Creating an effective transparent banking and financial system in Ghana to promote foreign direct investment for the private sector development

Tweneboah Senzu, Emmanuel

Frederic Bastiat Institute- Africa, Cape Coast Technical University-Ghana

13 November 2019

MONOGRAPH

PROJECT FINANCE (2019) CONFERENCE, ACCRA- GHANA

11TH -13TH NOVEMBER 2019.

TOPIC:

CREATING AN EFFECTIVE TRANSPARENT BANKING AND FINANCIAL SYSTEM IN GHANA TO PROMOTE FOREIGN DIRECT INVESTMENT FOR THE PRIVATE SECTOR DEVELOPMENT

Presented Paper Sponsored by: Frederic Bastiat Institute, Africa (www.fbiresearchedu.org)
Affiliations: Cape Coast Technical University, Ghana (www.cctu.edu.gh)

Emmanuel TWENEBOAH SENZU, is a professor of economics, and banking. Director of Research Frederic Bastiat Institute, Africa. Fellow of International Federation of Technical Analysts (IFTA), Maryland, USA.

---

tsenzu@fbiresearchedu.org | Ghana office: SEC-GICEL Block A9/10- Accra, Ghana.

ABSTRACT

It is a paper presented at the project finance conference 2019 in Accra-Ghana, with the article focus to propose structural innovations required to attract foreign direct investment for the current emerging market dynamics evolving around the formal and informal economy of Ghana with a special study focus to the small and medium scale enterprises towards its sustainable economic growth.

Keywords: *Banking & Finance, Financial Sector, Macroeconomics, Monetary Policy, Central Bank, Foreign Direct investment*

Jel Codes: E5, E22, E26, G21, G28

Questions subjected for inquiry and model design:-

1. How should, the transparent banking system look like in the context of a developing economy?

2. What is the State of the Banking and Financial sector of Ghana as of today and the aspired progression to the future?

3. What is the structural functioning of the financial sector of Ghana, the strength, and weakness?

4. What is the effective role of foreign banks, towards the economic stability of Ghana?

5. How should, the quality of retail banking through micro-finance institutions, be modelled as a product for foreign investment funding?

6. What quality standards are required of a financial market and its Institutions to attract foreign investment?

7. How should the policy design for the autonomous operation of the Central Bank in fragile countries be modelled for effective performance?

This is to acknowledge the conference organizers, especially to (Surv.) Kofi Obeng Ayirebi, the Chairman of TrustworkOakBuild International Ltd.

A. **HOW SHOULD A TRANSPARENT BANKING AND FINANCIAL SYSTEM BE DESIGNED**

It is mostly submitted in numerous public debates in the form of media publications, in Ghana, as well on most electronic cables of the member countries of the African Union, enquiring for transparency in banking, as a demand reformation mechanism. I hereby, do differ on my intellectual stance, because the extent of one desire for transparency in Banking has a direct correlation to the quality of regulatory laws enacted to govern the setup of Banking Institutions. As once argued by Salami (2010), Africa was previously absent from the International Financial Market, excluding South Africa due to weak financial regulation regimes and failure to implement international financial standards, but as at 2007, Nigeria, Ghana and Kenya became active and Ghana judged the best-performing capital market in the world in 2008 report of Bloomberg statistical studies. Which the existing empirical evidence available concludes, Africa as a continent currently, could not be exempted from other continents in terms of having a good legislative instrument governing their banking system, even if, there are still identified poor banking regulatory rules, it will still not exceed 9% in examining the regulation structures and procedures of Banks in the 54 countries of Africa per empirical reports (Senzu, 2019).
This indicates a significant improvement after the report of Benhamdan, et.al (2016) suggesting that, even though the Banking penetration of West Africa and Central Africa is among the lowest in the world, the regulatory framework is more favourable in West Africa than in Central Africa. Furthermore, this study does acknowledge the works of Bending, et.al (2016) on the regulatory standards of Banks in Sub-Sahara Africa, which contends, it's needed to evolve to bring its Banks into closer alignment with the Basel principle and best practices across the board. While it's supervisory authorities remain short of capacity and expertise in many markets, limiting them to on-site visits. The field study confirmed Bending, et.al (2016) argument that, across the continent of Africa, it is largely observed that the challenges in the finance sector, emanate from the poor supervision on the behavioral conditions of agents at play, within the financial market. Mostly the behaviours of agents are careful designed to exploit the loopholes in the financial market and the related regulations as observational findings, hence, difficult to preempt other than observing critically, to make note of any anomalies in early stages before it gets out of control, like the case study of the Central Bank of Ghana regulatory measures to bring sanity to the financial market, leads to the collapse of sixteen (16) Banks, twenty three (23) Savings &

Loans companies and three hundred and forty-seven (347) microfinance companies in the financial industry of Ghana (Bank of Ghana Report, 2019).

