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Asset Quality and the Financial Performance of Commercial Banks in South Sudan

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Abstract

Banks are of great and noteworthy importance in preserving and promoting the advancement of diverse economic sectors, making them crucial components of the economy. They shift the resources' attention from areas with surpluses to those with deficits. However, majority of nations have encountered banking issues that have necessitated significant banking system reforms. The issues are primarily the result of domestic factors including poor banking supervision, ineffective management, and insufficient capital. Making sure companies participating in the sector are managed prudently is a crucial aspect of bank regulation. The primary aim of this study was to determine the effect of asset quality and the financial performance of commercial banks in South Sudan. An explanatory research design was used in the study. The target populace was commercial banks in South Sudan. There were 29 commercial banks that existed in South Sudan between 2017 and 2021. The study used purposive sampling to sample 23 banks that were in operation between 2017 and 2021. Secondary information was used in the study. For analysis, the obtained information was cleaned and imported into STATA 17. Descriptive statistics and regression analysis was conducted. The inferential statistics used were correlation and regression. Descriptive outcomes showed that the mean asset quality ratio from 2017 to 2021 for the commercial banks in South Sudan was 0.262, with the least asset quality ratio being 0.622 and the most being 4.395. Trend outcomes were clear that asset quality was inconsistent amongst South Sudan commercial banks. Outcomes were clear that asset quality negatively but significantly impacted by the performance. The study concluded that asset quality had a negative and noteworthy impression on financial success. As a result, the report advises banks to refrain from holding too many loans relative to their overall assets, as this reduces liquidity and negatively impacts the bank's ability to operate. The study suggests that banks implement appropriate credit risk management procedures. This is because inadequate credit risk management procedures lead to a large percentage of nonperforming loans, which eventually have a negative impact on commercial banks' profitability.

Keywords: *Asset quality, financial performance, commercial bank*

1.0 Introduction

Performance refers to the transformation of inputs into outputs to obtain certain results (Pinto et al., 2018). According to George, Walker and Monster (2019), organizational performance embraces three explicit spaces of firm outcomes: shareholder return, and performance on the financial and merchandise markets. The emphasis of this study will be financial success.

Financial success can be devoted to the degree of stability and safety in taking care of deposited funds (Muinamia & Atheru, 2018).

One of the profitability metrics, return on assets (ROA), weighs the efficiency with which a bank can turn a profit from its assets (Shrotriya, 2019). Return on assets will be of use in this study to gauge banks' financial performance. When a bank performs well, its shareholders are guaranteed dividend payments, which in turn encourages them to invest more money. On the other hand, poor financial performance not only causes hardship, as in the case of the monetary crisis of 2007–2008 but also causes bank failures (Abdul, 2017). Access to financial services for consumers, businesses, and governments becomes difficult when commercial banks are underperforming (Adeyinka et al., 2018). According to Bhati, De Zoysa, and Jitaree (2019), the asset quality of commercial banks affects how well they perform.

Asset quality involves assessing a bank's resources to make it a bit easier to weigh the scope and the extent of the credit risks that are attached to the bank's operations (Kitaka, Kiragu, & Marwa, 2020). Even though asset quality is imperative to the bank's profitability there are other essential elements that the financial market depends on. The non-performing loan (NPL) is a metric used to assess asset quality in banks and is connected to the value of loans that are offered (Kadioglu & Ocal, 2017). In this study, the asset quality will be the ratio of loans that are not performing to the total loan book.

South Sudan is the youngest nation in Africa, having only achieved independence in 2011. Commercial banks were already operating in South Sudan before its independence, although being managed by the Bank of Sudan, which was based in North Sudan at Khartoum (Mabil, 2019). However, since the nation's independence, commercial banks and financial systems in general have developed and are now seen to be of great importance to the nation (Chol et al., 2019).

The Bank of South Sudan, the nation's central bank, oversees and controls banking business in the nation. The capital and largest city of the nation, Juba, serves as the bank's permanent headquarters. It oversees monetary policy and guarantees both price and exchange rate stability. Eleven commercial banks were in operation at the time of independence. There are currently twenty-nine commercial banks in South Sudan (Mabil, 2019).

