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The Impact of Policy Reforms on Bank Efficiency and Savings Mobilization in Ghana

1. Introduction

The efficiency of financial markets in promoting financial deepening and savings mobilization of financial resources has been recognized by policy makers and economists such as Ronald McKinnon (1973) and Edward Shaw (1973). McKinnon postulates that an increase in holding financial assets (financial deepening) by the public promotes savings mobilization, which leads to higher levels of savings, investment, production, growth, and poverty alleviation. However, financial market intervention by governments in developing countries constrains the potential of financial markets to mobilize savings for growth and development.

In the 1980s, as part of their structural adjustment programs, many developing countries embarked on financial sector reform to remove the vestiges of financial market repression in order to promote financial market efficiency and savings mobilization. As part of Ghana's financial sector reform, which was supported by the World Bank and the IMF, the government launched the Financial Institutions Sector Adjustment Program, hereafter referred to as FINSAP, to address Ghana's endemic financial sector problems.

This study provides a detailed examination of the problems in Ghana's banking sector that led to the implementation of the financial sector reform. Based on the problem analysis, this study raises various policy research questions as a basis for an analytical framework and hypotheses formulation and testing framework. Answers to the policy research questions and hypotheses were assembled through field survey of 45 bank branches, including rural banks in four regions of Ghana. The survey includes the administration of survey questionnaires to bank managers, bank staff and employees, bank depositors at the various bank branches, bank examiners, and regulators at Bank of Ghana, Bank Supervision Department. Other methodologies include parametric statistical analysis of prudential and audited bank data, as well as other macro-financial and macroeconomic data over the study period from 1980 to 1997.

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On a micro level, the study develops an index of banking efficiency and bank performance (TARCSIMEL) for comparative analysis of Ghana's banking sector. The study also examines the efficacy of existing and new policy changes in promoting banking efficiency, soundness, and savings mobilization for credit allocation to the private sector.

2. Findings of the study

The study shows that the financial sector reform has had a considerable impact on the capacity of the Ghanaian banking sector to mobilize financial savings. The post-reform era witnessed the establishment of nine new banks, other non-bank financial institutions, and the so-called "magic banks" that were competing with the traditional banking sector for savings mobilization.

An important emerging feature of the post-reform financial market development in Ghana is the introduction of innovative information technology in the delivery of financial services to the public. The introduction of automatic teller machines (ATM) by the foreign banks as well as some of the newer ones have set Ghana's financial market on the path of electronic banking.

The repackaging of savings instruments through the introduction of the "Gold Account" by Standard Chartered Bank, the "Sika Card" by SSB Bank, Econbank's "Econet" and the "Barclay card," has created opportunities for savings mobilization and financial deepening.

Privatization of the banking sector has been on course. Two banks have been privatized and listed on the Ghana Stock Exchange. The remaining government-owned banks are being prepared for privatization or mergers with other, stronger banks before being divested.

The efficiency index (TARCSIMEL) analysis results show that the efficiency indicators of the banking sector have improved since the financial sector reform. The transaction costs of the banking sector have been reduced while its assets quality and capital adequacy positions have been greatly improved.

3. Remaining problems and challenges

However, there are a number of problem areas and unfulfilled expectations associated with the financial sector reform. The study shows that the financial sector reform was not accompanied by a substantial increase in bank deposit rates to obviate the negative impact of inflationary pressures on deposit rates. As a result, aggregate savings with the banking sector expressed as a ratio to gross domestic product (GDP) declined after the financial sector reform. The disaggregated savings of demand and time deposits also show the same downward trend.

Thus, a decade after the launch of FINSAP, savings rates continue to decline. Total deposits as a ratio of GDP fell from 13.45% (pre-reform) to 10.88% (post-reform). Compared to East Asia's 37% and Latin America's 20%, Ghana's savings rate is very low. Part of the reason for the weak savings response is that an unstable macroeconomic environment has undermined the reforms. From a low of 10.1% in 1992, inflation peaked at 70% in 1995 and only recently moderated to 22% at the end of 1998. The net effect is that real interest rates on deposit rates have been negative for many years after the financial sector reform.