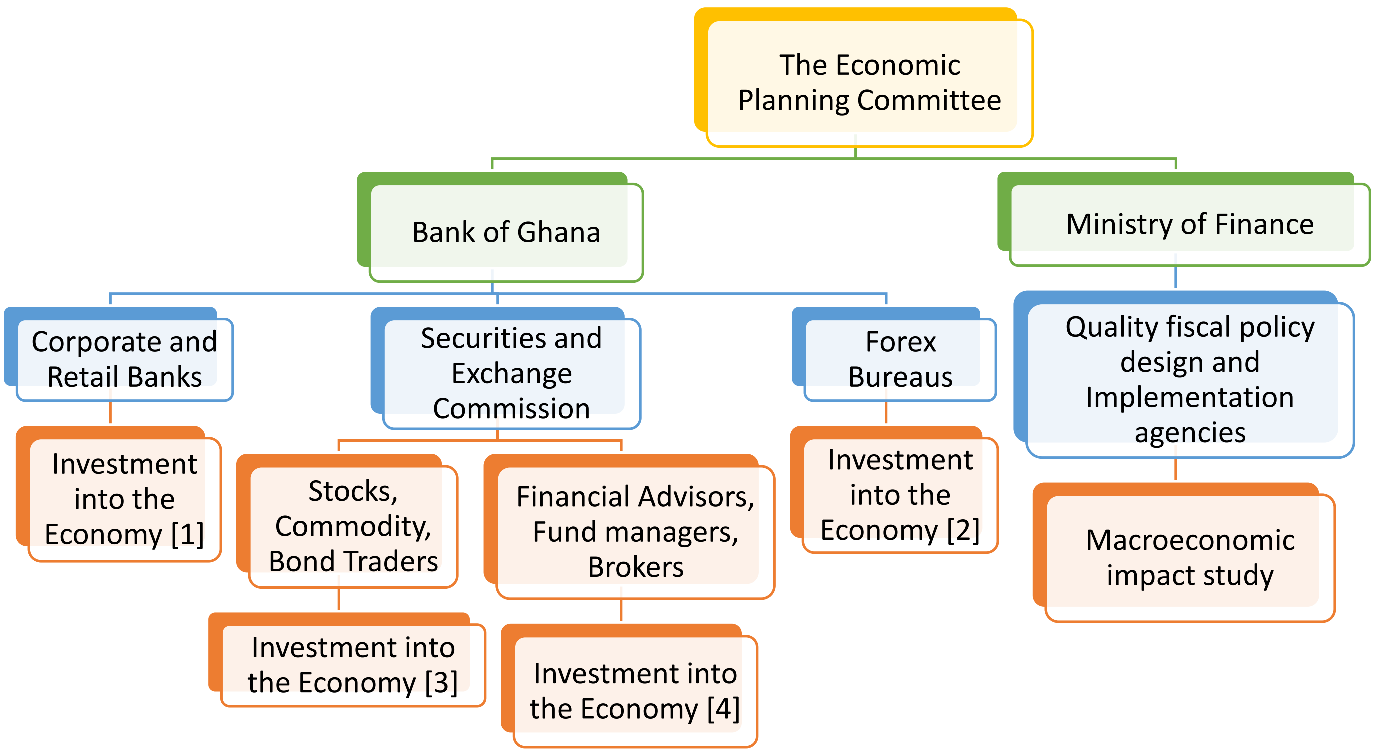
A1. Exiting model of Central Bank supervisory role and recommendation

The paper suggests that the current existing accounting-based data used by the Central Bank of Ghana as the Commercial or Retail Banking reports for risk and sensitivity text analysis may not be sufficient for supervisory standards. There is the need to establish a detailed internal data model between the commercial banks and the Central Bank on the extent of short term domestic project investment in the SMEs sector as a microeconomics boost programme, which should be an assessment recommendation criteria for Ghanaian banks performance and innovations for reward, taken into consideration the kind of economic market run by Ghana and most developing countries in Africa.

