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Crisis, Restructuring and Challenges of Finance in Development: Recent Experiences of Banking in Ghana*

Introduction

For two years from 2017, Ghana underwent a "banking crisis" which is not fully over with continuing ripple effects. Like other crises before, the effects have been potentially cataclysmic, with life-changing social consequences for all, but particularly for the more vulnerable members of society. At the same time, however, the crisis allowed insights into the workings of the banking sector in Ghana, with opportunities to build in resilience and perhaps more closely align policy to developmental goals. An important point of the departure for this is better understanding of how the banking sector, as a result of periodic bouts of restructuring, has been positioned in relation to long-term development finance in the country.

The contemporary structure of the banking sector in Ghana derives from the 'reforms' that began in the 1980's in ostensible response to the prior decade of economic crises. The Ghanaian economy, in the period 1976 to '83, experienced severe crises as well as poor economic growth and severe balance-of-payments problems. An economic recovery program was initiated, which sought to restructure the economy and modernize the banking system.

As part of this, in 1987, a slew of financial sector reforms was introduced with the financial sector adjustment program, all of which contributed to shaping the fundamentals of the banking industry we have today. The characteristic feature of these reforms was liberalization of finance. To begin with a large number of non-performing loans of existing banks, especially the public banks, were absorbed by the state as part of the restructuring process. Almost hand in hand with this was a general reduction of barriers to entry across in the sector, as happened in other countries across the continent of Africa. Virtually everywhere, small non-banking institutions, savings and loans companies exploded side by side with the effort to grow stock markets. The minimum capital requirements for banks reduced such that savings and loans companies could transition very quickly into full-scale commercial banks. In tandem, the development banking sector was killed, and all the development banks became general commercial banks. The concept of development banking was thrashed.

However, the explosion of banks and financial institutions did not necessarily co-relate to actual deeper lending or finance to activities in the wider economy. Instead, as in all parts of Africa which underwent similar reforms, the growing numbers of banks and financial institutions continued to make their money from government debt, mobilizing savings and then transfer those to government securities. So even as the numbers of banks and financial institutions grew, the percentage of credit to GDP has remained almost unchanged, on average, across the continent of around 20, 25 percent of GDP since the 1980s. This relationship was, furthermore, underpinned by developments in commodity prices in the

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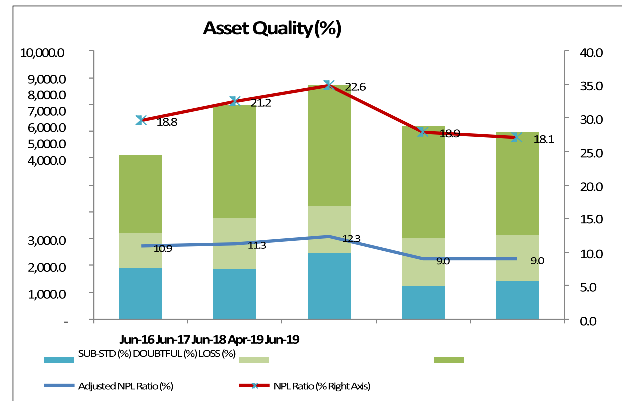
international market. Thus, whenever gold and cocoa and oil prices rose, credit to government also. It is a procyclical process with no countercyclical arrangements for the future, nor regulatory measures of capacity to align banking better to the wider economy and its deepening.

The on-going distress in Ghanaian banking is best appreciated in this light

Renewed Crisis and Banking Sector Responses

Following the West African Ebola crisis of 2015, the energy crisis of 2012 to '15, the Ghanaian economy was once again launched into a tailspin. The sectors most affected were the energy, oil and gas, manufacturing, and the nascent tourist and hospitality sectors. By September 2015, the country's debt-to-GDP ratio crossed the 70% debt mark, and Ghana was officially classified as a highly indebted country. By 2015, the banking system was also in crisis. Non-performing loan ratios exceeded 10%, and some banks were unable to meet their liquidity obligations without resorting to borrowing from the Central Bank. Capital adequacy ratios were deteriorating, and some banks struggled to meet minimum requirements. By June 2016, the Bank of Ghana was reporting non-performing loan ratios of 18.8%. There was a further down-take by June 2017 to 21.2%



Banking Sector Performance, 2016-2019
Source: Bank of Ghana, Banking Sector Report, July 2019

As the system's liquidity deteriorated, more banks were applying for liquidity support from the Central Bank. This facility is usually short-term in nature, but some bank borrowings were becoming long-term, in certain cases exceeding 24 months. To further compound issues during this period of crisis, the financial sector saw an average of two to three new banks being licensed each year. Meanwhile, the more established banks were experiencing levels of high staff turnover as new entrants and some non-banking financial institutions were paying over the odds for experienced personnel, particularly, experienced managers, credit, IT, and operational personnel. As the banks struggled to maintain their cohorts of skilled personnel, the overall quality of staff dwindled, and staff costs, as a percentage of income, increased year on year. In 2015, the Central Bank, at the suggestion of the World Bank, commissioned a loan quality report on the sector, and as a result, some initial courses of action were embarked on. An immediate decision was taken to reduce the amount of government debt sitting on the banks' books by converting the energy sector debts of almost 1 billion Cedis to a 10-year bond, and the plan was discussed to increase the minimum paid-up capital of banks. However, it was not until the last quarter of 2017 that the

Central Bank announced a banking sector reform program. New minimum paid-up capital was 400 million Cedis, which is the equivalent of about $94 million.

