
Bank Performance: Do Political, Legal and Regulatory Institutional Reforms Matter?

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Abstract

This study sought to ascertain if political, legal, and regulatory factors influence the performance of Tanzania's publicly traded commercial banks. A quantitative data was obtained from three major commercial banks notably CRDB, NMB, and NBC with a sample size of 120 employees of the commercial banks. The result from multiple regressions shows that political and regulatory reforms improved commercial banks' operational performance. However, legal reforms had a significant negative impact on commercial bank operational performance. The study therefore recommends that commercial banks be politically flexible and adaptable to changing political regimes. Fiscal and monetary policies must be flexible. The central bank and ministry of finance and planning should regularly review regulations because they affect commercial bank performance, the research suggests. Legal reforms should be fair to commercial banks and their customers to avoid harming commercial bank performance.

Keywords: Political Factor, Regulatory Factor, Legal Factor, Commercial Banks, Tanzania

JEL Classification: G24, P37

1. Introduction

According to Iskandar et al. (2019), a country's banking company's expansion is one factor that actively contributes to the nation's overall economic development. The private banking sector is said to have significantly contributed to both the macroeconomic environment's recovery and the high level of economic development prior to the financial crisis of 2008. Maintaining the system's stability and viability has moved to the top of the priority list for all countries as a result of globalization and increased financial integration (Javaid, 2016). This is due to the rise in financial integration brought on by globalization. Therefore, it is essential to ensure that the

commercial banking sector, which acts as a representative of the financial sector, continues to generate revenue and operates efficiently. The financial stability of commercial banks is directly correlated with the rate of economic growth in any nation, whether Tanzania or any other country at large. The current returns that investors are seeing on their investments are directly attributed to the economy's robust and ongoing operation. In essence, it promotes more investment and helps the economy expand. Poor or mediocre performance in the banking sector can lead to bank failures and crises, both of which are detrimental to economic growth (Boateng, 2019).

Tanzania's commercial banks have undergone significant changes as a direct result of the liberalization strategy that was implemented on the banking system as well as on other economic and social sectors in 1991. The banking sector, along with other sectors of the economy and society, used this strategy. Pastory and Qin (2012) assert that in addition to the banking sector, other economic and social sectors have also been affected by the liberalization process. The barriers that had prevented commercial banks and other businesses from participating were eliminated by the changes. According to Lema (2019), this was one of the elements that made it possible to successfully strengthen the institutional framework, regulatory agencies, and commercial banks. Commercial banks in Tanzania have recently performed differently. The number of commercial banks in the nation have decreased due to their poor financial performance. 42 banks with licenses in 2022. 34 commercial, 2 community, 4 microfinance, and 2 development banks were among them. Tanzanian commercial banks have been impacted by recent legislative and regulatory reforms. Banks and other financial institutions in Tanzania are governed by the BFI Act of 2006. Another is the Bank of Tanzania Act of 2006. Due to persistent capital shortages, the Bank of Tanzania closed five smaller financial institutions in 2018. More specifically, in July 2018, one of Tanzania's top ten banks was taken over by the Bank of Tanzania due to liquidity problems (PWC, 2019).

Studies on the local and global levels have looked at bank profitability factors. The majority of these studies, such as Lema (2019), concentrated on internal profitability factors like sufficient capital, bank size, asset quality, liquidity, and operational effectiveness. As a result, macroeconomic factors that affect the performance of commercial banks have been disregarded. Additionally, factors investigated in relation to commercial bank performance are inflation, interest rates, GDP, and money supply. Moreover, Developments in politics, law, and regulation have been ignored. This study looks into the performance of Tanzanian commercial banks in relation to political, legal, and regulatory developments.

2. Literature Review

Yıldırım and Berkman (2022) used quarterly data of the G-7 countries from the second quarter of 2012 to the fourth quarter of 2021 to examine how national political risks affect bank profitability. The study found a strong correlation between political risk index and bank profitability. Similarly, Alsagr (2020) examined how geopolitical risk (GPR) affects banking sector profitability in emerging countries of "oil and nonoil reliant." Research on annual macroeconomic statistics of all GPR index countries from 1998 to 2017 created the index. According to the fixed effect model, the GPR significantly affects banking industry profitability, and findings of the fixed-effects shows a decrease in domestic lending to the private sector whenever there is an increase in the level of geopolitical threats. Ngakoka (2020) used panel data to evaluate the performance of Tanzanian commercial banks in light of the policies of the central bank, the researcher investigated the effectiveness of Tanzania's commercial banks in light of the central bank's policies. According to statistics, the sole regulatory factor influencing Tanzanian commercial banks' success was their operational efficiency. Robin *et. al.* (2018) evaluated the financial performance of commercial banks in Bangladesh before, during, and after a period of financial liberalization in terms of profitability indicators. According to empirical results, banks' returns on assets (ROA) and returns on equity (ROE) have not changed considerably as a direct result of financial reform; nonetheless, the banks' net interest margin (NIM) has increased.

