted in fraud and abuse of depositor's funds by the bank owners. These weaknesses contributed to a liquidity crisis in Royal Bank which resulted in the bank's collapse at the height of the financial sector crisis. The case also indicates regulatory failures in the manner in which the bank was licensed and the bank's shareholding structure which was a result of advice from the central bank (*See Appendix 9*).

6.2.5 Sub Summary on Group A cases.

This section has analysed three cases in Group A of banks that collapsed before or as a result of the 2003 financial sector crisis. The three cases indicated ownership concentration in the banks' sponsors who were the executive directors. The case studies suggest that inside ownership concentration and resultant weakness in corporate governance such as poor internal control

mechanisms and lack of board independence may have contributed to the practices which finally led to the collapse of UMB, Trust Bank and Royal Bank.

In all the cases analysed in this section, evidence by forensic experts, alleged that the indigenous owners used their ownership control to extract private benefits of control through tunnelling and expropriating stakeholder interests which resulted in a liquidity crisis. The corporate governance weaknesses in all the three banks emerged as a result of a liquidity crisis which forced them to access liquidity support from the central bank. In the UMB case, the bank's collapse was in 1997 when the Zimbabwean economic crisis is recorded as having commenced.

The corporate governance weaknesses in UMB and how these were addressed by the central bank are strikingly similar to the Royal Bank and Trust Bank case. Despite the allegations against executive directors, none of the directors were convicted on any of the charges. Most of the directors in these banks were never charged with any wrongdoing and for the few who were charged, the central bank failed to secure a conviction in light of evidence they believed was overwhelming which casts a doubt on whether the allegations were true or whether the legal system had the capacity to deal with the complex financial crimes.

6.3 Group B Cases – NMB Bank, Barclays Bank and TN Bank.

This section discusses three cases of banks which either survived the 2003 banking crisis or were established after the regulations requiring substantial separation between ownership and management. The first case is NMB Bank, which changed in 2004 from being an owner managed bank to a separation between ownership and management after the departure of the owner managers. The second case is Barclays Bank, a foreign owned bank which had a separation between ownership and management before and after the regulatory changes. The third case is TN Bank, one of the few banks licensed after the banking crisis.

6.3.1 Background of Group B Cases

NMB Bank (“NMB”) was licensed in 1993 as the first indigenous bank to be set up after the liberalisation of the financial sector in 1991. Having survived the 2003 crisis, the NMB case allows for an observation of the changes in ownership structure before and after the 2004 regulatory changes was introduced. The bank was previously under owner management and suffered a period of acute instability after the flight of its directors, a liquidity crisis and several internal frauds which paralysed its operations. NMB Bank restructured its management after the departure of the owner managers in 2004. The bank has always been considered as a ‘blue-chip company’ and one of the best banks in the country, winning several international awards for best banking practice.¹²⁰

Like the previous case studies, NMB experienced liquidity problems during the 2003 financial sector crisis which forced the bank to access liquidity support from the central bank. During this period, allegations of externalisation of foreign currency were made against the bank’s executive directors. All the bank’s four executive directors in the bank skipped the country fearing arrest. However, unlike UMB and Trust Bank analysed previously, the bank survived the 2003 financial sector crisis and managed to repay the liquidity loan to the central bank.

The profile of the bank’s founding directors suggests that all of them had the requisite skills and experience to become directors in a financial institution. This view is corroborated by an interviewed stock exchange executive who commented that the directors of NMB were ‘eminently qualified to run the financial institution’. Unlike other private indigenous banks registered at the onset of financial sector liberalisation, a key informant from the central bank interviewed suggested that NMB was granted a license on merit rather than due to its political connections although this also

¹²⁰ A blue chip company is defined in investment terms as a well-established and finally sound company. Blue chips generally sell high-quality, widely accepted products and services. The companies are known to weather downturns and operate profitably in the face of adverse economic conditions, which help to their long record of stable and reliable growth.

played a part. Compared to the other banks, NMB appeared to have had the highest concentration of qualified executive directors and management team.

The ownership structure of Barclays Zimbabwe is not different from the other cases in terms of ownership concentration. Since it was licensed, the bank has always been owned and controlled by its foreign parent company. With its parent company in London, United Kingdom, Barclays Zimbabwe enables an analysis of ownership structures and corporate governance of a foreign owned bank. Unlike all the cases analysed previously, neither Barclays Zimbabwe nor its directors were affected by the 2003 crisis. This allows for comparison of the ownership structure and corporate governance issues in Barclays Zimbabwe with the Group A cases analysed in the previous chapter.

Barclays Zimbabwe survived the 2003 financial sector crisis during which a number of indigenous banks collapsed. None of the directors in the bank were affected in the form of arrests, accused of fraud or abuse of depositor's funds. Due to its international character, the bank is believed to maintain higher standards of corporate governance and a traditional approach to banking, focusing on retail banking. A key informant from the central bank expressed the view that there was no record of Barclays Zimbabwe having engaged in speculative, short term investments which were apparent in other banks. This may explain how the bank survived the crisis. The discussions in the historical background chapter suggests that due to its focus on core retail banking services, the bank became one of the major beneficiaries of the financial sector crisis as depositors pulled out their deposits from indigenous banks.

The third bank, TN Bank, a subsidiary of TN Financial Holdings (TNFH) was one of the few banks that were licensed after the 2003 financial sector crisis. The bank was licensed as a commercial bank after TNFH acquired a finance house and thereafter converted the license into a commercial bank in 2009. TNFH was founded by Tawanda Nyambirai in March 2001 following his departure from NMB Bank

where he was a company secretary and general manager in the corporate finance department. When it was established, TNFH operated as an asset management and financial advisory services firm.

Following this acquisition, TNFH established a separate holding company in which the financial services subsidiaries and the furniture company would be held. The result was a convoluted corporate structure in which a new entity, TN Holdings Limited, became the holding company for TNFH, which in turn holds subsidiaries such as Tedco Retail and Springmasters. The group's corporate structure is highlighted in **Annexure 10** and shows TN Bank as a wholly-owned subsidiary of TNFH. Since its formation, the group has been on an aggressive growth plan, growing into a highly diversified group within a short period of time. In addition to the furniture company, TNFH has also added a Medical Benefit Fund company as one of the subsidiaries.

6.3.2 Shareholding Structure of Group B cases.

When NMB Bank was licensed in 1993, the Banking Act placed no restrictions on the amount of shareholding that individual shareholders could hold in banks. Despite being the first private indigenous bank to be licensed, the bank's ownership structure did not typify ultimate ownership as was the case in UMB analysed in the previous section. One of the reasons for this is probably because by 1997, the bank had already listed on the ZSE and on the LSE.

Although the majority shareholder in the bank was an institutional investor, Old Mutual Life Assurance, which controlled 21 percent of the shareholding, the bank's founders controlled a significant amount of shareholding. Dr Julius Makoni (the MD) and James Mushore (the deputy MD) each controlled 10.49 percent of the shareholding through their family trusts, Cornerstone Trust and Alsace Trust respectively as the second and third largest shareholders. Of the other executive directors, Mr Francis Zimuto was the fourth largest shareholder in the bank with an 8.85 percent

shareholding through Wamambo Trust and Mr Otto Chekeche (the finance director) controlled about 3.32 percent of the shareholding.

In total, the four former executive directors controlled 35 percent of NMB's shareholding which indicates a significant concentration of the bank's shareholding by insiders. Based on this shareholding structure, NMB had insider concentration by the four founding executive directors.¹²¹

In this regard, the bank's shareholding structure was similar to that of the banks analysed in the previous chapter. In NMB's case all the 4 founding directors left the bank in 2004 fearing arrest. With the departure of the founders in 2004, all the executives subsequently appointed to manage the bank had no shareholding interest in the bank. NMB's top 10 shareholders between 2007 and 2008 presented in Table 6.6 shows that the bank's largest shareholder was an institutional investor, Old Mutual Life Assurance with a 21.11 percent shareholding.¹²² The shareholding of the banks' former executive directors remained at the same levels despite their departure.

An analysis of the bank's shareholders shows that as at 2008, the bank's top 5 shareholders controlled 57.76 percent of the bank which indicates a degree of ownership concentration. The concentration levels are even higher considering that the top 10 shareholders control 76.37 percent of bank's shareholding. The majority of NMB's shareholding was held by insurance companies, Investments, Trusts and Property companies which controlled 49.79 percent of the banks' shares.¹²³ Insurance companies held a total of 21.11 percent whilst individual investors accounted for 4.32 percent. Table 6.6 indicates that NMB Bank had a concentrated ownership structure before and after the introduction of the 2004 regulations. The only distinction with the banks analysed in the

¹²¹ In chapter 4, a limit of 10 percent was set to distinguish between banks under owner management and those under managerial control.

¹²² Old Mutual is one of the biggest and oldest institutional investors in the country with a history of shareholder activism, often holding executive directors on the companies in which they invest in to account in the boardroom. As a result, Old Mutual has often conflicted with some indigenous companies regarding directionality of business strategy.

¹²³ It must be noted however that within this total, is the indirect shareholding for the former directors held through family trusts.

previous section being that in the case of NMB, after 2004 the shareholders with concentrated shareholding no longer had presence in management.

Table 6.6: NMB Top 10 Shareholders

Name of Shareholder	2007		2008	
	No of shares	% of total	No of shares	% of total
Old Mutual Life Assurance	346 492 017	21.55	346 492 017	21.11
Cornerstone Trust (Former MD)	168 755 799	10.49	168 755 799	10.23
Alsace Trust (Former Deputy MD)	168 755 795	10.49	168 755 795	10.23
Wamambo Trust (Executive Director)	142 260 092	8.85	142 260 092	8.67
M Lynton Edwards Stockbrokers (Pvt) Ltd	118 907 309	7.39	123 424 919	7.52
Drakmore Investments	109 627 112	6.82	109 627 112	6.68
Elsha Investments	53 435 939	3.32	53 435 939	3.26
Martcap Investments	51 090 385	3.18	51 090 385	3.11
Local Authorities Pension Fund	47 676 500	2.96	45 689 628	2.78
Rayvonne Trust	46 137 727	2.87	46 137 727	2.78

Source: NMB Annual Report, 2008

The shareholding structure of Barclays Zimbabwe shows that since it started trading in Zimbabwe and its subsequent listing on the Zimbabwe Stock Exchange, Barclays Zimbabwe has remained a foreign owned bank, with Barclays Bank PLC owning 67.7 percent through a proxy shareholder, Afcame Zimbabwe Holdings. Besides the concentrated shareholding by the foreign shareholder, other shareholders are listed in table 6.7.

Table 6.7: Barclays Bank Top Ten Shareholders (As at June 2009).

Name of Shareholder	Number of Shares	% of shares
Afcame Zimbabwe Holdings P/L	1,457,266,232	67.77
Old Mutual Life Assurance	144,212,218	6.89
Old Mutual Zimbabwe Ltd	124,709,112	5.67
Barclays Zimbabwe Nominees A/C #1	49,375,625	2.29
Fed Nominees P/L	34,869,899	1.62
Mining Pension Fund	14,046,734	0.65
Old Mutual Life Assurance	12,378,857	0.58
Barclays Zimbabwe Nominees P/L-NNR	10,647,726	0.49
Stanbic Nominees P/L-NNR	9,329,541	0.44

Source: Zimbabwe Stock Exchange (2010)

In addition to the proxy shareholder of Barclays Plc, all the other shareholders in the bank are institutional investors, the majority of which are pension funds and insurance companies. The top 5

shareholders in the bank control a total of 83.47 percent of the shareholding in the bank whilst the Top 10 control 85.63 percent indicating a high level of concentration of the bank's shareholding. Although there is ownership concentration, all the top shareholders are institutional investors.

Besides being listed on the Zimbabwe Stock Exchange, the shares of Barclays Zimbabwe are tightly held, with only a small portion of the shares being in the hands of individual investors. The current CEO has no shareholding in the bank, which is quite different from the cases of the other banks analysed so far, where the CEO was the main sponsor and the majority shareholder in the banks. On the bank's current board, only one of the executive directors owns a small and rather insignificant number of shares in the bank in his individual capacity. In this regard, the bank has a substantial separation between ownership and management.

One of the distinctions between the ownership structure of Barclays Zimbabwe and that of the other cases analysed so far is that, since it was established in the 1800s during the colonial era, the bank has been run by professional managers who have little or no equity interest. Although one executive director owns a small fraction of the bank's shares in their personal capacity, the total percentage of this shareholding is below one percent. Historically, the bank has always had a separation between ownership and management. The distinction between Barclays Zimbabwe and the previous case studies lies in that there is no significant insider ownership in Barclays Zimbabwe.

The shareholding structure of the third bank in Group B cases, TN Bank shows that the bank is a wholly owned subsidiary of TNFH. All the directors (executives and non executives) in TN Bank have no shareholding in TN Bank and none of them were the bank's sponsors. On the face of it, it would appear that TN Bank has a separation between ownership and management. However, a better understanding of the entire group's shareholding structure requires an analysis of the shareholding structure of TNFH and TN Holdings. This is because these two holding companies control the shareholding in TN Bank.

As indicated earlier in the history of the company, TNFH's takeover of a furniture firm, Tedco resulted in a restructuring of the company. As a result, TNFH itself is now a subsidiary of TN Holdings, a more diversified holding company. Table 6.8 shows the shareholding structure of TNFH in which TN Bank is a wholly-owned subsidiary.

Table 6.8: TNFH Limited Top 20 Shareholders

Rank	Detailed Shareholding	Number of Shares	%
1	A Simba Private Equity Partners (Pvt) Ltd	70 325 560	13.32
2	Almond Trust	36 794 181	6.97
3	Dominion Trust	36 794 181	6.97
4	Remnant Trust	36 794 181	6.97
5	Mamre Trust	36 794 181	6.97
6	Olive Trust	36 794 181	6.97
7	Awesome Trust	31 790 375	6.02
8	Tawanda Nyambirai	21 989 190	4.16
9	Serene Trust	18 397 091	3.48
10	Remembrance Trust	15 834 244	3.00
11	Abba Trust	14 035 863	2.66
12	George Nyashanu	13 448 693	2.55
13	Zimbabwe Spinners And Weavers Limited	13 237 913	2.51
14	Hallowed Trust	12 349 438	2.34
15	William Marere	12 345 044	2.34
16	A Simba Holdings (Pvt) Ltd	9 000 000	1.70
17	Equivest Nominees (Pvt) Ltd	6 954 648	1.32
18	Everjoice Nadzo	5 984 236	1.13
19	Msasa Nominees	5 919 630	1.12
20	Others	92 413 057	17.50

Source: Author's compilation from Fieldwork Data

The majority shareholder in TNFH is A Simba Private Equity Partners, with a 13.32 percent shareholding. This is the investment company of Mr Simba Mangwende, the founder of Tedco, the company that was acquired by TNFH. The result of the takeover of Tedco by TNFH was that Tedco directors would swap their shareholding in Tedco for TNFH shares. Consequently, Mr Mangwende swapped his 57.74 percent majority shareholding in Tedco for a 13.32 percent of TNFH shares making him the majority shareholder in TNFH. The total amount of shareholding under control of the executive directors and the former Tedco owner in TNFH is therefore approximately 23.50 percent.