The financial sector imbalance has led to market failure in pricing financial assets. The higher pricing of risk free government Treasury bills over risky loans resulted in a mismatch of yields on private sector loans and government Treasury bills. Additionally, the comparative high yield on government Treasury bills, as compared with deposit rates, gave rise to savings flight from the banking system to the short-term Treasury bills market.

As a result, banking institutions portfolio allocation has been in favor of short-term government Treasury bills. This has reduced the incentive for savings mobilization and efficient allocation to the most productive sectors of the economy. Also, government fiscal deficits accommodated by floating billions of Cedis in Treasury bills crowd out small- and medium-sized enterprises from the credit market. Consequently, domestic private lending has not increased to an appreciable level.

FINSAP has not made a significant impact on the term structure of bank lending in Ghana. The assets of Ghanaian banks consist primarily of short-term investments, dominated by Treasury bills. High nominal yields on Treasury bills, fueled by large government deficits, have provided a relatively safe outlet for bank's profit maximization, leaving a big gap in the long-term segment of the market.

FINSAP encourages consolidating banking activities and downsizing as a means of increasing bank efficiency. However, one negative effect of this strategy was the reduction of the banking services national reach before new structures that provide alternative banking services for the rural population could be put in place. As a reaction to this rapid phase-out of formal banking in rural communities, informal finance has expanded, presenting the challenge of integrating the two sectors and harnessing the informal sector's financial resources or micro-finance and rural credit.

Although there has been some progress in the privatization of state owned banks and the formation of many private financial institutions, the dominant position of the four largest commercial banks remained entrenched. As a result, competition in the banking sector is still low. The oligopolistic nature of the banking industry means that the smaller and more efficient private banks, which have already been established, continue to earn "super-normal" profits by pricing as followers of larger banks.

The macroeconomic imbalance of the government budget deficit and its monetization tends to weaken the Bank of Ghana's monetary control powers. As a result, its indirect monetary control powers are found to be ineffective in stabilizing the macroeconomic aggregates that provide an environment conducive to savings mobilization, growth, and poverty alleviation.

Our survey results confirm the continued lack of confidence in the banking system following the unorthodox policies of the government in the 1980s and 1990s. The majority of the respondents indicate that the lack of banking confidentiality and a fear of government probes of individual bank accounts serve as a deterrent to deposits, especially large deposits. Additionally, the continued inflationary pressures and the perennial depreciation of the Cedi also affect the public's confidence in depositing their funds with the banking sector. As a result, depositors have increased their asset holdings in foreign denominated bank accounts as a hedge against the inflationary and depreciating value of the Cedi.

One positive impact is the disappearance of long waiting lines at some of the large banks that have introduced ATMs and computers. However, at other state-owned banks that have not been fully computerized, some depositors still complain about delays in making deposits or withdrawals.

In terms of banking hours, the majority (76.2%) of the respondents indicated their dissatisfaction with the current banking hours (8.30 a.m. - 2.00 p.m.). Sixty-five percent of the respondents indicated their preference for longer hours, from 8.30 a.m. to 4.00 p.m. On the other hand, 35% indicated their preference for bank opening hours on Saturdays.

The study also finds that proximity of banks to place of work and/or residence is a major determining factor.

Over 80% indicated that their choice of banks was largely influenced by close proximity to work place or residence. This finding has major policy implications for branch banking networks and mobile banks serving the suburbs of the country's major metropolitan cities.

We also tested the impact of the government's 1991 decision to start paying government employees and civil servants salaries through the banks. Our survey shows that the majority (87%) of the beneficiaries find the practice very convenient. Additionally, the majority indicate that the practice helped their savings habits. This is also confirmed by some bank managers. However, there is currently insufficient data to test whether this policy change has resulted in increased savings by the government employees.