In recent years, South Sudan's banking industry has experienced rapid expansion. This is due to the Bank of South Sudan's efficient regulation and prompt changes. Recent years have seen a volatile macroeconomic environment in South Sudan. However, despite the banks' expansion most banks were declining in performance and others have ceased operations (BSS, 2021).

1.1 Problem Statement

Banks are of great and noteworthy importance in preserving and promoting the advancement of diverse economic sectors, making them crucial components of the economy. They shift the resources' attention from areas with surpluses to those with deficits (Guțu, 2018). However, majority of nations have encountered banking issues that have necessitated significant banking system reforms. The issues are primarily the result of domestic factors including poor banking supervision, ineffective management, and insufficient capital. Making sure companies participating in the sector are managed prudently is a crucial aspect of bank regulation (Shrotriya, 2019).

Commercial banks in South Sudan have shown deteriorating financial performance in the period 2017 to 2021. This has been shown by the substantial number of commercial banks making losses and with the profit-making ones exhibiting fluctuating performance as well as reducing financial performance levels. For example, only 25% of the commercial banks made a profit in the year 2021 with the majority making losses (BSS, 2021). Further, the sector has made losses for the last five years. For example, Liberty Commercial Bank recorded a decline in ROA from 0.58 in 2018 to 0.53 in 2019 and a further decline to 0.51 in the year 2020. If nothing is done to improve South Sudan's commercial banks' financial performance, then the contribution of the banks to the country’s welfare will be watered down.

1.2 Objective of the Study

The primary aim of this study was to determine the effect of asset quality and the financial performance of commercial banks in South Sudan.

2.0 Literature Review

2.1 Theoretical Review

Commercial Loan Theory informed this study. This hypothesis emerged from the work of Adam Smith who posited that a financial institution should provide short-term settling loans to enable the firm to meet working capital requirements. This implies that the bank should balance between the issuance of long-term and short-term loans to ensure that it is liquid enough to meet its operations and demand withdrawals. The implication of this theory to financial institutions is that the loans to deposit ratio and the loans to assets ratio should not be remarkably high as this would make the institution vulnerable to liquidity risks. This is because customer deposits in financial institutions are short-term demand liabilities that customers can call at any time (Fama & Jensen, 1983).

By ensuring that the loans-to-asset ratio and loans-to-deposit ratio do not exceed given thresholds, financial institutions can meet cash withdrawal demands from their customers and be able to meet other emergency cash requirements. The basis of the commercial loan theory is that customer deposits in financial institutions are near-demand obligations that should be backed by short-term self-liquidating liabilities. By reserving some of their deposits and ensuring that their loan-to-deposit ratios do not exceed risky levels, financial institutions would not be stressed to meet their emergency obligations when they arise (Fama & Jensen, 1983). This would provide a lower cost of capital and hence improve their financial performance. Therefore, the quality of the assets is looked at in this theory. The metric of quality of the assets in this study was calculated by taking non-performing loans and dividing by the total loan book.

2.2 Empirical Review

Roselyne, Mackton and Kiganda (2022) concentrated on asset quality and financial standing regarding Kenya's Tier III commercial banks. In this study, a longitudinal research strategy was used. STATA was used to examine panel data. Asset quality (AQ) and monetary performance had a positive link, according to Pearson's product-moment correlation. These findings suggest that asset quality significantly impacts financial success.

The study conducted by Chindengwike and Mnyampanda (2021) examined the correlation between the financial performance and asset quality of commercial banks before and after the relocation of the capital city to the Dodoma Region of Tanzania. In this investigation, purposive sampling was used. The information was taken from reputable sources, including the Dar es Salaam Stock Exchange (DSE) and the Bank of Tanzania (BOT). The results demonstrate a correlation between financial success and asset quality both before and after Dar es Salaam was replaced as the capital city. Therefore, it is determined that there is a statistically significant correlation between Tanzania's commercial banks' financial performance both before and after the country's capital was moved from Dar Es Salaam to the Dodoma Region.