However, as indicated earlier, TNFH itself is now a subsidiary of TN Holdings which is the enlarged bank holdings company. The shareholding structure of this enlarged Holdings Company indicates that the majority shareholder of TN Holdings is TNFH, which controls 69.7 percent of the shareholding. The main sponsor and Group CEO, Tawanda Nyambirai, is the second largest shareholder in TN Holdings in which he controls 18 percent of the shareholding through Nyambirai Associated Trust. For this reason, although the group CEO only controls 4.16 percent of the shareholding in TNFH, he has indirect control of the bank through TN Holdings Limited. As a result, the group CEO indirectly controls all the subsidiaries under TN Holdings including TN Bank through a complicated cross shareholding structure.

The Group CEO's shareholding is higher than the allowed 10 percent threshold of the 2004 regulation. The regulatory restriction applies to anyone in management of the bank or the bank holding company. TN Holdings and TNFH which directly or indirectly control TN Bank and other subsidiaries are categorised by the central bank as 'bank holding companies' regardless of the fact that there are other subsidiaries in the holding company with non banking services. The Group CEO indicated in an interview that he had applied for, and was granted a special dispensation by the central bank which allowed him to stay in his position as Group CEO despite his substantial shareholding.

The granting of a special dispensation for a limited time to the Group CEO by the central bank was on the basis that the bank was relatively new, and required the guidance of the founding shareholders through a critical growth phase. Granting a special dispensation to the CEO of TN Holdings who owned 18 percent of the shareholding appears to be a result of a weak or inconsistent enforcement of the regulations since the Corporate Governance Manual (2004) which introduced the requirement does not give the central bank the discretion to offer a special dispensation in some circumstances. In this regard, there is no marked difference between TN Bank and the other banks analysed in the previous chapter with regards to the ownership structure.

6.3.3 Board Structure of Group B Cases.

Besides the restructuring of the management team in NMB after the departure of the owner managers discussed in the previous section, the bank's board of directors experienced several changes between the two periods covered in this analysis. Prior to 2004, NMB had a diverse board which included foreign experts with international banking experience. The board had prominent lawyers and accountants who were non-executive directors.

The board chairman, Mr Paddy Zhanda, was a non-executive chairman, although he had connections with the executive directors. Mr Zhanda was also a senior figure in the ZANU PF government and is believed to have been key in the bank being granted its license.¹²⁴ Table 6.9 which lists the NMB bank directors as at 2002, shows that the bank had a total of ten board members, six of which were non-executive directors. Another distinguishing feature with the NMB Board at that time was that at least two of the six non executive directors were international financial experts who were not resident in Zimbabwe.

Table 6.9: NMB Bank Directors as at 2002

Executive	Non-Executive
Dr Julius Makoni (Managing Director)	Paddy Zhanda (Non Executive Chairman)
James Mushore (Deputy MD)	Dr C.J Constable
Francis Zimuto (Executive Director – Banking)	James Friedlander
Otto Chekeche (Finance Director)	Arthur Mutsonziwa
	Freeman Kembo
	Mr ML dos Remedios

Source: Author's compilation from fieldwork data.

¹²⁴ Mr Zhanda later became a Member of Parliament in the 2008 Parliamentary elections becoming the chairman of the Parliamentary Portfolio Committee on Budget, Finance, Economic Planning and Investment Promotion. There is however no direct evidence to suggest that Mr Zhanda assisted the directors in acquiring the banking license.

Following the departure of the executive directors in 2004, most of the bank's non-executive directors also resigned for various reasons, plunging the bank into chaos. According to an informant interviewed, the resignation of the board members may have been due to the problems which affected the banking institution following the departure of the executive directors.

When interviews were conducted at the bank in March 2010, the NMB board had twelve directors, ten of which were non-executive. The chairman of the board and those of the Board sub-committees were all non-executive. The changes in the bank's board structure indicate an increase in the number of non executive directors from six in 2002 to ten in 2010. The bank's 2008 annual report indicates that the bank had constituted several board committees outlined in **Appendix 11**. The majority of these sub-committees are made up of and chaired by non executive directors. In particular, the Audit committee, Loans Review Committee and the Remunerations committee were entirely constituted of non-executive directors in accordance with international best practice on corporate governance.

The board of Barclays Zimbabwe is chaired by a non executive director. The board has a total of nine board members, six of which are non executives constituting 66.67 percent of the entire board. This complies with the combined code (UK) and the Zimbabwe Corporate Governance Code. The Barclays Zimbabwe board also closely mirrors the Barclays PLC board which has a total of 13 directors with 11 of them being non-executive directors.¹²⁵ Besides the main board, Barclays Zimbabwe also has an Audit Committee, Human Resources Committee, Credit Committee and a Loans Review Committee which are all chaired by a non-executive director.

¹²⁵ See www.barclays.com. As at 2011, the bank's directors are Marcus Agius (Chairman), Robert Diamond (CEO), Chris Lucas (Executive Director), David Booth (NED), Sir Richard Broadbent (NED), Alison Carnwath (NED), Fulvio Conti (NED), Simon Fraser (NED), Rueben Jeffry 111(NED), Sir Andrew Likierman (NED), Dambisa Moyo (NED), Sir Richard Rake (NED), Sir John Sunderland (NED).

Table 6.10: Barclays Bank Zimbabwe Board structure. (30 June 2010).

Executive Directors	Shareholding	Non Executive Directors	Shareholding
GT Guvamatanga (MD).	Nil	AS Mandiwanza (Chairman)	5 117
S Matsekete	10 000	I Diouf	Nil
J Phiri	Nil	CF Dube	3 000
		E Fundira (Mrs)	2 415
		A, J Lawson	15 642
		Prof H Sadza.	Nil

Source: Barclays Audited Financial Statement (June 2010).

TN Bank (TNFH's wholly-owned subsidiary)¹²⁶ has a separate board from that of the two holding companies. The board of the banking subsidiary is outlined in **Appendix 12**. All the directors of TN Bank have no shareholding in the banking subsidiary since it is owned 100 percent by TNFH. None of the directors in TN Bank are founders of TNFH or TN Holdings. However, as highlighted in the analysis of the bank's shareholding structure earlier, a fuller picture of the bank's board structure would require an analysis of the board structure of TN Holdings and TNFH.

The TN Holdings board of directors shown in Table 6.11 indicates that the ultimate holding company has a total of 11 board members. Nine of these are non-executive directors whilst two are executives. The board structure of TNFH had a similar pattern to that of TN Holdings, with eight non executives and two executive directors.

Table 6.11: TN Holding (Bank Holding Company) Board of Directors – As at July 2011

Executive	Non Executive
Tawanda Nyambirai - Group CEO (LLBS).	Harry Kantor - Non Executive Chairman (LLBS)*
George Nyashanu (B Acc, CA).	Richard Summers (FCIS)
	William Marere (B.Acc)
	Rugare Chidembo (B Acc, MBA, CA)
	Beatrice Mtetwa (LLBS)
	Alex Danso (B Med, MSc)
	William Leith (B Acc).
	Boyman Mancama (BA Econ.)
	Simba A Mangwende (B Compt, CA)

Source: Author's compilation from fieldwork data.

* The qualifications of the board members are in brackets.

¹²⁶ Repeated here for purposes of clarity due to the Bank's complicated ownership structure.

The composition of the three boards (TN Holdings, TNFH and TN Bank) complies with the central bank's Corporate Governance Manual (2004), which requires that executive directors should constitute no more than two-fifths of the total members on the board whilst non-executive shareholders should be in the majority. The qualifications of the directors in all the three boards indicate a diversity of skills. The chairman of TN Holdings is a non-executive director. However, according to a key informant interviewed for this company, most of the non-executive directors in the three boards were appointed or have connections with the group CEO.

6.3.4 Corporate Governance and internal control mechanisms in Group B banks.

In appearance, NMB Bank's corporate governance practices have always been regarded to be higher than those of other indigenous banks. This may be because besides complying with local corporate governance guidelines such as the Reserve Bank of Zimbabwe (RBZ) Corporate Governance Guidelines and the Zimbabwe Stock Exchange requirements, the bank also followed a set of principles of corporate governance derived from the code of best practice in the UK's Combined Code on corporate governance. Since the bank has a dual listing on the London Stock Exchange, it is required to meet the LSE minimum corporate governance requirements. In this regard, NMB's corporate governance practices are subject to extra scrutiny from international shareholders.

A senior executive in the bank who was interviewed confirmed the importance of NMB's dual listing and indicated that this may have contributed to the adoption of best international practise by the bank. The bank's level of disclosure is also high with its annual statements submitted and published at the London Stock Exchange. In its various annual reports, the bank declares that it follows local and UK corporate governance principles together with other regional codes such as the King Corporate Governance Report of South Africa.

However, according to a key informant from the central bank interviewed, although NMB Bank appeared to have implemented sound internal control systems which resulted in adequate checks

and balances in the bank, there were several internal control weaknesses in the bank which resulted in speculative investment and management frauds. The ownership concentration by the executive directors prior to 2004 may have been a factor in the practices adopted by the bank, particularly with regards to speculative investments such as foreign currency trading.

Unlike in the previous cases in which information regarding corporate governance weaknesses was collected from various data sources, there is no evidence collected by this research of corporate governance weaknesses in Barclays Zimbabwe. As a result, the data regarding whether or not there were related party or fraudulent transaction are based on the bank's responses from the questionnaire survey. The bank's survey responses indicate that there were no reported frauds or related party transactions in Barclays Zimbabwe. This was corroborated by a central bank official who was interviewed who confirmed that there were no reports of this nature against the bank. He expressed the view that one of the reasons why Barclays Zimbabwe was not affected by the 2003 crisis may have been because the bank did not depart from its core activities unlike other banks which engaged in speculative investments to hedge against inflation. A senior officer in the bank's legal department who was interviewed commented on the bank's internal systems commented that;

“The internal protection mechanisms within the bank are highly effective; one of the reasons for this is intensive staff training and guidelines on Code of Conduct, Anti Money Laundering, Speak Up policy and Conflict of Interest.”

The officer pointed out that the bank's Financial Crime Risk department helps to curb fraud and money laundering activities by staff and customers. He observed further that although local laws or national codes take precedence over group codes, in most areas the Bank would have already developed its corporate codes to be in alignment with those of its parent company, which resulted in a higher standard of corporate governance.

However, despite there having been no reports of corporate governance weaknesses in the bank, it can also be argued that Barclays Zimbabwe despite the macroeconomic environment at the time, and even if the bank had suffered a liquidity crisis like the other private indigenous banks, the bank may still have survived the crisis due to financial support from Barclays Plc. Nonetheless, the absence of frauds and insider transactions in Barclays Zimbabwe may indicate sound internal control mechanisms in the bank.

One of the issues reported in the Group A cases was the prevalence of insider loans to related parties such as the bank's executive directors, connected business or to the bank's holding company. An executive who was interviewed in TNFH disclosed that the banking subsidiary, TN Bank, had extended loans to related parties. The responses from the bank's questionnaire completed by the bank's legal secretary also confirm that some loans were extended to executive and non executive directors. Evidence from Reserve Bank statements corroborates this finding. The disclosures by TN Holdings to the central bank indicate that in 2010, TN Bank had extended significant insider loans amounting to US\$2,67 million, against the bank's verified core capital of US\$11,01 million. The executive who was interviewed indicated that the borrowing by insiders had been properly disclosed in the financial statements to ensure transparency. Nonetheless, it is un-deniable that there were significant levels of insider loans to connected shareholders, which is similar to that observed in the other private indigenous banks analysed.

Besides the reports of related party loans being extended to directors, there were no reports of fraud or the arrest of the executive directors for abuse of depositor's funds in TN Bank. A key informant from the central bank corroborated the survey responses, indicating that the bank appears to have implemented sound internal control systems with checks and balances to avoid fraudulent transactions. However, it should be noted that lack of reported corporate governance violations in the bank do not necessarily mean that the bank had an impeccable corporate

governance record. As noted earlier, this may just be because the bank has only been operational for about 2 years compared to the other banks which were established much earlier.

Despite operating for less than two years, TNFH and the banking subsidiary has adopted an aggressive growth plan which has resulted in a highly diversified banking conglomerate with interests in non banking activities which was previously discouraged by the central bank due to the risk of cross lending and the potential for corporate incest.¹²⁷ This aggressive growth strategy appears similar to that adopted by banks such as Royal and Trust Bank, which may indicate poor risk management practices.

6.3.5 Corporate governance weaknesses and related practices in Group B cases.

The case study evidence in the Group B banks, NMB Bank, Barclays and TN Bank also revealed some corporate governance weaknesses in some of the banks. In spite of multiple supervisory corporate governance structures, there were several allegations of impropriety made against NMB Bank and its directors which may indicate poor internal control mechanisms within the bank. In the case of NMB, unlike in the previous case studies such as Royal, Trust or UMB analysed earlier where the allegations suggest that the directors engaged in opportunistic behaviour for their personal benefits, the allegations against the NMB directors were that in their official capacities as directors of the bank: the directors authorised transactions by NMB which violated the law resulting in prejudice to the country. According to the informant interviewed, these externalisation allegations were made by a former employee who was the whistleblower to the central bank.¹²⁸

¹²⁷ The only other bank to have adopted such a diversified structure into non banking activities was Kingdom Meikles African Limited (KMAL).

¹²⁸ The whistleblower, identified in central bank papers as Reginald Magejo was a former manager in NMB's IT department. It is alleged that Magejo was dismissed from the bank after he used a forged bank statement in order to acquire a visa to travel to the UK. Magejo is alleged to have used one of the executive director's bank statements in his visa application, substituting the name on the statement with his own. He was denied the visas after British embassy officials called the bank to confirm the statement and were alerted of the forgery. The bank's directors attempted to bring disciplinary proceedings against him but he quit the bank before any action was taken. He warned the NMB directors that he would bring the bank down because he knew a lot.

Soon after the restructuring of management after the departure of the owner managers in 2004, NMB suffered a US\$6 million managerial fraud after a junior manager in the treasury department swindled the bank in what may have been one of the biggest frauds in the history of the Zimbabwean banking sector. Besides being indicative of poor internal control systems, the fraud case highlighted the problem that where there is a separation between ownership and management, owners are unable to effectively monitor internal affairs in the bank. This vacuum of monitoring after the departure of the owners in 2004 could have given room to managers to engage in frauds and private benefits at the detriment of other stakeholders (Shleifer & Vishny, 1997).

The case study suggests that NMB experienced problems relating to poor internal control systems both before and after the 2004 regulations were introduced. Before 2004, the externalisation allegations against the former directors related to the set up of a subsidiary at London Trust Bank in the UK to undertake illegal foreign currency transactions, a decision which was authorised by the executive directors without the involvement of the board. This indicates the undue influence that the executive directors had in making unilateral decisions based on their collective shareholding. The fraud by the manager after 2004 highlighted the problems of weak monitoring which can occur after a separation between ownership and management. These corporate governance weaknesses in NMB indicate poor internal control systems before and after 2004.

The responses from NMB bank's questionnaire survey indicate that the bank extended some loans to its executive directors when they were still at the bank. It was reported by the respondent that some executive directors had borrowed or attempted to borrow from the bank to fund their personal business ventures between 1991 and 2003. There was also an indication that the bank had extended loans to its holding company. However, the questionnaire survey data noted that none of the executive directors were ever questioned charged or arrested by the police regarding any loans

NMB reported the case to the police and he was arrested and immediately released. In the course of his police interview he is believed to have cut a deal and provided the police with the evidence they required to make a case against the directors.

taken out. The extension of loans to executives in NMB was similar to the practises observed in the banks analysed in the previous chapter.