The study shows that the reform of the banking sector has no significant effect on the use of checks as a means of payment. The financial system still remains cash-based with large liquidity outside the banking system. This has limited the potency of indirect monetary policy to stabilize macroeconomic aggregates for economic growth. The bank management indicated their reluctance to accept checks in payment due to the following factors: (a) the lack of universal acceptance of checks by the public, merchandise houses, and retailers, (b) lack of verification due to depositors' and customers' lack of universal identification numbers, (c) lack of credit bureaus, and (d) the slow clearing system of checks drawn on third parties.

One other major objective of FINSAP is to upgrade the skills and educational training of the Bank of Ghana's Bank Supervision Department staff. It is encouraging to note that over 85% of bank examiners are university graduates, and over 14% hold post-graduate degrees. However, the majority indicated that they had not attended any professional courses of training since joining the bank. In terms of access to computer and information technology, over 85% of the bank examiners (both on-site and off-site) indicated that they had no access to computers on the job. As a result, bank examination results have to be processed manually on typewriters. This practice, as the examiners admitted, leads to low productivity and delays in completing bank examination results. Additionally, the lack of computerization of commercial banks, especially in the rural areas, slows their progress on the job.

These findings are corroborated by the results of bank employee surveys. Over 62% indicated that they have not participated in any professional training since joining the bank. Also, in terms of job satisfaction, over 51% indicated their displeasure with their current work status due to lack of professional training and the lack of opportunity for promotion and professional advancement. This finding is very troubling and merits further investigation.

Privatization of government-owned commercial banks has raised the issue of public confidence regarding the safety of depositor funds in times of banking troubles. Thus, the issue of bank deposit insurance has come to the forefront. The majority of bank managers indicate their preference for introducing bank deposit insurance to cover depositor funds in the event of bank failures. This response is also corroborated by depositors who express their confidence in knowing that their deposits are protected by some form of insurance.

The results of our study show that there has been a redirection of credit away from the agricultural and the industry sectors that were favored during the pre-FINSAP era. The beneficiaries of increased credit are those sectors such as construction, service, retailing, and hotels that are perceived by the banks to be less risky than the agricultural and industry sectors. As a result, the agricultural sector's share of GDP, which rose to 60% of GDP before the pre-reform era, declined to 40.8% in 1997.

The goal of the country's Medium-Term Co-ordinated Program of Economic and Social Development, popularly referred to as "Vision 2020," prescribes a savings ratio of 20% by the year 2000. This savings rate was intended to sustain an average real GDP growth rate of 8% so that by the year 2020, Ghana would have advanced to middle-income status with an increased standard of living comparable to that of Singapore. However, Ghana's current savings rate is too low to support such a growth prospect.

The policy dilemma facing Ghana is that of sustaining growth and development in the face of falling savings mobilization. This raises the policy question of how to increase financial savings in order to promote economic growth. The policy dilemma originates from the high post-reform inflationary pressures in Ghana that resulted in negative real interest rates, which provides disincentives for savings mobilization. This situation has also created a savings/investment gap in the country. Thus, if no action is taken to reduce the inflation rate and therefore to increase savings, this may lead to further widening of the savings/investment gap and deepen Ghana's dependence on foreign funds for domestic projects. Dependence on unpredictable foreign sources of capital may lead to a higher debt service burden and a slowing in foreign asset accumulation for financing domestic projects. The increased debt burden may also put severe pressure on Ghana's foreign exchange rate, which may escalate depreciation of its local currency.

The role of Bank of Ghana is to control and regulate aggregate money supply in order to stabilize the domestic economy through price and foreign exchange rate stability. However, in practice, the Bank of Ghana's monetary policy objective conflicts with the government's continuous budget deficit. Thus, the Bank of Ghana must have a certain degree of autonomous monetary policy in order to stabilize the macroeconomic environment for growth and poverty alleviation.