AlFadhli and AlAli (2021) undertook a study on Kuwaiti banks' success and the impact of bank size. The study adopted a correlational research design. Using the data of 10 Kuwaiti banks for 10 years, results showed that banks' resource size had a negative connection with profitability, yet that connection was genuinely insignificant. Then again, results showed a huge direct connection between investor's values and bank success.

Ray (2019) concentrated on India's microfinance institutions' performance and asset quality. Descriptive was the major design used. The analysis discovered that the asset quality declined considerably throughout the study, which had a detrimental effect on the MFIs' performance. Predatory lending and unethical debt collection techniques were made possible by the MFIs' commercialization, which increased payback rates.

Wambugu (2019) concentrated on the financial health and asset quality of Kenya's commercial banks. The study used a census sampling approach rather than a causal research approach. The findings demonstrated that among the Kenyan commercial banks that were chosen, there was a hugely substantial variation in average ROE. According to the report, commercial banks' overall performance has been declining. The study settled that variations in the financial performance of Kenyan commercial banks are strongly explained by changes in asset quality.

Kimutai et al. (2019) examined the asset quality and operational effectiveness of Kenya's SACCOs. Explanatory research design and positivist philosophy were of use in this study. According to descriptive analysis, the average asset quality is higher than the regulator's mandated maximum. A statistically significant impact on efficiency was also caused by asset quality. According to the study outcomes, an increase in non-performing loans lowers efficiency.

The emphasis of Ray and Mahapatra's (2019) empirical investigation of Indian microfinance institutions was asset quality and performance. The research design for the study was desktop-based. The investigation revealed a significant drop in asset quality, which negatively impacted the performance of the MFIs. The commercialization of MFIs led to higher repayment rates and enabled predatory lending and unethical debt-collecting practices. The study's use of a desk research design reveals a methodological hole.

The study conducted by Kimutai, Jagongo, and Omagwa (2019) centered on the asset quality and efficiency of credit cooperative societies and deposit-taking savings in Kenya. In this study, positivist philosophy and an explanatory research approach were employed. Descriptive analysis indicates that the average asset quality exceeds the maximum required by the regulator. Asset quality also has a statistically significant effect on efficiency. The study findings indicate that efficiency decreases as the number of non-performing loans rises. The effectiveness of deposit-taking savings and credit cooperative societies in Kenya was the study-dependent variable, indicating a conceptual gap.

Said (2018) focused on US Commercial Small Banks' asset quality on bank profitability. The correlational research approach was used. There is a negative and strong link between ROA and the total amount of loans and leases that are past due, as well as loans that are in a non-accrual position and advances that are 90 days or more past due. Additionally, between 2011 and 2016, the analysis showed a negative connection between ROE and asset quality. Increased regulation and interest rate control can be used to explain the study's findings.

2.3 Conceptual Framework

The connection between dependent and independent variables serves as the basis for figuring out predicted results.

Independent Variable | **Dependent Variable**

Asset quality
- Non-performing loans/total loans

→

Financial Performance of Commercial banks
- Return on Assets

Figure 1: The Conceptual Framework

3.0 Methodology

An explanatory research design was used in the study. The target populace was commercial banks in South Sudan. There were 29 commercial banks that existed in South Sudan between 2017 and 2021. The study used purposive sampling to sample 23 banks that were in operation between 2017 and 2021. Secondary information was used in the study. For analysis, the obtained information was cleaned and imported into STATA 17. Descriptive statistics and regression analysis was conducted. The inferential statistics used were correlation and regression. The ratios for financial performance and the percentages for the predictor factors served as the basis for the analysis. The exams included model specification tests, multicollinearity, and normality.

4.0 Results and Discussion

4.1 Descriptive Analysis

The study used the four common measures of descriptive statistics; minimum, maximum, mean, and standard deviation to present the data patterns. Table 1 shows descriptive data, followed by interpretations.