The evidence discussed in this case study show some similarities between NMB Bank and previous cases in particular in the period before 2004. Like other indigenous banks established before 2004, the bank had concentrated ownership with the founding executive directors controlling 35 percent of the shareholding. The bank had a concentration of shareholding within insiders before 2004. However, following the introduction of the new regulations in 2004, the bank had a separation between ownership and control.

NMB Bank had been suffering from weakness in corporate governance both before and after 2004. Before 2004, internal control weakness as a result of un-checked power of the founders had led to the persistent allegations of illegal foreign currency trading. As a result of this, the bank's foreign currency trading license was withdrawn. The bank's directors also fled the country fearing arrest for foreign currency violations. After 2004, management fraud was alleged when there was a vacuum of monitoring following the departure of the owner managers. This pointed to internal control weakness in the bank which allowed managers to expropriate private benefits of control.

An interesting question to ask is why NMB survived the financial sector crisis whilst the other three previously analysed banks collapsed? First, NMB is the only indigenous banking bank with a dual listing on the London Stock Exchange.¹²⁹ This listing may have positively influenced corporate governance in the bank, by for instance, compelling the adoption of international best practices. Second, despite allegations of externalisation, insider loans and a possible abuse of depositors' funds were made, these have not seemed to affect the bank's capital position compared to the other case studies. Third, although NMB accessed liquidity support from the central bank in 2004, the bank paid off this facility to the central bank, escaping its compulsory collapse into ZABG. In comparison, Trust

¹²⁹ The only other indigenous bank with a dual listing is BancABC which has its primary listing on Botswana Stock Exchange and a secondary listing on Zimbabwe Stock Exchange.

and Royal Bank who also accessed liquidity support from the central bank failed to pay the loans back resulting in the banks being declared insolvent and collapsed into a new bank, ZABG, following a period of curatorship. Fourth, the regulatory or political forbearance could have resulted in the bank receiving a different treatment from other private indigenous banks with the same circumstances.

In the case of Barclays Bank, the case study evidence shows a high concentration of shareholding by the bank's parent company before and after the introduction of the 2004 regulations. However, it is apparent that the bank's executive directors had little or no shareholding in the bank, which indicates a separation between ownership and management throughout the history of the bank's operations in Zimbabwe. This contrasts to all the other banks analysed so far, where there was insider ownership concentration by the executive directors.

The analysis also indicates that the bank's internal control mechanisms may have been more effective and contributed to preventing related party transactions, asset stripping and stopping management from engaging in self-interested behaviour. Neither the bank nor its individual directors were affected by the crisis or the new regulatory policies introduced in the aftermath of the crisis. The case study evidence suggests that the bank was in many respects, already compliant due to a long history of good corporate governance practices.

One of the major reasons for the good corporate governance practises cited by the Barclays Zimbabwe's executives interviewed was that as a foreign bank with its head office in London, the bank had multiple layers of rules to comply with. These included its internal corporate rules, local laws and international corporate governance codes such as the Combined Code, applied in the United Kingdom where the bank is domiciled.

The case study findings also indicate that Barclays Zimbabwe was one of the major beneficiaries of the 2003 financial sector crisis as a result of a 'flight to quality' as depositors moved their deposits

from the 'unstable banks' private indigenous banks which had been affected by the crisis to the 'traditional foreign banks' which were perceived to be conservative.¹³⁰ Good corporate governance in the bank paid off when depositors were willing to punish risky behaviour in banks which engaged in speculative activities and seek refuge in banks such as Barclays Zimbabwe which were considered safer, traditional and conservative in their approach.

The case of TN Bank has been used to explore the ownership structure of a bank which was granted a license after the 2004 regulations which introduced a separation between ownership and management. The evidence discussed suggests that TN Bank has insider ownership concentration due to cross-shareholding by the executive directors in the holding companies. In this sense, the insider ownership concentration in the company is similar to that observed in UMB, Trust, Royal Bank and NMB Bank cases, where the bank's main sponsors formed part of senior management.

Despite the regulatory restrictions which separate ownership from management, TN Holdings' Group CEO controlled more than 10 percent of the shareholding through cross-shareholding. The group CEO who is the majority individual shareholder in TN Holdings remained as the CEO of the holding group after acquiring a special dispensation from the central bank. His appointment despite the regulations may indicate weakness in the enforcement of the regulations. Despite being the only bank licensed after 2004, the ownership structure of TN Holdings and its banking subsidiary did not comply with the new regulatory requirements which were meant to address the problem of ownership concentration.

There is an indication of high levels of insider loans similar to those reported in the previous cases. This might not be surprising in light of insider control through cross-shareholding. However, there have been no allegations of the abuse of depositor's funds or fraudulent activities by the bank's

¹³⁰ During the last quarter of 2009, figures released by the central bank showed a deposit concentration of 68.4 percent within the country's top five banks, Standard Chartered Bank, Barclays Bank, CBZ Bank, Stanbic Bank and FBC Bank which may have been a result of this deposit flight.

executive directors. One of the reasons for this could be that the bank has only been operating for the past two years, which could be a short period for the results of corporate governance weaknesses to surface.¹³¹

6.4 Comparative Analysis of the Cases Studies.

The previous sections have analysed ownership structures and corporate governance of six banks in Zimbabwe. The first three case studies were banks which were established before the 2003 financial sector crisis but which all collapsed before or as a result of the 2003 financial sector crisis. The case study findings in these three cases highlighted inherent corporate governance weaknesses which could have contributed to their collapse. Characteristically, all the banks in this group were owner managed with concentrated shareholding by the executive directors.

The other three banks in Group B either survived the 2003 banking crisis or were established after the regulations requiring a separation between ownership and management.¹³² The banks in this category also exhibited a concentration of shareholding. One of the banks is foreign owned, while another was established before 2003 and survived the crisis, the other was established after 2004. This section makes a comparative analysis of the two groups of banks and highlights the differences and similarities in ownership structure and corporate governance.

6.4.1 Ownership Structure

i. Comparative Analysis.

This section makes a discussion on the ownership structure of the banks and examines how these ownership arrangements may have affected or influenced corporate governance practices. Table 6.12 below, summarises the ownership structure of the six banks. An analysis of the shareholding structure of the banks indicates that all Group A banks were *owner managed*, with the CEO as the

¹³¹ This must however be interpreted cautiously since the bank was licensed in 2009 and opened its doors to the public in 2010.

¹³² Group B cases.

controlling shareholder. In the case of Trust Holdings Ltd this was through proxies. The banks also had high levels of shareholding by executive directors. After the ownership restrictions were introduced in 2004, evidence from the category B cases indicates that all the banks still had concentrated ownership although two of the three banks had a separation between ownership and control.

There were some similarities between the ownership structure in NMB before 2004 and the Group A banks although the bank had a separation between ownership and management after 2004. However, NMB Bank has now recently come under owner management with the return as CEO of one of the bank's founders who owns over 10 percent of the shareholding. The third bank, TN Bank was under owner management as a result of a special dispensation granted by the central bank for the founder who had more than the 10 percent shareholding limit to remain as CEO of the group.

The case study evidence indicates ownership concentration across all the cases before and after 2004. The findings also highlight insider ownership concentration in all the private indigenous banks or banks that were previously private indigenous for the period before and after 2004. These banks, which had high levels of ownership concentration by insiders suffered corporate governance problems which resulted in their collapse.

Despite operating for a short period of time, the case study evidence also indicates significant insider loans in TN Bank in 2009, although these had been declared to the central bank. The case of Barclays Zimbabwe shows that ownership concentration may not always be a bad thing. Concentrated ownership may give incentives to monitor the management. The differences between Barclays and the other cases lies in whether there are constraints on managers and whether managers are controlled and/or connected to the controlling shareholder.

Table 6.12: Ownership Structure of Six Case Study Banks.

GROUP A CASE STUDIES		
Before 2004		
United Merchant Bank (UMB)		
Roger Boka (CEO)	100	Was owner managed, ownership concentration, CEO had ultimate control of the bank. Insider Model.
Total	100	
Trust Holdings Limited		
	Top 5 Shareholders %	Shareholding Description
Trust Employee Share Ownership Trust	11.46	Owner managed CEO and Executive Directors exercised control of Bank through Nominee companies. Insider Model, Ownership concentration.
Ludham Investments P/L	8.76	
NRZ Contributory Pension Fund	8.73	
Old Mutual Life Assurance	6.69	
Wilta Investments (Connected to CEO)	6.16	
Total	41.8	
Royal Bank		
Jeffrey Mzwimbi (CEO)	25 %	Owner Managed. Founders controlled close to 75 percent of the bank. Few institutional shareholders. Executives had ultimate control. Top 5 shareholders controlled 92% of issued shares. Ownership concentration, Insider Model.
Victor Chando (Executive)	25%	
Durajadi Simba (Executive)	20%	
Hardwork Pemhiwa (Executive)	20%	
Intermarket Unit Trusts	2%	
Total	92.0	
GROUP B CASE STUDIES		
After 2004		
NMB Bank Limited*		
Old Mutual Life Assurance	11.27	Owner managed till 2003, executive directors controlled 30 percent of the issued share capital before 2003. Separation between ownership and management after 2004.
Cornerstone Trust (Former MD)	10.28	
Alsace Trust (Former Deputy MD)	10.28	
Wamambo Trust (Fmr. Executive Director)	8.67	
Old Mutual Zimbabwe	7.71	
Total	48.21	
Barclays Bank Limited**		
Afcame Zimbabwe Holdings	67.77	Foreign owned bank, 67.77 percent of the shares held by Barclays PLC. Ownership concentration by the parent company.
Old Mutual Life Assurance	6.89	
Old Mutual Zimbabwe Ltd	5.67	
Barclays Zimbabwe Nominees	2.29	
Fed Nominees	1.62	
Total	84.24	
TN Holdings Limited		
TNFH	69.71	Owner managed. CEO controls majority shareholding through cross shareholding. Ownership concentration. Insider Model.
Nyambirai Associated Trust (CEO)	18.00	
Dominion Trust	6.97	
Remnant Trust	2.11	
Mamre Trust	2.09	
Total	96.88	

Source: Owner's compilation from fieldwork data

*NMB Shareholding before 2004 was similar to that after 2004. The only change was that before 2004, the executive directors controlled 30 percent of the shareholding. When the directors left the bank in 2004, their shareholding remained unchanged except that they were no longer in management.

**The Barclays shareholding was unchanged before and after 2003.

In this regard, a number of conclusions can be drawn from these findings on the ownership structure of the case study banks. Firstly, the cases indicate that despite all banks having ownership concentration, this concentration may not in itself be a problem. This is because only the banks with insider ownership concentration seem to have suffered corporate governance weaknesses. Ownership concentration by the CEO or the executive directors gave ultimate control to the owner managers. Second, the control by the insiders led to ineffective boards and weak internal controls which in turn resulted in frauds, insider transactions and abuse of depositor's funds.

Third, the new regulations set an arbitrary threshold of 10 percent which only disqualifies executives with more than 10 percent of the shareholding from being part of a bank's management. However, this limitation has several loopholes which can be exploited. This is because individuals could have a controlling shareholding in a bank through an intermediate institution and still take the position of CEO or a senior managerial position. Another associated weakness of the new regulations is that individuals with less than 10 percent shareholding who are in senior management could still control the bank if no other individual or institution has a bigger shareholding. Fourth, another conclusion which can be drawn is that for the regulations to have a positive effect, this will depend to a large extent on how they are enforced. As shown in the case of TN bank, weak enforcement would surrender any merits of the regulations.

ii. Perceptions on the separation between ownership and management

The introduction of the regulation which prevents anyone with more than 10 percent shareholding from being part of the management team is believed to have had some impact on ownership structure and corporate governance of banks. A key informant from the central bank, who was interviewed, expressed the view that separating ownership and management was the right thing to do. He argued that even with ordinary companies, where you have someone owning and running a

business there is potential for an erosion of corporate governance because people tend to disregard the distinction between themselves as a shareholder, and the company as a separate entity.

A similar view was expressed by a senior executive at the Zimbabwe Stock Exchange who agreed with the separation of ownership and management, but expressed reservations regarding the 10 percent figure as the limit, arguing that the separation of roles was necessary to curb practices such as insider loans. However, most of the CEOs of private indigenous banks which were affected by the 10 percent limitation disapproved of the cap with many of them arguing that the cap was arbitrary, restrictive and did not reflect the desires of the shareholders.¹³³ One of the former CEO who had to step down to comply with the ownership restrictions argued that the ownership restrictions were unfair, contesting that;

“I look across the street I see the guy who started a cellular phone company who did as much and was as passionate as I am, why should I be constitutionally prejudiced to 10 percent, when a shoemaker can own 100 percent of their business and I am told I must go down to 10 percent, that cant be fair. “

According to another bank CEO who was interviewed, an insider or outsider ownership model has its merits and demerits and every country has its own model which yields different results. The executive argued that introducing a separation between ownership and management in an illiquid market in which almost all the businesses are historically characterised by insider ownership may not be the best solution. The assertion by this interviewee reiterated the argument that there is no ‘one size fits all’ approach to ownership arrangements due to country specific institutional arrangements which may be significant in the development of ownership characteristics (Arcot & Bruno, 2006).

Literature suggests that where inside owners control large shareholding in a bank, this can lead to adverse incentives contrary to the interest of the bank’s creditors by undertaking risky investment

¹³³ View also expressed by *Interviewee Number 6*.

strategies, bad banking practices and frauds (Brownbridge, 1998).¹³⁴ The evidence discussed in respect to group A cases suggest that excessive concentration of ownership by the owners may have been a factor in the weakness in internal control, which resulted in the abuse of depositors funds as observed in Trust, Royal and UMB. The conduct of the owner managers within these three banks highlight the conflict that can arise between controlling shareholders, minority shareholders and other stakeholders.

6.4.2 Board of Directors of the case study banks.

The board of directors in the three banks in Group A and that of NMB before 2003 were largely ceremonial, ineffective and incompetent having been highjacked by executive owners. In banks such as Trust Bank, the case study findings suggest that the board chairman was involved in some tunnelling activities together with management which may have weakened his independence to monitor management. Where the board were aware of speculative activities by management, indications are that this was ignored as the board expected greater returns from the speculative activities. The board members assumed that the central bank would not allow any of the indigenous banks to fail since they represented the government's drive toward the indigenisation of the financial sector.¹³⁵

A common feature noted within the boards of most of the case study banks with the exception of Barclays Zimbabwe is that the board members were often appointed by the executive directors who were also the bank's founders. These board appointments consisted of corporate insiders with close connections to the bank owners. This practice may have compromised the independence and effectiveness of these directors. The evidence analysed in these cases suggests that the board of directors and their sub committees did not effectively perform their oversight role due to the

¹³⁴ According to Brownbridge, bank owners have incentives to undertake such strategies because, with limited liability, they bear only a portion of the downside risk but stand to gain, through higher profits, a large share of the upside risk.