The Ghanaian experience with financial reform supports the general notion that financial reform carried out in countries with an unstable macroeconomic environment resulting from high inflationary pressures has less chance of success than in those countries where macroeconomic stability prevails at the time of reform. In the case of Ghana, the partial liberalization of interest rates has not been accompanied by increases in real deposit rates. The high inflationary pressures have resulted in negative real rates of interest. This has produced a disincentive for financial savings. In addition, liberalization of the exchange rate in an inflationary environment has led to constant depreciation of the Cedi and has created a volatile foreign exchange market. This is illustrated by the increasing dollarization process in Ghana. Based on the findings noted above, the following recommendations are offered.

4. Policy recommendations

A precondition for an efficient deregulated financial sector is a stable macroeconomic environment during the time of the financial sector reform. Thus, in order to ensure effective financial development and savings mobilization, the government should stabilize the macroeconomic environment. This will create an environment conducive to financial deepening and savings mobilization.

The role of monetary policy in stabilizing macroeconomic variables has been hampered by the government fiscal policy of deficit financing. It is therefore essential to ensure that government fiscal policies are designed to complement monetary policies, not to work against them. This will ensure harmony of monetary and fiscal policy and restore domestic and international confidence in the banking system. Furthermore, the Central Bank must have a reasonable degree of independence in the conduct of monetary policy. In this regard, the Central Bank must be free to use its instruments to attain broad targets consistent with stable economic growth and poverty alleviation. In particular, interest rate policy must be freed from governmental influence so that it can be effectively employed in response to actual or anticipated developments in the monetary situation and the rate of inflation.

It is necessary to adopt policies to lower inflation rates to single digits in order to raise real interest rates and provide a conducive environment for savings mobilization. Such practices should include efficient government revenue and expenditure management through programmed budgeting. In addition, Ghana may learn the virtues of cash budgeting from the Tanzania government. Even though others argue about its constraining impact on long-term capital spending, cash budgeting ensures against fiscal imbalances that undermine economic stability.

One major unintended consequence of reform is the closure of banks in the rural areas and the concentration of banks in the urban centers. It is necessary to adopt various policy measures to restore banking services to the rural population. This may include the introduction of "banks on wheels" to the rural areas of the country in order to mobilize savings from the informal sector. Further savings mobilization may be enhanced by the revival of the Ghana Post Office Savings Bank, which dates back to 1888. This may be possible since there is a post office in every town in Ghana and many Ghanaians, especially the elderly people, used that service in the past.

Based on the survey report, location plays a major role in the choice of banking services among Ghanaians. The concentration of banks in the urban centers has denied the suburbs of banking services. We recommend moving banking services closer to the people in the suburbs. The extension of bank branches and ATMs to the suburbs will enhance mobilization of savings. Additionally, it will ensure access to depositor funds, especially during weekends, when most people's demand for cash is on the rise.

The survey results indicate that the current banking hours from 8.30 a.m. - 2.00 p.m. are inconvenient for the public, especially market women and white-collar workers. There is a need for longer banking hours and Saturday banking services. In addition, the location of ATMs at market centers in urban cities and major government institutions will enhance the public's bank patronage.

One ingredient of savings mobilization is the enhancement of the public's confidence in the banking system. Policy changes such as the introduction of privacy laws to govern individual bank deposits will go a long way in encouraging the public, especially large depositors, to keep their money in the banking system. In addition, prudential regulations monitoring the activities of banking institutions and the enforcement of banking laws will enhance confidence in the banking system.

It is necessary to provide high quality bank services. Adoption of high professional standards, prompt attention to depositors' needs, and shortening the time it takes to withdraw or deposit funds will reduce the public's banking transaction costs. This could be achieved by (a) hiring and training of qualified staff and management team, (b) utilizing bill-counting machines to shorten long waiting lines at banks, (c) computerizing of banking services, and (d) ensuring sensitivity to depositors' complaints.