Table 1: Outcomes for Descriptive Statistics

Variable	Obs	Mean	Std.Dev	Min	Max
ROA	115	0.587	0.867	-0.420	7.010
Asset Quality	115	0.262	0.622	0.006	4.395

According to the descriptive findings, the mean return on assets from 2017 to 2021 for the commercial banks in South Sudan was 0.587, with the least ROA being -0.420 and the most being 7.010. The standard Deviation fluctuation was 0.867.

The findings also showed that the mean asset quality ratio from 2017 to 2021 for the commercial banks in South Sudan was 0.262, with the least asset quality ratio being 0.622 and the most being 4.395. The standard Deviation fluctuation was 0.006.

4.2 Trend Analysis

Trend results were outlined for the independent and dependent variables.

4.2.1 Trend Analysis for Asset Quality

The outcomes of the trends of asset quality ratio are shown in Figure 2.

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Figure 2: Trends for the Asset quality

The outcomes showed that the mean for the asset quality ratio was 0.248 in the year 2017. The mean of the asset quality ratio increased to 0.276 in the year 2018 and further increased to 0.293 but declined to 0.275 in the year 2020. The mean of the asset quality ratio further declined to 0.121. This infers that the asset quality of banks in South Sudan was inconsistent. The decline in asset quality from 2020 to 2021 could have been a result of Covid 19. The study findings agreed with Wambugu (2019) who found that asset quality was inconsistent in most banks.

4.2.2 Trend Analysis for ROA

The outcomes of the trends of return on asset ratio are shown in Figure 3.

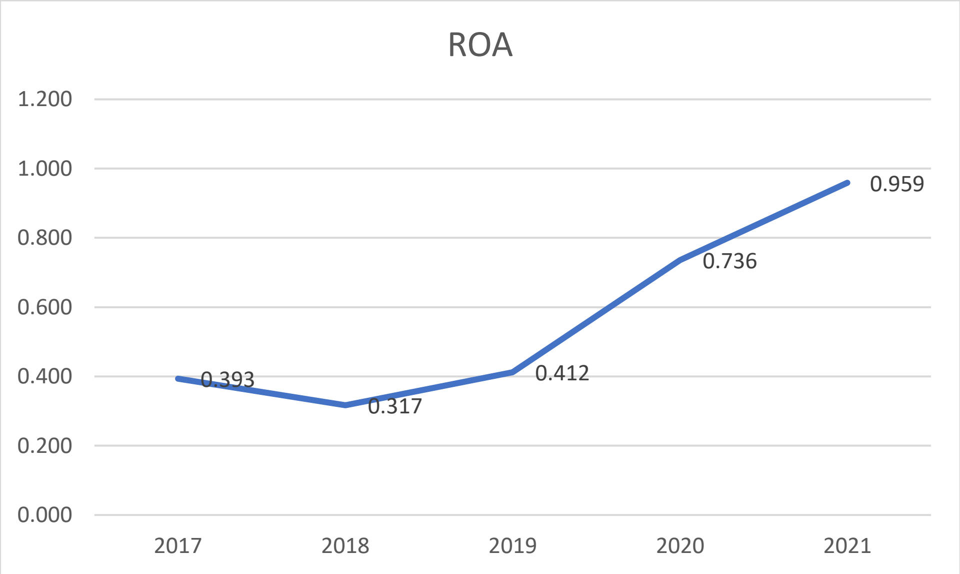

Figure 3: Trends for the ROA

The outcomes showed that the mean for the return on assets ratio was 0.393 in the year 2017 but decreased to 0.317 in the year 2018. The mean return on assets ratio increased to 0.412 in the year 2019 and further increased to 0.736 in the year 2020 and further increased to 0.959 in the year 2021. This infers that the ROA of most commercial banks in South Sudan was inconsistent.

4.3 Correlation Analysis

The investigation used Pearson Correlation to conduct the correlation between asset quality and financial performance of commercial banks.