¹³⁵ This is based on an observation by Interviewee No 5, a senior executive at the central bank.

incompetence of board members and/or their lack of independence. Effective oversight by a bank's board of directors over senior management is critical as the board should play a central role in approving overall policies of the bank and ensure the existence of an effective internal control system. The observed weakness in internal control systems in the banks was related to malfunctioning of the board arrangements.

The 2004 regulation has brought in changes in the board in all the case study banks. Since the 2004 regulations were introduced, banks have reported a higher proportion of non executive directors, separation between the role of chairman and CEO, the establishment of various committees and the appointment of directors with suitable qualifications to manage the affairs of the banks.

6.4.3 Malpractices as a result of corporate governance weakness

Based on the evidence discussed in the case study chapters, it was observed that the private indigenous banks which operated before 2004 were owner managed with concentrated ownership by insiders. The board members within these banks were connected to the executives which compromised their independence and were at large ineffective. These concentrated ownership structures led to paralysed boards and weak internal control, which in turn led to mal-practices by the owner managers.

The evidence from the case studies has highlighted several malpractices in all the private indigenous banks analysed as a result of weaknesses in corporate governance. These banks include UMB, Trust Bank, Royal Bank, NMB pre 2004 and post 2004, and TN Bank. The corporate governance weaknesses in these banks resulted in problems such as insider lending, frauds and abuse of depositors' funds, speculative investments and rapid expansion. Some of these weaknesses are analysed below.

i. Insider lending.

Evidence from the various investigations following the collapse of UMB, Trust, Royal Bank and NMB bank (in the period before the crisis), highlighted cases of insider loans being extended to the owner managers in their personal capacities and to their private business ventures. In some cases, executive directors used the insider loans to buy shares in their own banks in violation of the prevailing legislation.¹³⁶ Literature suggests that financial institutions have less incentive to monitor loans issued to owners or managers which increases the moral hazard incentive for the borrowers while increasing the risk exposure of the banks (Mishkin, 2005). The loans extended to the insiders in the case of UMB, Trust and Royal Bank could have been one of the factors which contributed to a liquidity crisis within the banks.

Following the banking crisis, the central bank's regulations introduced in 2004 were intended to restrict the prevalence of insider lending by putting restrictions on executive shareholding. The restrictions on connected lending have also been implemented by a number of countries with mixed results.¹³⁷ The evidence regarding the banks which survived the 2003 crisis or were established after the ownership regulations indicate that there has been no significant change among private indigenous banks. It is reported that in both NMB Bank and TN Bank, insider loans had also been extended to executive directors after 2004. In the case of TN Bank, these insider loans were extended in 2010. A number of executives interviewed on the impact of insider loans of banks

¹³⁶ The share buy backs were used as a strategy to increase the director's shareholding within the banks they managed or to prop up the share price.

¹³⁷ An argument proffered by Eichengreen (2002) is that restrictions on connected lending can hinder financial transactions in emerging markets since it may be the only effective way of structuring and enforcing financial contacts in countries where the information and contracting environments are weak. He argues that there are informational and enforcement benefits that can accrue from family and other connections, and this is why it often makes sense to have interfamily lending and family control of businesses in poorer countries. However, connected lending by banking institutions which have access to liquidity support from the central bank and which have access to a government safety net can lead to moral hazard and excessive risk-taking that is very destructive as established by the cases analysed in Category A banks which collapsed under the weight of non-performing loans to the founding directors.

expressed the view that insider loans within owner managed banks had been largely responsible for the liquidity crisis in UMB, Trust and Royal Bank.¹³⁸

It was also evident that a second type of related party lending was prevalent in most of the banks, namely loans issued to the bank holding companies. Two of the collapsed banks, Trust and Royal extended significant loans to their bank holding companies. The case study findings suggest that related party transactions were common within the private indigenous banks which had concentrated insider ownership before and after 2004. In contrast, there were no reports of insider loans in the Barclays Zimbabwe case.

ii. Fraud and abuse of depositor's funds.

Besides the prevalence of related party transactions discussed in the previous section, the case study evidence also highlighted several allegations of tunnelling, fraud and the abuse of depositor's funds in UMB, Trust Bank and Royal Bank. The allegations were made by the central bank and the forensic auditors against the bank founders and owner managers.

NMB bank which had similar insider ownership concentration but survived the crisis also experienced managerial fraud after the departure of the owner managers in 2004. This was different from the ownership fraud experienced by other banks before 2004. Table 6.12 summarises the fraud allegations in the banks. The managerial fraud in NMB bank, after the separation between ownership and management can highlight the agency conflict which can exist between owners (principals) and managers (agents). In this regard, the fraud by a manager in the bank after the departure of the owners highlights one of the limitations of the new regulations introduced in 2004. The regulations emphasise separation between ownership and management but does not give any guidance on how to deal with potential agency problems between managers and owners when they

¹³⁸ Interviewee Number 5, 10 and 14.

arise. In this regard, the regulation gives little attention to the deeper cause of weak internal control systems in banks.

The separation of ownership and management can lead to an agency problem whereby management operates the firm in alignment with their own interests (Jensen and Meckling, 1976). Within a generalised agency approach, the managers may have used their effective control rights to pursue projects that benefit them rather than other stakeholders (Williamson, 1964; Jensen, 1986 and Grossman and Hart, 1988). According to one of the bank executives interviewed, the agency problems experience in NMB Bank may have been because of the departure of the owner managers.

Effective corporate governance systems are important in deterring managerial opportunism (Fama and Jensen, 1983). One of the executives commenting on the management fraud in his own bank suggested that poor internal control systems may have been to blame for the spate of frauds in the bank. Table 6.13 highlights the observations made earlier that in all the case studies, the banks in which allegations of ownership fraud or abuse of depositor's funds were made were private indigenous banks with insider ownership concentration.

The similarities in the ownership structure and corporate governance practices of these private indigenous banks indicate some form of "mimetic" isomorphism which is defined in the theoretical framework chapter as the tendency for social actors to imitate other social actors for competitive reasons (Scott, 2001).

Table 6.13: Ownership Frauds and violations*

Name of Bank	Fraud Dates	Nature of Fraud/Allegations	Outcome	Regulatory Response.
United Merchant Bank (UMB) <i>Owner controlled Pvt. Indigenous</i>	1998	Several allegations of fraud and externalisation against the owner managers.	Owner manager fled the country to the USA before formal charges were brought against him. He later returned to Zimbabwe but died without being charged.	Liquidated
Trust Bank <i>Owner controlled Pvt. Indigenous</i>	1996 -2003 2004	Several allegations of Technical and cosmetic fraud against former owner managers Z\$7 billion fraud perpetrated by one of the bank's managers	Owners left country for South Africa, specified by the Government. Owners were never charged with the alleged fraudulent activities. Subsequently de-specified. The fraud contributed to a deepening liquidity crisis within the institution resulting in Trust Bank being placed under curatorship.	Bank placed under curatorship. Curator's determination was that Trust Bank was technically insolvent, collapsed into ZABG.
Royal Bank <i>Owner controlled Pvt. Indigenous</i>	2005	Former directors of bank arrested for fraud following forensic investigations into the causes of bank's collapse	Directors were acquitted after the state failed to prove a case against them. Directors were also subsequently de-specified.	Bank placed under curatorship. Curator's determination was that Royal Bank was technically insolvent, collapsed into ZABG
NMB Bank <i>Owner controlled before 2004 had a separation between management and control after 2004</i>	2003 2005	No fraud allegation against any of the bank's directors. Owner managed charged with externalisation of foreign currency The bank is rocked by a massive fraud of approximately US\$6, 3 million in depositor's funds after one of the managers in the treasury department siphons money out of the country without being detected.	Owners skipped the country to the United Kingdom, specified by the government. Externalisation charges brought against directors on their return. Found not guilty and de-specified. The crisis forces the bank into a liquidity crisis resulting failure to reimburse depositor's funds for four months	Bank suffered a run on deposits and a subsequent liquidity crisis. NMB had to access liquidity support from RBZ. Bank's forex license was suspended due to poor internal control weaknesses. NMB also approached central bank to liquidity support.
Barclays Bank <i>Separation between ownership and control Foreign owned</i>	1903-2010	No fraud allegations uncovered against current owners	N.A	N.A
TN Bank <i>Owner controlled Pvt. Indigenous</i>	2008-2010	No fraud allegations uncovered against current owners	N.A.	N.A

Source: Author's own compilation from fieldwork data.

iii. Speculative investments

Evidence from all the private indigenous banks before 2004 indicates investments in speculative activities by the banks as a result of the deteriorating macroeconomic conditions and pressure on banks to remain profitable. The findings in respect of UMB, Trust, Royal Bank and NMB Bank before 2004 indicate risk taking by the owner managers which was manifest through investments in speculative investments such as the stock market, real estate developments and other illiquid investments which were used to hedge against inflation during the economic crisis. Findings from the case studies indicate investments in illiquid speculative activities could have contributed to the liquidity crisis in the private indigenous banks which collapsed as a result of the crisis.¹³⁹

The speculative investments were made through nominee companies in which the executives were controlling shareholders, using depositor's funds which indicate a moral hazard in which bank owners undertook risky investments where they bear disproportionately a small fraction of the downside risk but gain a large share of the upside potential prejudicing depositors and other stakeholders (Brownbridge, 1998). The case study findings highlighted that executives of banks such as Trust and Royal Bank invested in illiquid assets such as immovable property and motor vehicles in an attempt to hedge against inflation and boost profitability. It appears that the deregulation of the financial sector made it possible for most of the banks to diversify into opaque activities which were of a speculative nature and to organise a substantial portion of their activities in off balance sheet operations as noted in Trust, Royal Bank and NMB Bank case studies. These speculative investments indicate the dominant role played by insider owners in investing in risky projects often without board approval.

¹³⁹ In one of the cases study banks, evidence revealed that some banks are alleged to have purchased liquid assets such as buying a controlling shareholding in a brick company, properties and cars.

iv. Rapid expansion

Another factor which indicates the risk appetite of the owner managers was the evidence of rapid expansion noted in Trust, Royal Bank and also in TN Bank which was established after the 2004 regulatory changes. Indications are that in some cases the expansion was funded by depositor's funds and not by real growth, which highlight poor risk management frameworks in the banks.¹⁴⁰ In the case of Trust Bank, it has been noted that the bank grew to become the largest bank in the country in terms of assets between 1996 and 2004 whilst Royal Bank expanded to more than 20 branches countrywide in less than two years which also resulted in a rapid expansion of the bank's loan book. Similarly, TN Bank, established in 2009 also reported rapid expansion and acquisitions.

6.4.4 Sub-Summary

The case study findings have highlighted ownership concentration in all banks before and after 2004. The evidence has also established insider ownership concentration within the private indigenous banks. It has been established that the banks which operated after 2004 show little or no improvements regarding ownership concentration and corporate governance practices, particularly in the private indigenous banks. The three banks which either survived the 2003 banking crisis or were established after the regulations requiring separation between ownership and management still indicate ownership concentration in all the banks. TN Bank had insider ownership concentration whilst NMB Bank which had a separation between ownership and management after the departure of the owner managers in 2004 returned to being owner managed after one of the founders with significant shareholding returned to the bank.

The case study evidence highlighted corporate governance weaknesses in NMB Bank and TN Bank similar to those in the Group A cases. The case study findings show how corporate governance weakness in private indigenous banks with insider ownership concentration resulted in outcomes

¹⁴⁰ Interviewee Number 5.

such as frauds, tunnelling, insider lending and the abuse of depositor's funds by owner managers and speculative investments. These problems were observed in UMB, Trust Bank, Royal bank, NMB and TN Bank. In the case of NMB Bank, the results of the corporate governance weaknesses in the bank were speculative foreign currency trading and fraud by one of the managers.

The ownership concentration by insiders among the private indigenous banks highlights some agency problems. The first is the agency problem between insider controllers and other shareholders and between insiders and depositors. This agency problem appears to have resulted in self-interestedness and opportunism by owners with insider ownership concentration. The second type of agency problem from the case study findings was between shareholders and managers. This was evident in the management fraud reported in NMB Bank. As noted earlier, the new regulations provided little solution to the first type of agency problem and may have resulted in the second type of agency problem in which the departure of the owner managers with concentrated ownership resulted in less monitoring by the owners which could have opened the window for fraud by managers.

In this section, it has been highlighted that despite the ownership concentration in all banks, the differences between insider and outsider ownership concentration could explain why corporate governance weaknesses were reported in the private indigenous banks whilst there were no reported cases in Barclays Bank.

The discussions in the case studies have also highlighted that Barclays Bank and NMB Bank survived the financial sector crisis whilst all the other banks collapsed. This could be explained by a number of reasons; first, both Barclays and NMB were listings on the Zimbabwe Stock Exchange and the London Stock Exchange. This listing on multiple stock exchanges results in discipline from the exchanges which may, to some extent, serve as constraints on managerial abuse. Secondly, case study evidence suggests that the survival of NMB Bank when other private indigenous banks in similar

circumstances were being closed down may indicate regulatory forbearance in which the central bank did not act to address the weaknesses in NMB Bank in a similar way to the other banks.

6.4.5 Institutional arrangements and corporate governance of banks.

Whilst the previous section has focused on the corporate governance problems in the case study banks before and after the introduction of ownership reforms in 2004, this section analyses how the ownership and corporate governance practices within the case study banks were affected by some country specific institutional arrangements. These include the legal and regulatory framework on the ownership and corporate governance structure within the case study banks. The macro-economic environment is also discussed as an important context in which the practices were analysed.

The context of macro-economic environment.

The deterioration of Zimbabwe's macro-economic environment has been discussed in greater detail in the *Background Chapter*. The economic crisis which began in 1997 resulted in the contraction of the economy resulting in unsustainable exchange rates and high interest rates with inflation reaching 516 quintillion percent in 2008.¹⁴¹ The case study findings suggest that these macro-economic conditions which worsened in 2003 had an effect in exposing the underlying weaknesses in the financial sector (IMF, 2005). A study by Llewellyn (1999) suggests that macro instability usually reveals existing weaknesses within the banking sector.¹⁴² Other studies also suggest that the trigger for many bank crises has often been macroeconomic in origin (Lindgren et al, 1996).

¹⁴¹ Mambondiani (2007). : A minute of Silence for 'Black Friday' The Zimbabwe Independent Newspaper, 2 November 2007. The Zimbabwean economic crisis is often traced back to the 14th of November 1997, a day referred to 'Black Friday', when the Zimbabwe dollar lost 71.5 percent of its value against the US Dollar, the stock market subsequently crashed, wiping away 46 percent from the value of shares due to investor flight.

¹⁴² Llewellyn also points out that the seeds of a problem (for example, over-lending, weak risk analysis and control and so on) are usually sown in the earlier upswing of the cycle: mistakes made in the upswing emerge in the downswing with the downswing phase revealing previous errors and over optimism.

The case study findings on banks such as Trust, Royal Bank and NMB Bank revealed that owner managers engaged in non core, speculative investments buying properties, cars and investing depositor's funds on the stock market and the illegal foreign currency market. These investments were intended to hedge against inflation and increase profitability within a contracting economy. In this regard, the macro-economic environment is therefore an important context in which the ownership structure and corporate governance practices within the banks are analysed.

Legal system and regulatory environment.