Bank deposit insurance, as has been practiced in many developed countries, ensures the protection of depositors' savings during times of insolvency or bank failure. The existence of deposit insurance would have averted the loss suffered by many depositors with the "magic banks" during the early part of the financial sector reform. Thus, the government should encourage the introduction of bank deposit insurance programs in order to ensure public confidence in the banking system. This may also protect the government from unnecessary bailout of private banks during times of bad management decisions.

The encouragement of check usage and the reduction of cash holding should be encouraged. The establishment of legal frameworks and the enforcing of "returned check laws" will increase the banking institutions' and the public's acceptance.

One other hindrance to check usage is the structural rigidity of clearing checks through the banking system. Computerization and the establishment of a national or regional clearing system would expedite check clearance and encourage the banking sector and the public to embrace the use of checks. Furthermore, the use of innovative banking products and services such as the "Sika card" and other pre-payment devices may reduce the excessive liquidity outside the banking sector.

The computerization of the Bank of Ghana, especially the Bank Supervision Department (BSD) should be accorded top priority in order to link the BSD with the commercial banks. This will enable bank examiners to carry out their on-and off-site examinations of the commercial banks more efficiently.

Integration of the informal and formal banking system will enhance the prospects of mobilizing savings from the informal sector in the urban and rural areas. It is recommended that other commercial banks and non-banking financial institutions embrace the introduction of innovative products such as the "Susu savings scheme" initiated by other commercial banks in Ghana. This Susu scheme will increase savings mobilization from the informal sector.

The government's imposition of high reserve requirements on the banking sector leads to the banks' inefficient portfolio management. This also leads to higher spreads between lending and deposit rates. It is recommended that the government consider lowering the high reserve requirements on deposits in order to allow for portfolio diversification by the banking sector. Additionally, the government should adopt the strategy of synchronizing its sources and uses of funds by exploring the opportunity to issue long-term bonds in order to raise needed funds for long-term projects. This may remove a lot of pressure from the short-term securities market.

Financial deepening can also be accomplished by the introduction of improved banking products such as credit cards, commercial paper, credit counseling, travelers checks, money orders, bankers acceptance facilities, and other services that facilitate commercial transactions.

It is necessary to rationalize the cost structure of banking services. The multiplicity of service charges such as commission on turnover (COT), charges on checks purchased (C/P), commitment and processing fee, and interest on drafts and monitoring fees have a tendency to increase the effective cost of borrowing from the banking system. This practice also discourages the public from saving through the banking system.

The separation of the banking system into commercial, merchant, and development banks seems to be gradually eroding. As an indication of change, many developed countries are following the footsteps of the German and the United States systems of "universal banking," or a one-stop banking where banks engage in providing various financial services, including traditional deposit mobilization and credit allocation, purchase of stocks on behalf of clients, and investment and consumer credit counseling.

Recent developments and the insolvency of some of the rural banks have undermined the public's confidence. This development has threatened the unit banking system's status of providing banking services to the rural population. There is the need to integrate the rural banks with the strong and well-managed commercial banks in the urban areas in order to infuse the rural areas management talents and skills. Furthermore, it is necessary to train the staff and management of the rural banks. Frequent monitoring and examination will also improve the rural banking sector's efficiency and solvency.

As many depositors reveal that they are at the mercy of commercial banks for loans and other banking services, it is essential for the government to enact laws to protect the rights of the public and ensure equal access to credit from the banking sector. It is recommended that Parliament enact the Consumer Bill of Rights for equal access to credit regardless of individual social status, sex, marital status, connection, and class. A cornerstone of this bill should be the enactment of various consumer protection regulations such as the Equal Credit Opportunity (ECO) and the Truth in Lending and Disclosure. It is recommended that the enforcement of this regulation be entrusted into the hands of the Bank of Ghana.

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