Cerqueiro *et. al.* (2016) analyzed the effects of the collateral channel on the entire economy. The findings of the study indicated that a decrease in the value of collateral results in a reduction not only in the total amount but also in the duration of a firm's debt, as well as in the investment, employment, and assets of the organization. It was found that the modification to the legislation had an effect on investment decisions as well as decisions on asset allocation. As a result of the adjustment, businesses that lowered their holdings of assets with low collateralizable value and organizations that maintained more liquid assets were both less productive and imaginative. Yona & Inanga (2014) did a study on Financial Sector Reforms in Bank Regulations and Supervision and its Impact on Banking Competitiveness and Economic Efficiency of Commercial Banks in Tanzania. Results indicate a negative relationship between changes to banking regulations and economic effectiveness, which leads to the conclusion that commercial banks' competitiveness has not been impacted by financial sector reforms. Furthermore, Obadire & Obadire (2023) did a study on the impact of bank regulation on bank performance. The study concludes that Basel III's adoption of stricter and higher regulatory requirements has contradictory effects on the financial performance of African banks. This conclusion is based on research showing that while

liquidity and the minimum capital requirement have negative effects on the financial performance of African banks, the capital adequacy ratio has a positive impact.

3. Methodology

The study was conducted in Dar es Salaam in three commercial banks. As a result, the individuals who worked for the three commercial banks—that is, the CRDB bank, the NMB bank, and the National Bank of Commerce (NBC)—constituted the population of interest for the purpose of this study. From these, a sample size of 120 respondents was chosen. Due to the fact that employees of the selected banks were busy with their day-to-day jobs and obligations, the research utilized the convenience sampling technique. This was done because it was possible that some of the employees would not be accessible for the study. As a result, the technique of convenience sampling was appropriate because it picked respondents on the basis of their willingness to participate in the study and the ease with which they could participate (Creswell, 2014). The research utilized first-hand quantitative information. According to Creswell (2014), primary data are those that are gathered freshly from the field and are not modified in any way. As a result, the research collected information from a sample of respondents representing three commercial banks. The study used questionnaire as a data collection tool. A closed ended 5-point Likert scale questionnaire was prepared covering all the study variables. The questionnaire was administered to the selected respondents and were collected after they have been fully filled.

Table 1: Variable Measurements and References

Variable	Measurements	Source
Political Reforms	Banking services tariffs; Change of political regimes; Government spending; Monetary policy	Yıldırım and Berkman (2022) & Alsagr (2020)
Regulatory Reforms	Reserve requirement; Interest rates; Capital adequacy; Liquidity requirement	Ngakoka (2020) & Robin et al. (2018)
Legal Reforms	Legal protection for lenders and borrowers; Legal protection for depositors; Loan Insurance	Cerqueiro et al. (2016)
Operational Performance of Commercial Banks	Market share; Service delivery; Technology; Customer satisfaction	Akbar (2021) & Nigangwa (2020).

Source: Researcher (2023)

During the course of this investigation, operational performance was analyzed. The operational performance evaluates factors such as market share, the effectiveness of service delivery, the degree to which technology is adopted, and the level of happiness experienced by customers (Nigangwa, 2020). The study had three independent

variables which are political risk, regulatory reforms and legal reforms. The political factor was measured by the change in political regimes, introduction of transaction tariffs, fiscal policy and monetary policy and the regulatory reforms were measured through reserve requirement, capital adequacy, interest rates and liquidity requirement. The legal reforms were measured through the legal protection of the lenders, legal protection of the borrowers and loan insurance.