The case study findings in the previous chapters have highlighted the important role played by the legal system and the regulatory environment in shaping the ownership structure and corporate governance practices within the banks. The evidence suggests that the country's legal system and regulatory environment may have had a significant effect on the development of ownership patterns and corporate governance structures before and after 2004.

i. Legal System

The liberalisation of the financial sector in the early 1990s played an important role in changing the governance structure of the Zimbabwean banking sector. Deregulation opened up the financial sector, facilitating the registration of private indigenous banks. A direct result of the deregulation of the sector was the exponential increase in the number of indigenous banks which were granted banking licenses. All the private indigenous banks analysed in Group A cases and NMB bank in group B were licensed as a result of the deregulation. UMB, Trust and Royal Bank were licensed in that respective order. Ironically the banks collapsed in the same order amidst allegations of poor corporate governance practices, asset stripping and fraud by the owner managers.

However, the banking legislation after the deregulation of the sector did not limit ownership concentration in banks and appears to have contributed to a pattern of insider concentration by owner managers in all the case study banks. This ownership concentration by insiders in all private

indigenous banks suggests a form of *mimetic isomorphism* in terms of which banks adopted almost similar ownership structures. A key informant from the central bank interviewed on the reasons for this concentration of ownership by insider blockholders has argued that owners of the newly registered private indigenous banks preferred to be in total control of their banks to avoid theft of their assets by outsiders.¹⁴³ He attributed this to the fact that over a long period of time, Zimbabwe's common law system had suffered credibility challenges as a result of a poor record regarding the enforcement of property rights and a selective enforcement of the law. The poor regulatory environment could have had an impact on corporate governance and the ownership structure of the banks.

The views expressed by the central bank executive are corroborated by Mangena and Tauringana (2005) who also argued that the weaknesses in the Zimbabwean legal system were a major contributor to the concentration of shareholding by inside blockholders and the majority of the owner managers being the CEOs of the banks they founded. In this regard, the concentration of shareholding may have been used by the owners to leverage up legal protection and help address the agency problem which can be considered as a protective institutional measure to compensate for low legal protection.¹⁴⁴

Besides the lack of ownership restrictions in the legal system, case study findings suggest that the legal system failed to adequately prosecute the violations reported in the case studies. Despite detailed allegations of fraud and abuse of depositor's funds being made against the executive directors of UMB, Trust Bank, Royal Bank and NMB Bank, the central bank failed to prosecute or secure a conviction in any of the cases. The key informant from the central bank observed that

¹⁴³ Interviewee Number 5.

¹⁴⁴ According to Shleifer and Vishny (1997), the principal reason why investors provide external financing to firms is because they receive control rights in return. If the firm managers violates these rights (voting duty of loyalty, creditor remedies etc) then the financiers can ask the courts to enforce them. Thus, legal protection of financiers (shareholders and lenders) is a central issue in corporate governance and this varies from one country to another.

weaknesses in the legal system may have been the reason why the central bank' failed to secure convictions despite clear evidence indicating that the some of the bank owners had engaged in fraudulent activities using depositor's funds.¹⁴⁵ This may highlight weaknesses in the banking laws and the competency of the judiciary system to deal with the complicated banking violations. It also raises doubts regarding whether the allegations against the owner managers were criminal offences.

ii. Regulatory environment.

The case study findings have highlighted lax regulation and supervision of the banking sector, weaknesses in enforcement and regulatory forbearance. The enforcement of the regulatory provisions by the central bank has emerged as a key issue. In particular, the case study evidence suggests that the regulator failed to stop expropriation by owners over many years in banks such as UMB, Trust and Royal Bank. This may have been due to lax regulations and or regulatory forbearance. A senior Executive in the central bank commenting on these regulatory weaknesses after the deregulation of the banking sector observed that;¹⁴⁶

"It appears that a laissez-faire policy approach was adopted in terms of bank supervision and surveillance, regulatory measures post-liberalisation seem to have been lax resulting in structural weaknesses in banks such as UMB and Trust. Perhaps the assumption was that the newly freed capital markets would take care of themselves."

These regulatory weaknesses were manifest in the licensing of banks after deregulation. The case study findings in UMB suggest that political interference may have subverted prudential criteria in granting the bank a license. The licensing of the indigenous banks with great euphoria and optimism and the reserve bank's open ended liquidity support to all the banks before 2004 created the belief that indigenous banks would not be allowed to fail because of the government's indigenisation

¹⁴⁵ Interviewee Number 5.

¹⁴⁶ Interviewee No 5

policy. This may have contributed to excessive risk taking within the banks and the prevalence of insider lending and abuse of depositor's funds by the bank owners.

Evidence discussed in respect to the Group A case studies suggests that the government's desire to increase the number of indigenous banks to correct historical imbalances may have resulted in a lax regulatory environment which contributed to increased risk taking and an adventurous business culture particularly within the banks which private indigenous banks. During this expansion of the financial sector, the case study findings in these banks indicate that the central bank failed to carry out effective regulatory and supervisory functions to curb risk taking by owner managers at the expense of depositors.

Another regulatory weakness identified within the case study chapters was the separation of the licensing and the supervisory function between the Ministry of Finance and the central bank respectively.¹⁴⁷ As a consequence of this separation, the central bank supervised banks in which they had played no role in licensing. The independence of the central bank was limited by the need to refer licensing decisions to the Ministry of Finance (IMF, 2005). The negative effect of this was noted in the licensing of Royal Bank where the central bank did not agree with the position of the Registrar of Banks regarding the directive for the executives to invest shareholding in their individual capacities.

The case study findings have also highlighted weaknesses in the 2004 regulations. The previous section made the argument that the new regulations set out an arbitrary threshold of 10 percent limit for those in management. However, these regulations have not been able to address the problem of insider ownership concentration with the results indicating that there are many ways to

¹⁴⁷ The Banking Act (chapter 24:20) provided for the establishment of the office of the Registrar of Banking Institutions. Section 4 (1) provided that 'There shall be a Registrar of Banking Institutions and such other officers as may be necessary for the proper administration of this Act, whose offices shall be public offices and form part of the Public Service. The Act also provided that 'the Registrar shall be responsible for registering banking institutions and cancelling their registration, and performing such other functions as are conferred or imposed upon him by or in terms of this Act or any other enactment'.

get around them. After the deregulation of the sector, the banking regulations placed no restrictions on the amount of shareholding by a single shareholder within a bank. The consequence of this was ultimate ownership in the UMB case in which the owner controlled 100 percent of the banks shareholding. Another result of the lack of ownership restrictions could have been concentrated insider ownership within all the private indigenous banks registered in this period since there was no limitation on ownership.

Although the ownership regulations were first amended in 1998 to limit shareholding by individual shareholders, and in 2004 to separate ownership and management, the case study findings indicates that when Royal Bank was licensed, the new regulations could not stop control by insiders. The evidence from the TN Bank case study in which the group's CEO had more than 10 percent of the shareholding but was granted a special dispensation indicates poor enforcement of the regulations. The new regulatory provision also provides no guidance on how to deal with the potential agency problem between owners and managers as was shown in the NMB case.

The case studies also highlight regulatory forbearance by the central bank which could have increased moral hazards in all the private indigenous banks. The central bank was slow to act in the case of UMB, Trust and Royal Bank in the face of solvency problems in the banks. In UMB bank, one of the reasons for this regulatory forbearance may have been because the bank owed its license to politicians. Evidence of connected lending and abuse of depositor's funds may not have been addressed due to political pressure since the bank had extended substantial loans to politicians. In the other private indigenous banks, the regulator's failure to address these weaknesses could have led to a belief that the central bank would not close them due to the government's policy of promoting indigenous businesses post independence.

In particular, the evidence discussed in the cases suggests that the regulators failed to stop expropriation by owners over many years in banks such as UMB, Trust and Royal Bank. This suggests

a form of regulatory forbearance or weaknesses within the regulatory mechanisms may have contributed to corporate governance problems experienced by the case study banks. Although the government revoked United Merchant Bank's license in 1998 and introduced new banking regulations in the same year, the case study findings in this bank suggest a weak enforcement of the regulations by the central bank on the newly licensed banks which could have contributed to weaknesses in the banks (Bond, 1996). In this regard, indications are that there may have been lack of political will on the part of the supervisory agencies to exercise strong supervision since the indigenous banks were a significant part of the government's drive to indigenise the economy in a market which was previously dominated by foreign players.

Another issue which highlights inconsistencies in the application of the banking laws was the central bank's recent decision to restore banking licenses to all the closed banks following protracted legal battles. The Trust Bank and Royal Bank cases studies have detailed the various legal battles by the owner managers seeking to overturn the amalgamation of their banks into ZABG Bank. The case study findings indicate that both banks were reissued with their banking licenses in 2010. Even in banks in which former owners were forced to leave banks, including in NMB Bank, the former owners have returned as CEOs of the banks despite previous findings by the central bank, the curators and forensic auditors who audited the banks. The decision by the central bank to return the banking licences of the banks raise credibility issues regarding the regulator's capacity to adequately resolve problem of weaknesses in the banks.

A regulatory system which exhibits signs of weaknesses as were highlighted in the case study banks can create incentives for owners to expropriate from other stakeholders (Mangena and Tauringana, 2005). The failure by the regulator to punish directors accused of serious bank violations and fraud such as in the case of UMB and Trust Bank and the failure to secure a conviction against any of the directors against whom these allegations were made suggests regulatory weaknesses and weaknesses in the legal environment.

6.5 Conclusions.

This chapter has made a discussion on the ownership structure and corporate governance practices across all the cases of banks. Similarities and differences among the banks were drawn from the case studies. The following findings are concluded;

- i. The case studies indicate a prevalence of ownership concentration in the banking sector. The cases also indicate the prevalence of insider control among private indigenous banks in both pre- and post 2004 periods.
- ii. It would appear that it was insider ownership control rather than ownership concentration itself that caused weaknesses in the board and other aspects of corporate governance. The malpractices reported in these banks were attributable to these weaknesses.
- iii. The new regulations setting the 10 percent arbitrary level as ownership limit for those in management may not have been effective in tackling ownership concentration or resultant corporate governance weaknesses. This is because there are ways for individuals to get around the regulations and form insider control.
- iv. Any positive effects of the new regulations depend to a great extent on how they are enforced. Weak enforcement by the regulators foregoes any merits of the new regulations.
- v. Constraints and disciplinary effects on banks can come from stock exchanges.
- vi. Whilst the new regulations focus on the separation between ownership and management, and the agency problem which can exist between insider controllers (owner managers) and other stakeholders, the regulations do not pay sufficient attention to another type of agency problem-between shareholders and unconnected managers which occurs after the separation.
- vii. The case study evidence also indicates lax regulation, poor supervision and surveillance, regulatory forbearance, and a weak regulatory enforcement which could have affected the development of ownership structures and corporate governance practices.

In conclusion, the case studies indicate that the banks which suffered distress had insider ownership concentration. In these banks, owner managers engaged in bad banking behaviour and invested in risky projects due to poor regulatory and board oversight. Executives and connected directors, mostly handpicked by controlling shareholders dominated the boards, compromising board independence. As such, the boards tended to serve the interests of controlling shareholders at the disadvantage of the other stakeholders.

Case study evidence indicate that the corporate governance weaknesses reported in the private indigenous banks before and after 2004 were a result of a complex interactive mix of factors internal to banks and also external factors such as the legal and regulatory environment. The findings suggest that concentrated ownership in all the banks had an effect of the corporate governance practices of the case study banks. In the private indigenous banks, inside ownership concentration resulted in corporate weaknesses whilst in Barclays Zimbabwe outsider ownership concentration appear to have resulted in increased monitoring by the controlling shareholders.

CHAPTER 7

CONCLUSIONS – DOES OWNERSHIP STRUCTURE MATTER IN THE CORPORATE GOVERNANCE OF BANKS.

7.1 Introduction

The subject of how firms are owned and governed, by whom and for whose benefit has recently assumed greater importance due to the corporate scandals worldwide. In developed countries, the collapse of firms such as Enron, WorldCom, Parmalat and more recently the global financial crisis which led to financial distress in global financial giants such as AIG, Merrill Lynch, Royal Bank of Scotland (RBS), Northern Rock and the shocking collapse of Lehman Brothers has raised concerns about corporate governance in the financial sector and more specifically, the importance of a stable banking sector.

In developing nations such as Zimbabwe, the importance of banks as engines for economic growth and their unique features as financial intermediaries has been cited as some of the reasons why banking sector governance in these countries should be addressed effectively (Arun and Turner, 2002a, 2002b). A number of developing countries have undergone World Bank and IMF pressured banking sector reforms which adopted Anglo-Saxon corporate governance norms such as the separation of ownership from management (Gustavson *et al*, 2009).

Due to the failure of these models in tackling the problems of corporate governance weakness particularly within private indigenous banks, it has been argued that there is no empirical

justification for adopting these corporate governance models in their totality.¹⁴⁸ Instead, there is need to consider which of the constituent parts of the corporate governance models are essential and in line with the institutional setting of the different countries to which they are applied. Despite the arguments regarding which corporate governance models are appropriate for different countries, the importance of implementing sound corporate governance for the sake of development in order to increase the flow, and decrease the cost of financial capital and to stimulate productivity growth is widely acknowledged for firms in general and banks in particular (Oman, 2001; World Bank, 1989; Arun and Turner, 2004).

In Zimbabwe, it has been noted in this study that the banking sector experienced major changes since the liberalisation of the financial markets in 1991. The sector expanded due to the entry of a significant number of private indigenous banks in a market previously dominated by foreign banks. The deregulation of the sector was intended to lead to improvements in services to customers and expanding access to credit, especially to small and medium scale businesses. However, the Zimbabwean financial sector experienced a financial sector crisis which resulted in the collapse of 13 of these newly registered banks. Following the 2003 financial sector crisis, the central bank implemented new corporate governance regulations in 2004 which introduced a separation between ownership and management. The objective of the new regulation was to address the problems relating to ownership structure and improve corporate governance in banks.

This study has explored the effects of ownership structure on corporate governance in Zimbabwean banks. The scope of the study covered the commercial banking sector, with a specific focus on private indigenous banks. The 2003 financial sector crisis has been taken as an important context. Three research questions have been used to guide this analysis. The research questions are restated here as follows;

¹⁴⁸ Ibid.

1. *To what extent and how has ownership structure affected corporate governance of Zimbabwean banks?*
2. *What were the weaknesses in corporate governance in relation to ownership structure, and what were the resultant problems experienced by banks?*
3. *Has the new regulation introduced in 2004, which separates ownership from management, been effective in tackling these corporate governance problems?*

The purpose of this concluding chapter is to summarise the main findings of the study and draw out areas of future policy considerations. The rest of this chapter is organised as follows; the next section presents a summary of the structure of the thesis. After this, the main findings from the study are outlined. The areas of future policy considerations based on these findings are thereafter discussed. The last section discusses the limitations of this study and suggestions for future research.

7.2 Summary of the structure of the thesis

To assist in answering the research question, this study was arranged into seven chapters. The first chapter introduced the study. In chapter 2, the study reviewed relevant literature on ownership structure and corporate governance in firms and in the banking sector. The chapter discussed mainstream corporate theories which include the agency theory, the stakeholder theory, stewardship model and the political model. A brief critique of these theories was also made after which a theoretical framework for this study was developed. The Chapter concludes with a review of the historical development of ownership structure and corporate governance in the Zimbabwean banking sector. Chapter 3 then outlined the methodology adopted to answer the research questions.