Even though Commercial or Retail Bank credit reporting to Central Bank, especially on SMEs Investment, is not an entirely new model in the Ghanaian Banking system. However, the focus on this submission as a proposal, is the Central Bank taking a keen interest and priority in such reports to reward, the innovatively performing banks, in a strive to solve SMEs investment challenges at a lowest capital cost in 'short term financing,' such will trigger the competitiveness in Banks investment innovations to the SMEs sector because the ecosystem of the Ghanaian formal economy is domestically driven by SMEs and externally by Corporate enterprises largely foreign investment. Which only requires government chosen rules of regulations, in the matter of law to be free and fair, as well as equitable to the market, not a system that upholds rules that lack fairness in favour of government banks, in most cases against the private sector Banks performance initiatives. This therefore stresses the vital role of the quality of laws and its role to promote financial market development as argued by (Armour et. al, 2009a; North, 1990).

Fig. A2. The Observed Structural Working Model of the Economy and the Financial System of Ghana

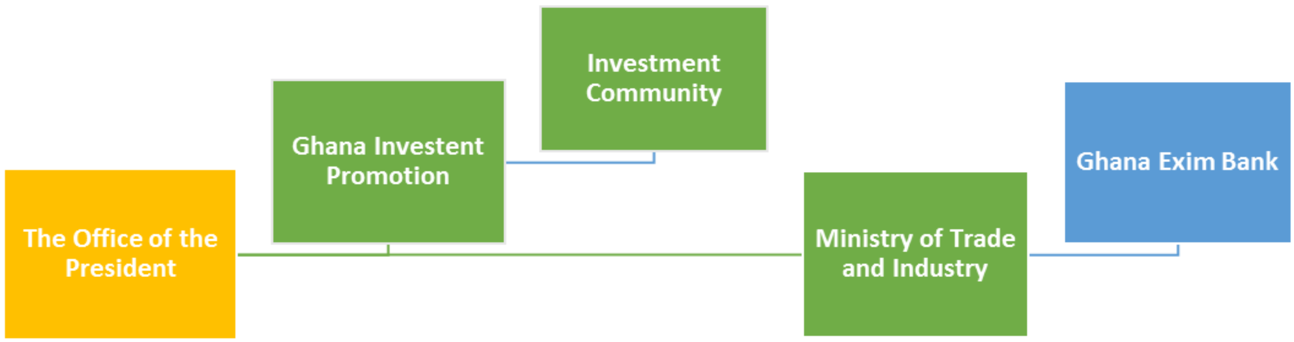
Model -1-



E. T. Senzu, 2019; Model-1-and Chart designed

†Model 1 and 2 is a presented exhibit of a projected economy and financial working system of Ghana, according to the observer conceptualized model.

Model-2-



E.T. Senzu, 2019; Model-2 and Chart designed

i. The Analysis of the Strength of Model 1 & 2

The strength of such a model structure of 1 & 2 is that all formalize transactions will need a bank account as a conduit for transactions, hence, easy to monitor the market volume and velocity of exchange, a means to approximately measure the health of the economy in a financial index.

ii. The Analysis of the Weakness of Model 1 & 2

The model 1&2 fails to prioritize and appreciate the exact sectors of the economy experiencing a high velocity of market currency exchange performance, furthermore lacking the indicators to analyze the cause and effect.

- This model, pay no attention to the harmonization of the significant output effects of various sectors of the economy to appreciate the true state of domestic economic performance, relating to growth.

- This model upholds a conception that, if there are an inter-ministerial and agency meetings, it establishes a harmonized execution at the Ministerial / Agency level within the economy, and that in practice beyond documented book rules, is false.

B. THE FUNCTIONAL STRUCTURE OF THE ECONOMIC MARKET OF GHANA; THE STRENGTH AND WEAKNESS

The paper argue at the backdrop of tremendous changes and complexity involved in the modern international trade and its related competition as succinctly argued by Shiozawa & Fujimoto (2018), on the cohort of age structure of current economy, diversified nature of economic structure of constituent countries and many more of complex factors drives the fiscal space of modern economy, which forced the architecture of contemporary monetary theory to adocate the functional separation of the Central Bank from the political governance of a State. Such an autonomous request of the Central Bank operation gives it's an independent introspection to the financial health of the economy as a check balance to fiscal management space. Unfortunately, in Ghana as well as many developing countries, the Central Bank may have a legal framework of autonomous in function, but in practice is a subservient to political administration. Hence, the consequence is foreign investors never consider this kind of fragile economy on the merits of independent market performance, rather makes the decision based on the collateral equity of the trustworthy level of government authorities in such countries, to determine the state of market risk in favour of investment.