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Table 2: Outcomes for Correlation

	ROA	liquidity reserve
ROA	1	
Asset quality	-0.119	1
	0.04	

Further results showed that there was a negative and significant correlation (r= -0.119, P=0.004) between asset quality and the financial success of commercial banks. The outcomes were consistent with Said (2018) who found that there was a negative and strong link between ROA and the total amount of loans.

4.4 Diagnostic Tests

These assumptions are varied based on the study. The current study tested assumptions of normality and multicollinearity.

4.4.1 Test for Normality

The Shapiro-Wilk test, which examines the relationship between facts and conforming normal scores, was used to determine whether the study's results were normal. Table 3 presents the results.

Table 3: Outcomes for Normality

Variable	Obs	Statistic of Shapiro-Wilk	P-value
Asset quality	115	0.8878	0.511
ROA	115	0.8836	0.098

The outcomes were clear that the p-values were all less than 0.05 implying that the variables were normally distributed.

4.4.2 Test for Multicollinearity Test

Multi-collinearity outcomes are displayed in Table 4.

Table 4: Multi-collinearity Outcomes

	VIF	1/VIF
Asset quality	1.48	0.677

The outcomes in Table 4 show that multicollinearity was absent; all variables had VIFs of less than 10. Similar to this, the asset quality under consideration had tolerance levels above 0.1, indicating that multicollinearity was not an issue.

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4.5 Panel Regression Analysis Results

Panel regression results between asset quality and bank performance are presented in Table 5.

Table 5: Effect of Asset Quality on Bank Performance

ROA	Coef	std. dev	z	P>|z|	{95%Conf.Interval}	
Asset quality	-0.2500	0.1212	-2.0600	0.0390	-0.4876	-0.0124
_cons	0.6526	0.1321	4.9400	0.0000	0.3937	0.9115
R squared=0.1420						
Wald chi2(1) =40.25						
prob>chi2=0.0392						

The results showed that asset quality accounts for 0.1420 of the variances in financial performance. This indicates that asset quality was responsible for 14.20% of the differences in financial performance. Outcomes (β=-0.250, p=0.0390), were clear that asset quality negatively but significantly impacted the bank's performance. Outcomes were consistent with Ray (2019) who discovered that the asset quality declined considerably throughout the study, which had a detrimental effect on the MFIs' performance. Outcomes were however not in agreement with Roselyne et al. (2022) who indicated that asset quality (AQ) and monetary performance had a positive link.

4.6 Hypothesis Testing Results

$H_0$1 is the initial hypothesis. Asset quality did not significantly affect the success of the banks in South Sudan. With a P value of 0.0390 which was less than 0.05, the discoveries demonstrate that asset quality has a significant effect on the financial performance of commercial banks in South Sudan. As a result, the investigation disproved null hypothesis $H_0$2. Outcomes were consistent with Ray (2019) who discovered that the asset quality considerably declined throughout the study, which had a detrimental effect on the MFIs' performance. Outcomes were however not in agreement with Roselyne et al. (2022) who indicated that asset quality (AQ) and monetary performance had a positive link.

5.0 Conclusion

The study also concluded that asset quality was seen to have a negative and noteworthy impression on financial success. Therefore, an upsurge in asset quality would lead to a decline in financial success of banks in South Sudan. The study further concluded that the performance of commercial banks is hampered by high levels of net loans. Loan loss provisions, loan advances, and non-performing loans (NPLs) can all be used to assess asset quality. Asset quality guarantees that creditworthy borrowers who can repay their loans are given credit.

6.0 Recommendations

The study concluded that asset quality had a negative and noteworthy impression on financial success. As a result, the report advises banks to refrain from holding too many loans relative to their overall assets, as this reduces liquidity and negatively impacts the bank's ability to operate. The study suggests that banks implement appropriate credit risk management procedures. This is because inadequate credit risk management procedures lead to a large percentage of nonperforming loans, which eventually have a negative impact on commercial banks' profitability.

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