In chapter 4, data from the questionnaire survey were analysed. This provided a general picture on ownership structure and corporate governance in the banking sector at the time the survey was conducted. Chapter 5 then explored the relationship between corporate governance and bank

performance using statistical tools which included; analysis of performance variables, corporate governance scoring and correlation analysis. Chapter 6 used case studies for an in-depth analysis of the banks at firm-level. In total, six case studies were analysed. These cases were separated into two groups. Group A constituted of three cases which consisted of banks which were all established before 2003 and collapsed as a result of, or before the 2003 financial sector crisis. Group B cases constituted three cases of banks which either survived or were established after the crisis. After this, chapter 7 drew some conclusions from the two case study chapters.

7.3 Theoretical Framework and Main Findings

7.3.1 Summary of the Theoretical framework

The study adopted a generalised agency theory combined with an institutional perspective as a theoretical framework. Complementing the generalised agency theory with rational choice institutionalisms was important to understanding the formal and informal rules in which the agency problems were analysed. The key assumptions of these two theories which include self-interestedness, opportunism and bounded rationality provided an important framework to analyse the effect of ownership structure on corporate governance.

There are several reasons why a generalised agency theory was adopted for this study. First, most studies analysing the corporate governance of banks have highlighted the limitations of the 'traditional' agency theory based on its focus on the primacy of shareholder value at the expense of other stakeholders such as depositors and regulators (Arun and Turner, 2004). According to the discussions in the literature review chapter, besides agency problems between shareholders and managers, agency problems in banks can also be experienced in two other areas. Agency problems can exist between managers and other stakeholders due to differences in preferences and also between bank owners and depositors. A generalised agency theory would be able to capture all three types of agency problems.

Second, it has been argued that the institutional arrangements under which a firm operates are important in shaping its behaviour and that of management (Zhang, 2002). The institutional problems in developing countries such as poor legal and regulatory environments, corruption and political interference means that understanding the institutional settings in which ownership structure and corporate governance is embedded justifies combining the generalised agency theory with an institutional perspective resulting in a multi-theory framework.

The study uses a positivist deductive approach and the analysis of data was conducted through the use of mixed methods. This involved a triangulation of research approaches, research methods and also triangulation of data. The empirical results in Chapters 5-9 examined the effects of ownership structure on corporate governance, and explored whether the new regulations introduced by the central bank in 2004 have been effective in tackling corporate governance problems. The major findings from these empirical results are summarised in the next section.

7.3.2 Main findings

The first research question asked; *To what extent and how has ownership structure affected corporate governance of Zimbabwean banks?* To effectively address this question, the study performed an analysis of the ownership structure and corporate governance of banks before and after the 2004 banking sector crisis using a questionnaire survey in chapter 4, a quantitative analysis in Chapter 5 and case studies in chapters 6.

The evidence presented in these chapters revealed ownership concentration in the entire banking sector and insider ownership concentration in private indigenous banks. The empirical evidence highlighted differences in corporate governance between banks with insider ownership concentration and those with outsider ownership concentration. In this regard, ownership structure had a considerable effect on corporate governance. In summary, the analysis from the empirical chapters on ownership structure established that;

- i. There was significant ownership concentration in the Zimbabwean banking sector both before and after the regulatory changes in 2004 across all ownership types.
- ii. Private indigenous banks or banks that were previously classified as private indigenous had insider ownership concentration. Findings from the questionnaire survey chapter indicate that when they were licensed, sponsor CEOs and/or other executive directors controlled more than 10 percent of the shareholding in all private indigenous banks, which suggests *mimetic isomorphism*. Although there was a reduction in the number of banks with insider ownership concentration, at the time the survey was conducted, the study findings indicate that some private indigenous banks still had inside ownership concentration.
- iii. The results in chapter 5 which analysed the relationship between Corporate Governance Scores (CGS), ownership structures and performance revealed that banks with professional CEOs have higher corporate governance scores and higher ROE ratios compared to banks with owner manager as a CEO. The results also indicated that banks with outsider ownership structures have higher corporate governance scores compared to those with insider ownership concentration.
- iv. The findings from the statistical analysis in chapter 6 which analyse the effect of corporate governance on performance indicate a '*positive relationship*' between corporate governance and performance within Zimbabwean banks. However, the results suggest that this relationship is not statistically significant. The correlation analysis between corporate governance variables, CGS and performance show a positive relationship, although the findings in this regard indicate that the relationship is neither strong nor significant.

The second research question asked; *What were the weaknesses in corporate governance in relation to ownership structure, and what were the resultant problems experienced by banks?* In answering this research question, the discussion in the survey chapter (chapter 4) and in the case study findings (chapters 7) revealed corporate governance weaknesses such as poor internal control systems, poor

risk management frameworks and weak board structures. These weaknesses led to problems such as related party transactions, frauds, abuse of depositor's funds and engagement in speculative activities. The main findings in this regard indicate that;

- v. Before 2004, the board of directors of most private indigenous banks were dominated by members who were appointed by the owner managers which compromised their independence and capacity to effectively monitor the executive directors from engaging in tunnelling activities. However, at the time the survey was conducted, all the surveyed banks met the minimum requirements of the 2004 regulations regarding board issues such as board size, composition, the number of board meetings and board qualifications.
- vi. There were corporate governance weaknesses in private indigenous banks before and after the 2004 regulation, which resulted in problems such as insider lending, fraud, abuse of depositor's funds and speculative investments.
- vii. It would appear that insider ownership control rather than ownership concentration was the cause of the weaknesses in corporate governance. The malpractices reported in banks with insider ownership concentration were a result of these corporate governance weaknesses.

The third research question asked; *Has the new regulation introduced in 2004, which separates ownership from management been effective in tackling these corporate governance problems?* The findings on this question indicate the importance of the legal and regulatory environment as determinants of ownership and corporate governance. Evidence from the case study chapters has highlighted weak enforcement of the regulations, poor supervision, regulatory forbearance and a deficient legal system. A summary of the findings on the legal and regulatory environment indicate that;

- viii. The new regulations, which set the 10 percent shareholding limit for those in management, may not have been effective in tackling ownership concentration and corporate governance

weaknesses. This is because there are ways to get around the regulations. The case study chapters indicate that individuals with less than 10 percent shareholding could still control the bank through intermediate institutions, cross shareholding or because there are no other shareholders with a higher shareholding.

- ix. Whilst it appears that the intention of the regulation was to tackle agency problems between insider controller (owner managers) and other stakeholders, the new regulation pays insufficient attention to another type of agency problem which could arise between shareholders and unconnected managers where separation has been achieved.
- x. The empirical findings indicate weak and lax enforcement of the rules by the regulators. Any positive effects of the new regulations depend largely on whether they are enforced timely, uniformly and consistently. Poor enforcement of the regulation as reported by the case study findings would forego any merits of the new regulations.

7.4 Sub-Summary

The results on ownership structure indicate that owner managers in private indigenous banks were potentially the greatest source of corporate governance weaknesses experienced. This is because banks under owner management are in a position to engage in risky actions, self interested or opportunistic behaviour due to poor monitoring. This may explain why owner managed banks were at the centre of the corporate governance problems before 2004. As a result of this insider ownership concentration, the study revealed that before 2004, owner managers controlled the structure and appointment of the board of directors which limited the board's independence and function to monitor management activities.

The empirical analysis in this study has revealed ownership concentration in all the banks, regardless of ownership type. Literature on ownership concentration based on the agency theory suggests that the concentration of ownership may be an effective approach to controlling the agency problems

between management and shareholders caused by the separation between ownership and control (Demsetz and Lehn, 1985). The empirical evidence however, indicates differences between corporate governance practices and performance in private indigenous banks which reported insider ownership concentration and the banks which had outsider ownership concentration.

The evidence indicates that whilst corporate governance weaknesses were reported in banks with insider ownership concentration, there were no reports of corporate governance problems in banks with outsider ownership concentration. The findings in this study support the view that, in developing countries, where there are weaker institutional environments, outsider ownership concentration will result in increased monitoring of banks whilst insider ownership concentration may result in corporate governance weaknesses (Brownbridge, 1998). The findings, in respect to third research question indicate that the 2004 regulatory changes have not been ineffective in tackling insider ownership concentration and the resulting problems.

Although the relationship between corporate governance and performance has not been central to this enquiry, with regards to performance differences between the banks with insider and outsider ownership, the statistical analysis in chapter 5 indicates that banks under diffuse ownership, in which the CEOs have less than 10 percent of the shareholding, perform better than those in which the CEOs have more than 10 percent shareholding. The findings also indicate that banks in which the CEO and or executive directors control less than 10 percent of the shareholding perform better than those with insider ownership concentration.

7.5 Areas of Future Policy Considerations

The findings from this study have revealed ownership concentration across banks, insider ownership concentration and corporate governance weaknesses in private indigenous banks. The study has also highlighted some regulatory weaknesses such as lax enforcement of regulations, regulatory forbearance, and a generally weak regulatory environment. Some loopholes and weaknesses in the

2004 regulation which were meant to address the insider ownership concentration and corporate governance problems have also been highlighted.

Using the generalised agency theory combined with the institutional perspective, the study has established that the problems relating to insider ownership concentration and the corporate governance problems which arise are complex and multi-dimensional. The study has also highlighted weak institutional arrangements such as a poor legal system and weak regulatory enforcement. Based on the findings in this research, some areas of future policy considerations can be highlighted.

Firstly, the study findings have revealed that the regulation introduced in 2004 may not have been effective in tackling the issue of insider ownership concentration. Some potential loopholes such as cross shareholding, ownership through intermediate institutions and failure of the regulation to stipulate the total shareholding which can be controlled by all the executive directors will need to be addressed. All these loopholes could potentially be used to circumvent the ownership limitations.

Secondly, whilst the focus has been in adopting an Anglo-Saxon type model of corporate governance which encourages a separation between ownership and management, the results from this study highlight that reformers should not simply adopt policies without looking at whether their normative descriptions fit the country context. According to Gustavson *et al*, (2009), the appropriateness of these models to specific countries has to be empirically assessed before such policies are implemented. The 10 percent threshold appears rather arbitrary and bears no historical relevance to the Zimbabwean banking sector. Although this is the threshold which is often adopted in some developed countries which encourage dispersed shareholding, whether this is the right threshold for Zimbabwe requires analysis. A framework for an effective separation between ownership and management has to consider country specific institutional arrangements before the policy is implemented.

Third, the 2004 regulations seem to focus on the separation between ownership and management as a panacea for solving corporate governance problems, however, the regulations pay insufficient attention to another type of agency problem which can arise between shareholders and unconnected managers where there is a separation between ownership and management. The study has highlighted that it may be insufficient for the regulators to simply prescribe such ownership restrictions without putting in place a regulatory environment which can deal with the agency problems which can arise as a result.

Fourth, although evidence from the study indicates that all the board arrangements of the surveyed banks met the minimum requirements of the 2004 corporate governance guidelines, a number of inadequacies from the current board structure will require redress. One of the provisions in the regulations require a board to have non-executive directors in the majority, constituting three-fifths of the board. However, this requirement does not compel banks to disclose whether the non-executive directors are independent of management or not. For this requirement to be effective, the regulations should compel banks to disclose in their annual reports whether non-executive directors are independent or not.

Fifth, the study has highlighted weaknesses in the regulatory environment. Rules on corporate governance are useless unless they are applied effectively. The effectiveness of these rules depends on the ability of the regulatory agencies to enforce them without deviation or selectivity. Enforcement of the rules and regulations must be strengthened and where there are violations, they must be consistently punished.

Sixth, the study has highlighted the importance of market discipline such as listing on local and external stock exchanges in improving corporate governance. Markets can undertake monitoring and impose discipline on the risk taking actions of banks. As a result, market discipline needs to be strengthened to improve corporate governance in banks. A local rating mechanisms or corporate

governance scoring (CGS) method can be published indicating how banks are ranked depending on their corporate governance practices based.

7.6 Limitations and Suggestions for future Research.

It is important to highlight that this research suffers from some possible limitations. Firstly, the survey analysis in Chapter 4 was carried out in 2010. Ideally, a survey which covers two different periods in time would have needed to be conducted at the same bank twice (in the case of this study, before and after the crisis) to get a more balanced view of the changes over different periods. A further survey at a later date would be able to extend and track the differences between the two time points. Secondly, the empirical analysis in Chapter 5 suffered from limitations such as lack of complete bank performance data for the period between 1992 and 2003. Performance data for the banks which collapsed as a result of the financial sector crisis in 2003 was also unavailable.

Third, there was no data at individual bank level for a longer period. The data used to compare performance and corporate governance practices after the 2003 financial sector crisis was for a short period of time between 2004 and 2010. This may be too short a period to observe the effects of the regulatory changes on ownership structure and corporate governance. Fourth, due to the small sample size, and the large number of corporate governance variables analysed, the statistical analysis was unable to perform a regression analysis, opting instead for a correlation analysis.

In light of these limitations, further research should be conducted to perform another survey at a later time point. A further study could also collect more individual bank data over a longer period. A wider research would be able to make an in-depth analysis of the banks across all three ownership types. Further, with more individual bank level data over a longer period, empirical studies can then be conducted using a time series or panel regression analysis.

It was also observed in the study that the situation in the Zimbabwean banking sector has been changing constantly. It was noted in the case study chapters that almost all of the banks which had

their licenses withdrawn in 2003 following allegations of fraud by the owner managers have had their licenses restored. Some of the founder CEOs have also returned to the country and to the banks as CEOs of the banks they were previously forced to abandon. As a result, there is an obvious need to carry out a series of follow-ups to modify the data and the arguments, where appropriate. However, despite these limitations, since this is one of the first studies to analyse the effect of ownership structure on the corporate governance of Zimbabwean banks, the study is expected to contribute to the literature on the corporate governance of banks in Zimbabwe and in developing countries in general.

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APPENDICES

APPENDIX 1

Survey Questionnaire on Corporate Governance Practices in Zimbabwean Banks To the Respondents

Thank you for your willingness to be part of this survey. This survey is being conducted as part of a Doctoral research by a Zimbabwean student from The Manchester University in the United Kingdom. The purpose of this survey is to understand corporate governance practises in Zimbabwe's Banking Sector at the firm level.

The Survey is asking questions on the practices in your banking firm, regardless of the laws and regulations. Your accurate and frank response is paramount to this research. The results will be used only for research purposes and be presented only in an aggregate form without being revealed by individual firms.

The Survey Questionnaire should be completed by the company secretary, the Chief Executive Officer or any officer or Director in charge of corporate governance at your banking institution.

Approximated Time to complete Questionnaire: **15-20 minutes**

Where appropriate please check the appropriate parentheses where required or express the extent to which you agree or disagree on the given statement by choosing (circling) one of the following;

Y+	strongly agree
Y	agree
O	neither agree nor disagree (or no opinion)
N	Disagree
N+	strongly disagree

1. General Information on the Bank and Respondent

1.1 What is your position (designation) in the Bank

1.2 Please indicate the period when your bank was issued with a banking license

a. Before 1991

b. Between 1991 and 2003

c. After 2003.