The linear multiple regression model was used to analyze the data collected to determine the relationship between study variables. The model used was of the form:

$$OP = \alpha + \beta_1 PR + \beta_2 RR + \beta_3 LR + \epsilon \dots\dots\dots 1$$

Where OP is the Bank operational performance, α is the Constant term, β_1 , β_2 & β_3 , are regression coefficients, PR = Political Reforms, RR = Regulatory Reforms, LR = Legal Reforms, and e represented the error margin for other variables that may not have been captured. In this study, a test of significance was carried out where the coefficient of determination was used as a measure of how much variability in bank performance can be explained by the regression equation. The significance of the regression model was determined at a 95% confidence interval and a 5% level of significance.

4. Results

The multiple regression analysis was used to determine the degree to which each independent variable affects the variable that is being studied (the dependent variable). The multiple regressions analysis produced a multiple regression model which shows the joint influence of independent variables on the dependent variable. Findings show that political reforms, regulatory reforms and legal reforms jointly have influence of 89.6% ($R=0.896$). Also, the R-Square of 80.3% ($R\ square=0.803$) indicates that political factor, regulatory reforms and legal reforms explain the variation of commercial banks operational performance by 80.3% keeping another factor constant.

Table 2: Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.896 ^a	0.803	0.798	0.50210

Note: a. Predictors: (Constant), LR, RR, PR .Source: Authors Computation

Multiple regression analysis also yielded regression coefficients that indicate the direction of the causal link between each independent variable and the dependent variable. It also generated p-values, which indicate the importance of the association between the variables. The results are shown in Table 3 below;

Table 3: Regression Coefficients

Variables	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.300	0.187		1.602	0.112
Political Reforms	0.810	0.119	0.795	6.825	0.000
Regulatory Reforms	0.453	0.107	0.477	4.224	0.000
Legal Reforms	-0.329	0.104	-0.382	-3.178	0.002

Note: Dependent Variable: OP. Source: Authors Computation

The results of the regression analysis revealed that political reforms have a positive, favorable and significant effect on the operational performance of Tanzanian commercial banks. The factor has a p-value of 0.000 and a beta coefficient of 0.810. As a result, increasing the political element as a dependent variable which resulted in a 0.810-unit improvement in commercial bank operational performance. This suggests that political influences have an effect on Tanzanian commercial banks' operational performance. The result of this study is in contrary to the findings of Yildirim and Berkman (2022). Moreover, the results of the regulatory reforms have a positive, favorable and considerable impact on bank operational performance. Regulatory changes were discovered to have a beta value of 0.453, implying that every unit rise in regulatory reforms leads to a 0.453 unit increase in commercial bank operational performance, and significant given the p-value of 0.000. this finding is in line with the study of Ngakoka (2020) and contrary to that of Robin *et. al.* (2018). According to the results of the multiple regression analysis, legislative reforms have a negative and significant impact on the operational performance of commercial banks. Rising legislative changes have a decreasing effect of -0.329 on commercial bank operational performance. A p-value of 0.002 indicates that the association is statistically significant. The finding is in line with the study of Ariasa et al. (2020).

5. Conclusion and Recommendations

The political reforms such as change in political regimes, banking services tariffs, government spending as part of fiscal policy and monetary policy jointly have positive impact on the operational performance of commercial banks. Thus, the political decisions of the country are helpful to the improvement of the financial system including the commercial banks. Also, the regulatory reforms which are normally implemented by the regulatory authorities such as the central bank and the ministry of finance are geared towards improving the financial system of the country which also includes the commercial banks. The reforms such as reserve requirement, interest rates, capital adequacy and liquidity management are important first for regulating the financial system and second for improving the operations of the commercial banks.

However, the legal reforms is more of consumers than the banks. Therefore, the legal reforms are affecting the operations of the bank in a negative way. The legal reforms which are legal protection for lenders and borrowers, legal protection for depositors and loan insurance looks to be against the operational performance of the commercial banks.

This study recommend that the commercial banks should be encouraged to be flexible with the political factors; they should be dynamic enough to react according to the political regimes. Also, they should be flexible with the fiscal and monetary policies of the country. For, instance when the government introduces new tariffs, commercial banks should adjust their internal charges for customers not to feel the pinch. Flexibility will help commercial banks to maintain their customers. Also, the study recommends to the policy makers who are the regulatory authorities such as the central bank and ministry of finance to regularly review the regulations since they influence the performance of the commercial banks. Therefore, they should administer more regulations which are geared towards enhancing the performance of commercial banks. Currently, regulations on government tariffs and internet banking have to be reviewed. Moreover, regarding the legal reforms; authorities should also implement legal reforms which are fair to both, the commercial banks and their customers so that they do not adversely affect the performance of commercial banks.

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