As part of the reform program, the Central Bank also issued four other significant directives, which went some way to improving the control they had over the banking system. The first was the Financial Holding Company Directive, which sought to bring the holding companies of banks and other regulated companies under their ambit. There's also the Capital Requirements Directive, which was issued as a corollary to the minimum capital requirements announced in 2017 and requires that banks hold capital that reflects the amount of risk they are prepared to take. There's also Corporate Governance Directive, which gives some guidelines as to level of qualifications, tenor, age limits, etc. of the directors of banks. There's a Fit and Proper Directive, which also outlines a framework for determining whether significant shareholders, directors, and persons occupying key management positions are fit and proper persons. The results of this reform program have been largely effective in identifying system weaknesses and strengthening somewhat the existing sector. That has led to improvements in asset quality. As at December 2018, the Bank of Ghana is reporting NPL ratios of 18.2%, down from a high of 23.5 in April that year.

Crisis Responses and Issues Arising

An important outcome of the policy responses are changes in the profile of the sector. At the commencement of the banking sector reform program in 2017, there were 36 licensed and operating banks, of which 3 were state-owned. By the conclusion of the program at the end of 2018, the number had reduced to 23, out of which we now have 6 state-controlled banks. Of the 14 banks which no longer exist, government had taken over 9. In addition, 2 previously privately-owned banks will now be majority state-owned through a new special purpose vehicle called the Ghana Amalgamated Trust Plc (GAT) which was created in January 2019 to raise funds to support the capital requirement of certain local banks. Now, these improvements, however, have come at some great cost. The total bill is currently pegged at about 13 billion cedis, which is approximately 5% of thew GDP. Public confidence is low. In the period from 2017 to 2019 banks assumed a really tight credit stance, particularly in relation to large corporates and SMEs. In addition, there were periodic runs on the less liquid banks and smaller financial institutions down the food chain. The limited liquidity of some banks left many depositors unable to easily retrieve their savings not only from the banks but from the smaller institutions that were funded by the banks. Overall confidence in the traditional banking system remained so low that the Bank of Ghana is taking out advertisements daily, assuring the public that banks are safe and urging people to renew their confidence in the system. The regulators expended considerable resource, time, and energy on this surgical clean-up with some positive achievements.

Regulatory Reforms

However successful the above interventions may have been as crisis management it is clear that longer terms issues are raised that need addressing. To begin with, recurrent full-blown banking crisis cannot be the way forward. It is expensive on many fronts and has the added disadvantage of distorting the country's developmental path. Asking banks to raise capital while engaging in massive sectoral reforms has been counterproductive. In the event, total new funds raised by banks

amounted to a mere 2 billion cedis, which is like $400 million. This is a fraction of what it costs the government and is just about matched by funds required to be raised by GAT. It is difficult to raise new funds when public confidence is low. The better option is constant, consistent monitoring and evaluation of the financial health of banks by the regulator, this being far preferable to the periodic grand sectoral restructuring initiatives, which are destabilizing to the economy and costly to the public purse. Now, if this continuous assessment approach is to work, however, changes are required. The regulator must be more proactive, must be empowered to act on information they acquire during audits and inspections. They must understand the underlying economic drivers as well as the implication of events and happenings in the finance and banking sector. The regulator should establish standard procedures for early intervention in financial institutions which are overly dependent on liquidity supports. The Central Bank also needs to invest in its Banking Supervision department, ensuring that it is fit for purpose, has access to updated monitoring systems and analytical tools and is able to constantly train and recruit personnel from top-flight institutions. Finally, the regulator should have the processes and procedures in place to oversee and audit their own agents as a means of ensuring that they do not go rogue. And in this regard, there is more work to do.

However, the more fundamental issue goes beyond regulatory over-sight and capacity. This concerns how to make the banking systems fit for the development purpose. One of the reasons why banking failures occur in Ghana is because the commercial banks have been made to bear the burden of development. The sources of funds are short-term. There may be some core longer-date funding, but this is usually a very small percentage of their loanable funds. And in order not to put their customers' deposits at risk, short-term funds have to be matched to short-term lending. However, the development agenda requires a longer-term funding, and this is the mismatch. In the events, however, some clients borrow short-term to invest long-term; to build factories, to order, acquire, and install equipment. They are building the productive capacity of the country. But if they are unable to pay in the stipulated time, prudential regulations require that these loans become non-performing. The lending bank is required to make provisions, profitability and liquidity are impacted, and crisis looms.

The commercial banking model is ideal for trade and commerce but, in the absence of long-term funding partners, is of limited use in supporting a development agenda. This is particularly pertinent in with regard to the funding of agriculture. The majority of farms in Ghana are small-scale operations. However, with the rate of population growth and, particularly, an expanding urban population which needs to be fed, much more productive farming, including farming at scale is becoming necessary. Such levels of farming require intensity of investments which can hardly be met by existing rural banks as well as the commercial banks would struggle to fill the void. The question for policymakers must be how to safely provide long-term funding to expand productive capacity in both industry and agriculture. In this regard, Ghana could do worse than go back to the development banking concept.