1.3 What was the Ownership Structure of the bank when it was established?

a. Government owned

b. Indigenous (Private) Ownership

c. Foreign owned **d. Indigenous and Foreign Private Joint venture**

e. Other (Please specify) -----

1.4 What is the Ownership Structure of the bank at the time this Questionnaire Survey is completed?

a. Government owned **b. Indigenous (Private) Ownership**

c. Foreign owned **d. Indigenous and Foreign Private Joint venture**

e. Other (Please specify) -----

1.5 Is the bank a stand alone company or a subsidiary of a Bank Holding group of companies?

a. Stand alone company **b. subsidiary of a Bank Holding Company.**

1.6 Since it was established, has the bank changed its ownership structure from either a stand alone company to be part of a bank holding company or from a bank holding company to a stand alone company?

a. Yes **b. No**

1.7 Is the Bank or Bank Holding Company listed on the Zimbabwe Stock Exchange?

a. Yes **b. No (Skip to 2.0)**

1.8 If you answered yes to 1.7 above please indicate when the bank was listed on the ZSE? -----

2. Bank Ownership Structure

2.1 When the bank was granted a license, was there a connection between the CEO and the founder of the bank?

a. CEO was founder him/herself **b. Founder's family member**

c. No, CEO was Professional manager **d. Other**

2.2 When the bank was established, was the CEO the majority shareholder of the bank?

a. Yes **b. No**

2.3 Is the CEO of the bank the majority shareholder at the time this Questionnaire is completed?

a. Yes **b. No**

If Yes, what is his percentage shareholding -----

2.4 How many CEO's has the bank had since it started Operating?

- a. One
- b. Btwn 2-5
- c. Btwn 6-10

2.5 Has any of your sitting CEOs ever been arrested or removed from his post due to allegations relating to corruption, violation of the Banking Act or externalisation of funds?

- a. Yes
- b. No

2.6 Has any member of the senior management of the bank ever been removed forced to resign or arrested for charges relating to violation of the Banking Act Bank? **If yes**, please indicate the category

- a. Yes
- b. No

Category

- a. Divisional Directors
- b. Executive Director(s)
- c. Senior Manager

2.6.1 Please indicate the reason(s) for the removal

- a. Corruption
- b. violation of banking regulation
- c. externalisation
- d. Other

2.7 Please indicate the current top 5 shareholders in your Bank starting with the largest shareholder. A list of the bank's shareholding structure should also be provided as an addendum

Name of Shareholder	Percentage Shareholding (%)

2.8 Has there been a significant change in the bank's top 5 shareholders since the bank started operating such as disinvestment by an institutional investor, a founder member selling off etc?

2.9 Has the bank been the subject of a Takeover/Merger with another financial institution, if yes, please indicates when?

- a. Yes
- b. No (*Skip to 2.11*)

Year of Takeover/Merger []

2.10 How did the Merger occur?

- a. Hostile Takeover
- b. Arranged by the Board of Directors
- c. Arranged by the Reserve Bank of Zimbabwe (RBZ)

2.11 Has the bank ever been placed under Curatorship by the RBZ, If yes, please indicate when?

- a. Yes
- b. No

Year of Curatorship []

2.12 When was the curatorship lifted []

2.13 Was the ownership structure or Corporate Governance standards of the bank an issue when the bank was placed under Curatorship or when the Curatorship was lifted?

- a. Yes
- b. No (*Skip to 2.15*)

2.14 If you answered yes to 2.13, has the ownership structure of the bank changed since the Curatorship, please indicate how?

- a. Yes
- b. No

How has ownership structure changed?

2.15 Does any of the executives own more than 5% of the bank's issued share capital? If yes, please indicate how many of them own more than 5%.

- a. Yes
- b. No

c. If you answered Yes please indicate how many -----

2.16 Has any member of the executive/top shareholders been asked or forced to reduce their shareholding in the bank to comply with change in legislation such as the RBZ's directive for a 5% shareholding cap for anyone in senior management.

- a. Yes
- b. No

2.17 What percent shareholding does the executive shareholders own within the bank?

- a. Yes
- b. No

3. Corporate Governance and effectiveness of the Board of Directors

3.1 Board Influence on Corporate Governance

3.1.1 Is there any member of the board who owns more than 5 percent of the bank's issued share capital in their individual capacity?

- a. Yes
- b. No

3.1.2 Has any member of the Board borrowed or attempted to borrow money from the bank to fund their personal business ventures.

3.2 Board Features & Corporate Governance

3.2.1 Please list the number of directors in the bank indicating whether they are executive or non executive. The qualifications of the directors should also be provided.

Name of Director	Exec/Non Exec	Qualifications
------------------	---------------	----------------

1
2
3
4
5

Please indicate whether the board chairman is an executive or non executive director.

3.2.2 How has this composition changed since the bank was first granted a license?

3.2.3 Please indicate whether the bank has the following board sub-committees

Audit/Risk	a. Yes	b. No
Remuneration	a. Yes	b. No
Investment	a. Yes	b. No
Nominations	a. Yes	b. No

3.2.4 How were these committees formed/established?

a. directive from the central bank b. corporate by-laws
c. initiative of the Board of Directors

3.2.5 How many times do the main board and the board committees meet in a year?

Main Board

Board Committees

Audit	-----
Remunerations	-----
Investments	-----
Nominations	-----

- a. Separation between the chairman and chief executive officer
- b. Appointment of independent non-executive directors.
- c. Appointment of a technically competent board.
- d. Shareholders with a 10% or more shareholding in the bank had to resign as Chairperson, Deputy Chairperson or as part of management.

4.3 Have the regulatory changes to ownership and board structure and disclosure introduced by the RBZ in 2004 affected any of the following Corporate Governance issues in your bank?

- Increased efficiency of the bank	Y+	Y	0	N	N+
- Reduced related party transactions	Y+	Y	0	N	N+
- Increased role of board in monitoring Bank management	Y+	Y	0	N	N+
- Reduced fraudulent activities	Y+	Y	0	N	N+
- Increased protection of depositors	Y+	Y	0	N	N+

4.4 Has the limitation of shareholders who own 10% or more from being Chairman, Deputy Chairperson or part of management improved transparency and accountability in the bank?

- a. Yes
- b. No

4.5 In your opinion, has the bank benefited in any other way from this separation of ownership and control

- a. Yes
- b. No (*Skip to 5.0*)

4.6 If you answered Yes to 4.5 above, please explain how bank has benefited.

5. Impact of Ownership changes on Corporate Governance.

5.1 To what extent have the measures introduced by the central bank after the 2003 banking sector crisis been helpful to your bank in each of the following [circle one answer for each line across]

- 1. To a very great extent
- 2. To a great extent
- 3. To some extent
- 4. To a little extent
- 5. Not at all
- 6. No idea

5.1.1 Improving bank supervision by the RBZ

-----1 2 3 4 5 6

- 5.1.2 Increased on-site surveillance by the RBZ Inspectors
 -----1 2 3 4 5 6
- 5.1.3 Increased off-site surveillance by Bank supervisors
 -----1 2 3 4 5 6
- 5.1.4 Improved internal controls-----1 2 3 4 5 6
- 5.1.5 Creating an enabling environment for banking sector development
 -----1 2 3 4 5 6
- 5.2 Which policies under the reform measures introduced by the central bank have helped your bank performance the most?
 a. Revised liquidity requirements
 b. new compliance requirements
 c. board requirements
 d. changes to bank ownership structure
 e. other (Please specify)_____
- 5.3 Which policies have hurt the bank the most?
 a. liquidity requirements
 b. new compliance requirements
 c. board requirements
 d. changes to ownership structure
 e. other (specify) _____
- 5.4 How serious is your concern about potential personal director liability (for breach of duty of care)?
 a. Very serious b. serious c. slightly concerned d. Not concerned.
- 5.5 Do you think the duty of care of Management and Directors to bank stakeholders have increased since the changes introduced by the Reserve Bank after the 2003 financial sector crisis
 a. Very much so b. have increased somewhat c. have not changed
- 5.6 Would you agree with the following statements about the expected consequences of stronger supervision and surveillance from the Reserve Bank of Zimbabwe?
 5.6.1 Abusive behaviour of controlling owners will be held in check
 -----(**Y+**, **Y**, **0**, **N**, **N+**)
- 5.6.2 Firm performance will be improved due to smoother information flow, better decision and enforcement -----(**Y+**, **Y**, **0**, **N**, **N+**)
- 5.6.3 Bank related laws and regulations will be better observed
 -----(**Y+**, **Y**, **0**, **N**, **N+**)

- 5.7 Whose role do you think is most important among the following entities in improving corporate governance of banks in Zimbabwe?
- the Reserve Bank of Zimbabwe
 - the press
 - shareholders
 - professional societies such as accounting and audit companies
 - the judiciary
 - the board of directors.
- 5.8 Which of the following tasks do you think is the most effective for better corporate governance of banks in Zimbabwe < Write 1, 2...6 starting from the most important.
- Making the internal corporate governance mechanisms (such as shareholder participation and the role of the board better. []
 - Making the external governance mechanisms (such as hostile M&A) or market controls more effective. []
 - enhancing the standards of accounting, audit and disclosure []
 - conducting and publicising corporate governance ratings []
 - Prohibiting or tightly controlling some types of related-party transactions (like lending to directors or senior officers and cross guarantees of repayment. []
 - Reducing ownership concentration (by tighter control of cross-shareholding or pyramid ownership structures, etc). []

6. Disclosure and Transparency

- 6.1 Does your bank disclose the following information? If yes, by what means?
More than one choice can be made

Web: company's web page	AR: Annual Report
RR: Report to regulatory agencies	No: No disclosure

- 6.1.1 Self dealing (related-party) transactions
- a. **Web** b. **RR** c. **AR** d. **No**
- 6.1.2 Directors' selling or buying shares in the company
- a. **Web** b. **RR** c. **AR** d. **No**
- 6.1.3 Significant changes in ownership
- a. **Web** b. **RR** c. **AR** d. **No**

6.1.4 Governance structures and policies (explicit corporate governance rules and vision)

a. **Web** b. **RR** c. **AR** d. **No**

6.1.5 The extent to which the bank's corporate governance practices conform to the established standards

a. **Web** b. **RR** c. **AR** d. **No**

6.2 Changes to Disclosure and Transparency Practises.

6.2.1 Has there been a change to the bank's disclosure and Transparency policy between the periods 1991 to 2009?

a. Yes b. No (*skip to 6.2.3*)

6.2.2 If you answered yes to 6.2.1, please indicate how the changes to Disclosure and Transparency came about

a. Directive from the central bank b. change in legislation

c. Initiative of the Board of Directors c. Other

6.2.3 Please indicate the kind of changes introduced to the bank's disclosure and transparency policy between 1991 to 2009.

APPENDIX 2

Definition of Variables

Variable Name	Definition.
Profitability Ratios	
ROA	Return on Assets (ROA) is equal to net income after tax to total assets, indicates how efficient a bank is at income utilisation of bank assets.
ROE	Return on equity is the ratio of net income after tax to total equity of the bank. It measures the profitability of the bank's equity being the bank's use of equity or own funds to earn profit.
NIM	Net Interest Margin (NIM) which can be used to assess efficiency as well as profitability of banks is the ratio of net interest income to total assets.
Cost to Income Ratio.	Shows a company's costs in relation to its income. It is equal to operating costs to operating income. The lower it is the more profitable the bank will be.
Asset Quality	
NPLs to gross loans	The amount of non-performing loans over total loans, expressed as a percentage. Higher NPLs would be associated with less efficient banks.
Loan Loss Reserves/Gross Loans.	A provision by banks to account for future loses on loan defaults. A bank making a small number of risky loans will have a low loan loss provision compared to bank taking higher risks.
Liquidity	
Advances to Total Assets.	Total loans outstanding as a percentage of total assets. A high ratio indicates that a bank is loaned up and that its liquidity is low,

Source: Author's own compilation.

APPENDIX 3: Trend Analysis of Asset Quality Ratio for Individual Bank by Ownership Type (2004-2008).

Bank Type	2004		2005		2006		2007		2008	
	NPL*	LLR**	NPL	LLR	NPL	LLR	NPL	LLR	NPL	LLR
State owned										
Agribank	12.1	8.3	40.7	28.2	7.1	3.1	2	1	5.3	4.3
ZB Bank	39.8	0	4.7	6.1	3.3	1.9	0.4	2.1	23.3	14.1
ZABG***					0	3.5	0.1	2.1	0	0.9
Average	25.95	4.15	22.7	17.15	3.47	2.83	0.83	1.73	9.53	6.43
Foreign owned										
MBCA Bank	8.9	5.2	3.6	2.2	10.6	6.4	12.7	6.3	1	2.9
Stanchart	3.9	2.9	28.8	1	1.9	1	1.4	0.7	0.1	0
Barclays	23.9	18	7.7	7.4	5.7	2.9	2.8	2.3	0.4	0.1
Premier	0	18.9	5.9	8.4	6.9	3.6	9.4	4.7	18.8	9.4
BancABC	1.4	5.1	21.8	19.2	28.8	14.8	0.8	0.4	0.2	0.1
Metropolitan	63.1	45.7	4.3	31	4.9	3.2	2.5	1.2	3.1	0
Average	16.86	15.96	12.01	11.53	9.8	5.31	4.93	2.6	3.93	2.08
Pvt. Indig Banks										
CFX	0	0	0	18	0		43.9	18	462.7	84.7
NMB Bank	17.7	13.5	4.7	4.5	1.8	2.3	1.9	2.5	15.9	0
CBZ Bank	11	6.8	8.3	5	2.9	1.9	5.5	3	4.5	2.2
Kingdom Bank	11	9.7	21.6	16.1	5.3	2.3	7		3.1	
TN Bank	10.5	12.2	3.7	4	0.4	0.3	2.5	0.3	2	2
FBC Bank	64.9	44.8	15	2.7	0.3	2.2	0	1.7	3.5	2.2
ReNaissance Bank	1.8	0	41.6	25	0.2	0.9	6.7	3.2	0.8	-0.4
Interfin	24.7	0	23.6	0	23.1	0	1.5	0.8	5.2	2.6
Average	17.7	10.875	14.81	9.4125	4.25	1.41	8.62	4.21	62.21	13.32
Av. All Banks	18.41	11.94	14.75	11.175	6.07	3.14	5.94	3.14	32.347	7.81

Source: Data compiled from Global Credit Rating, GRC Report (2009).

*NPL Non performing loans to gross loans

**LLRs Loan Loss Reserves to gross loans.

***ZABG was established in 2005 which explains the unavailability of data for the bank between 2004 and 2005.

APPENDIX 4

Liquidity Management (Loans/ Total Assets Ratio 2004-2008)

	2004	2005	2006	2007	2008
Bank Type					
State owned					
Agribank	49.8	44.9	34	32.1	0.1
ZB Bank	22.9	22.1	22.5	28.3	1.8
Average	36.35	33.5	28.25	30.2	0.95
Foreign owned					
MBCA Bank	32.3	44.9	26.1	24.2	54.9
Stanchart	32.5	16.3	24.3	24.2	1.3
Barclays	36.6	20.5	18.4	30.7	2.2
Premier	42.1	13.4	15.2	3.8	0
BancABC	39.8	7.3	13	21.8	22.8
Metropolitan	79.8	23.2	43.3	40.2	15.7
Average	39.94	19.15	24.5	26.5	16.2
Pvt. Indig Banks					
CFX	0	78.4	22.3	57	0.8
NMB Bank	68.1	45.6	26.1	35.4	4.3
CBZ Bank	73.2	44.9	54.1	37.1	31
Kingdom Bank	43.8	26	30.5	41.7	0.2
TN Bank	57.3	24.4	76.4	59.3	16.3
FBC Bank	56.7	33.3	22.8	37.2	76.2
ReNaissance	102.6	63.2	128.2	45.2	78.8
Interfin	52.2	19.5	8.9	14.1	82.4
Average	56.7375	41.9125	46.1625	40.875	36.25
All Banks	47.42	31.55	35.13	33.7	23.84

Source: Data compiled from Global Credit Rating, GRC Report (2009).

APPENDIX 5

Corporate Governance Ranking based on CGS.

Rank	Name of Bank	Corporate Gov. Score	CGS as a percentage.
1	Barclays	25.25	90.14
2	Stanchart	25	88
3	FBC	21.25	75.29
4	ZB	21	75.29
5	Kingdom	19.5	67.33
6	Agribank	19	66.29
7	TN Bank	18.5	66
8	BancABC	16.75	60.14
9	NMB	16	55.62
10	Premier	14.5	49.14
11	CFX	14.75	49
12	Met Bank	12.75	45.1

Source: Author's own compilation

APPENDIX 6: Trust Bank Top Ten Shareholders (Post Listing – 2001).

Shareholder	Percentage Shareholding
TMB Investments (Private) Limited	21.18
Management and Staff	18.54
NRZ Contributory Pension Fund	9.69
Zimnat Life Assurance Company Limited	9.35
ZESA Staff Pension Fund	8.45
Ludham Investments (Private) Limited	8.02
First Mutual Life Assurance Society of Zimbabwe	4.66
Mining Industry Pension Fund	3.38
PTC Pension Fund	3.38
Asset Management and Finance (Private) Limited	1.26

Source: Trust Prospectus (2001)

APPENDIX 7: Loans to a politician – Extract from Edgar Tekere’s Biography

“I did not know Boka until my return to Zimbabwe after independence; he sought me out and introduced himself to me. He was interested, he said, in improving my image, so as to fit me for the new role I was assuming.

It was as if he had listened to Samora Machel give me one of his lectures prior to my leaving Mozambique. And fit (find?) me out he did. I was taken to an outfitter’s and provided with three suits, several pairs of shoes, shirts, socks and ties.

When I was sacked from the Party, his concern mounted, and I would find that my rates had been paid, in credit. I would receive monthly cash payments, none amounting to less than Z\$800,000.00, which was a goodly sum in those days.

I had not known how ill he was, when one day he arrived in Mutare in his new Rolls. He had come, he said, to see his old school at Old Mutare, and he wanted me to accompany him there. He told his driver to disembark, and instructed me to drive him to the school. He said to me, “You drive very embarrassing cars.” (I was then driving a Mazda 323). “Let’s see how you like the feel of a really good car.”

He was to make presentations to the school, the church and the orphanage, and these he handed to me to give to the recipients. By the time we got back to Mutare, Boka was really very ill. I took him to doctor Kangwende, and later he went on to the governor, Kenneth Manyonda’s home.

I did not see him again. Some time later, Tradex Marketing called to inform me that my new car was ready. What new car? I asked. The representative replied that they had been instructed by Roger Boka to have a Mitsubishi Twin Cab delivered to me forthwith. It was a 1997 model, fully paid for. This is the car that I drive to this day”¹⁴⁹.

¹⁴⁹ Edgar Tekere: A Lifetime of Struggle (2007).

APPENDIX 8

KPMG Report on Trust Bank.

A KPMG report regarding some of the transactions by the former directors reveals some of these violations as follows;

- (a) Trust Bank maintained an offshore account with Commerz Bank¹⁵⁰, a German banking institution. The account had a net debit of Euro 346,556 in August 2004, significant foreign currency amounts were debited to Trust Bank's Nostro accounts yet there were no corresponding credits in the bank's ledger. The central bank report states that a total of R1 445 921, 64, P27 201, 57, Euro 706 059, 69 and US\$703 476, 50 could not be accounted for (RBZ Trust Report, 2004). The report says the money was transferred from Trust's First Rand account in South Africa to the local bank's former directors, Mr William Nyemba, the founder and CEO (R107 531,60) and Mr Chris Goromonzi, one of the founding directors (R45 277,20).
- (b) A significant amount of money is alleged to have been siphoned from the bank and fictitious assets were credited in the books. The RBZ report says on the 27th of August 2003, Trust Bank paid Euro 253,000.00 from Trust Bank Nostro account, through Commerz Bank on behalf of First Mutual Life (FML)¹⁵¹. The payment was in respect of cost of equity in FML in a foiled takeover bid. The Directors of Trust were to acquire 630 million ordinary shares in FML as its strategic partner for a consideration of Z\$23,170 billion in terms of the FML

¹⁵⁰ Commerz Bank is the second largest credit institution in Germany, and one of Europe's largest banks. The bank recently merged with Dresdner Bank in 2009.

¹⁵¹ First Mutual Life was one of the country's largest insurance company and an intended take-over target by Trust Bank. In terms of a Press Release dated 26 March 2004. According to the company's (Trust's) resolutions, they were to acquire a 40 % stake in First Mutual Asset Management (Pvt) Ltd for a consideration of Z\$2,702 billion to be settled partly by transferring to FML the Trust Asset Management Division of Trust Banking Corporation Ltd valued at Z\$855 million and the balance in cash, and to acquire a 40% stake in African Reinsurance (Pvt) Ltd for the price of Z\$2,400 billion to be paid in cash. The company was also to dispose of the following interests to FML – a 40 % stake in Trust Corporate Securities (Pvt) Ltd for a consideration of Z\$446 904 000 and a 40% stake in Trust Discount House for Z\$1,2 billion, both to be paid for in cash.

private placement. Based on the RBZ report, it would appear that a significant portion of the transaction fee was paid for by the directors using depositor's funds.

- (c) The RBZ report states that a Trust Bank cheque in the sum of Z\$961,180 261.00 was made payable to National Discount House (NDH).¹⁵² The proceeds were distributed by NDH amongst the former Trust Bank directors on the former CEO's instructions as follows;
- The sum of Z\$106,293,987.68 was paid to Luapa Holdings. One of the executive directors, Mr Goromonzi was a director of Luapa Holdings (Pvt) Ltd.
 - The sum of Z\$214,992,809.13 was paid to Wilta (Pvt) Ltd. Mr Nyemba, the former CEO was a director of Wilta.
- (d) Amounts of \$84,446,950.94 and \$800,000,000.00 were paid from Trust Bank to Uzben Enterprises and Transtobac companies in which the Finance Director Mr Nhlupo was a director and shareholder.
- (e) An amount of \$800,000,000.00 was paid from Trust Bank to Transtobac, a company in which Mr Dhliwayo, one of the executive directors was a shareholder.
- (f) According to the report, the bank's former directors and employees, Mr William Nyemba (CEO), Christopher Goromonzi, (Executive Director), Phillip Dhliwayo, Kevin Sachikonye (Chairman of the board), J Mavhimba, N.J MacDonald, Amon Chitagu, and Kennedy Mutonhori were involved in this fraudulent transaction which contravened the Prevention of Corruption Act, Exchange Control Act and Companies Act.

The investigations revealed that of the transferred amount, US\$2,972,946 was used for purchasing 100 percent shareholding in an offshore company called Barato through a special purpose vehicle called Blantyre, another offshore company incorporated in the Virgin Islands. The directors of CJ & MA, in which the following are shareholders and directors: William Nyemba, Nyevero Hlupo, Christopher Pasipanodya Goromonzi, Josephat Hatidikani

¹⁵² The cheque would have been made to the discount house (NDH) as an investment by Trust Bank, however, upon maturity, the proceeds from the investments which should have been paid to the bank were distributed to the personal accounts of the directors.

Kevin Sachikonye and Phillip Pishai Dhliwayo. It is also noted that Mr N. Hlupo and Mr. P Dhliwayo later became directors of CJ & MA after they had bought shares in the company using depositor's funds.¹⁵³ The conduct of the former Trust Bank directors besides being an abuse of shareholder funds was in violation of a number of statutory requirements. Firstly, the investigation by KPMG revealed that no Reserve Bank of Zimbabwe Exchange Control approval was obtained when the US\$2,972,946 in the above transaction was paid out.¹⁵⁴ Secondly, all the signatories of the facility also appear to have violated section 11 of the Exchange Control Regulations S.1 109/1996 when they issued guarantees against a foreign denominated loan.¹⁵⁵

¹⁵³ On the instructions of the Trust Directors, the CEO of Tarsal was instructed to deposit the US\$2,972,946 into Conafex's bank account. KPMG concluded from their investigations that the money was the purchase consideration for shares in a company called Barato and was not used for the purposes set out in the credit approval form or the facility letter referred to above. The KPMG report further indicates that a false paper trail was created by the former executive directors in order to give the impression that CJ & MA borrowed funds from Trust Bank on an arm's length basis with no connection to the directors

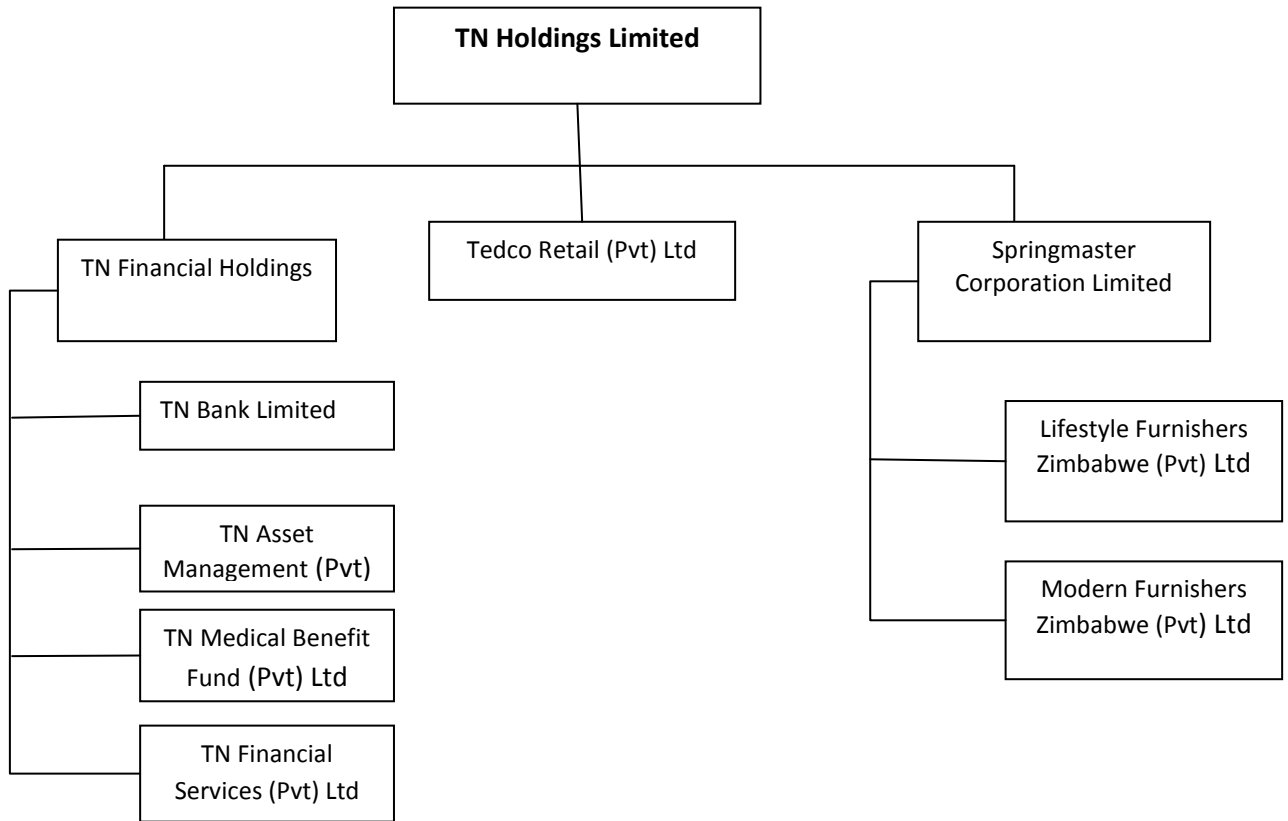
¹⁵⁴ Before 2009, due to severe foreign currency shortages within the country, all foreign currency transactions payments required the approval of the central bank

¹⁵⁵ Section 11 of the regulation prohibits a Zimbabwean resident, without due authorisation, from incurring an obligation denominated in foreign currency without obtaining the requisite authorisation, unless such payment is to be made with 'free funds'. In this case, the former directors of Trust Bank incurred an obligation denominated in foreign currency without obtaining the requisite Exchange Control approval by issuing personal guarantees in respect of an amount of US\$1, 933, 00 which they borrowed from A1 Shams, an offshore company, in order to make a part repayment of the US\$3,000,000.

APPENDIX 9: Royal Bank: Summary of Curator's findings.

- When the minimum capital requirements of commercial banks was increased by the RBZ, Royal Bank illegally gave financial assistance in the sum of Z\$480 million to its shareholders/directors for the purchase of its own shares;
- The directors of Royal Bank carried on the business of the bank recklessly; with gross negligence and intent to defraud the depositors, in doing this, the directors sought to advance their personal interests ahead of the bank;
- The directors had gross disregard for various statutes and regulations and for the Bank's Credit Risk Policy and Credit Risk Manual or proper risk management principles;
- The directors did not adhere to sound corporate governance principles. They claimed to observe the Code of Best Practice as recommended by the Cadbury and King's Reports but failed dismally to do so;
- Certain officers and directors showed complete disregard for the requirements of the Exchange Control Regulations. They bought foreign currency outside the country and paid for it within Zimbabwe and they transferred currency outside the country without obtaining exchange control approval.

Appendix 10: Corporate Structure of TN Holdings.



Source: TN Holdings website

Appendix 11: NMB Board Sub-Committee as at March 2010

Name of Committee	No of Executive Directors	No. Of Non-Executive Directors	Total
Audit committee	0	3	3
Remuneration Committee	0	3	3
Loans Review Committee	0	3	3
Credit Committee	2	2	4
ALCO, Finance & Strategy	4	2	6
Risk Committee	2	3	5

Source: NMBZ Holdings Annual Report, 2008

APPENDIX 12:TN Bank Limited Board Structure (As at July 2011).

Executive	Non Executive
Never Zirowwa - CEO (MBA Banking).	Elias Hwenga - Non Executive Chairman (BAcc)*
Douglas Mapuranga- Director IT (Diploma, IT).	Antony Eastwood (LLBS)
Stella Mandimika – CFO (B Acc).	Bernard Wekare (B.Acc)
Hazvineyi Kapfunde – Executive Director (MBA)	Jonah Mungoshi (BBS)
	Alex Danso (B Med, MSc)
	Dr Steve Chivasa(PHD).
	Ternard Kwashirai (BA Econ.)
	Christopher Maswi (B Acc)

Source: Author’s compilation from fieldwork data.

* The qualifications of the board members are in brackets.