Senzu (2019) posits that there are three (3) categorical industries operating within the Ghana economic ecosystem, constituting its active business market, which are;

i.The Corporate Sector - 12%

ii.The MSMEs Sector- 36%

iii.The Informal Sector- 52%

With the 12% forming the corporate sector, are made-up of governmental agencies holding 7% out of the 12% in Ghana's economy according per his empirical report. Which such agencies of government are naturally set up as non-profitable agencies in their Enterprise mandate, and reported such mandatory tasks by law is mostly abused on the implementation phase, which goes to the disadvantage of the State in terms of debt burdens against the expenditure books of the Central government. And the 5% are the multinationals with the most observed to be involved in high-tech complex illicit financial outflow as in capital flight and tax heavens in abetting with some of the indigenous politicians and lawyers. However, one must acknowledge that in the presence of advanced technology towards the exposure of tax heaven bearing Entrepreneurs and Politicians in the World, published by Panama Paper (2016), as an expose' has curb the act to a minimal trend in the context of the Ghanaian economy.

MSME's sector holds 36% of the volume of market transactions, which has been poorly exploited due to the poor performance of the financial institution in the past, because the setting-up of the local Banks in Ghana has been an arena innovatively exploited by the majority of financial opportunists, as a cartel grounds, where stakeholders gather their resource to create the Bank, not because of its integral function to the economy as a whole, but a means to acquire the depositors funds to run a self-serving project with parochial incentive, which has gone a long way to hurt the economy over a decade. Because most of these agendas were carried out intertwined with political interest, ignoring the consequence to the economic market as a whole.

The Informal Sector, which holds 52% of the volume of market transaction performance, and is observed to be the fulcrum of sustainable economic development to Ghana, has been largely ignored because most of the promoters of indigenous financial houses do have a self-driven incentive as soft hidden agenda and a motivation in setting up the financial institution contrary to what the Banking Laws demands in favour of addressing problems in the economic market, in return for a reward as an investor cum entrepreneur. Hence, the clean-up exercise of the financial sector, by the Bank of Ghana was to bring sanity, which is a commendable positive market regulatory engagement. However, the concerns are the method adopted in the financial market clean-up exercise.

Considering the regulatory actions taken, the effort of the Central Bank of Ghana, in the clean-up exercise is to inspire the market with quality and qualified financial institutions and its promoters to address the actual challenge of the Industrial sector production, for sustainable economic growth in Ghana.

C. THE EFFECTIVE ROLE OF FOREIGN BANKS TOWARDS THE ECONOMIC STABILITY OF GHANA

In sound economic reasoning, a 12% corporate market with a low depth of currency transactional volume for five (5) quality International Banks to explore is a grossly unprofitable investment to their stakeholders as Bankers. So to have more than five International Banks in Ghana, is a confirmation that, they have the confidence to explore beyond the 12% category of the corporate market to the 36% MSME's market. As Senzu (2019b) asserts, "Success in Banking is attained not by avoiding risk but effectively selecting and managing risk." It then brings us to the question of the method of execution to achieve such an objective?

This paper suggests that, due to poor literature reports of the evolutionary dynamics of MSME's in the economy of Ghana, it is perceived as a high-risk investment zone by the International Banks. However, the indigenous financial houses with an in-depth experience of the market, and the cultural dynamics of its defined agents at play, grant them a structural system performance to handle averse risk perception.

Therefore, the paper proposes a special kind of inter-marriage of the International Banks with the local financial houses to explore the MSME's market under structural innovative finance products, with a design of transferring the projected risk to the mediator, defined herein as local financial houses under a policy framework and profit-sharing ratio programmes.

While these indigenous local financial houses enjoy the international-local Bank relation as upstream opportunity to leverage their capacity to access low-cost capital, their performance retail medium structure then becomes an avenue to critically develop an innovative financial product that will tap deeply into the informal sector economy, which contains the greater transactional operative performance and productive capacity at the blind spot of the formal economy.

On the basis of the above postulation leads to the proposed model framework that is inductively anticipated to form an axiomatic of the economic stability and sustainable growth of Ghana's economy.

D. THE DESIGN OF RETAIL BANKING THROUGH THE MICRO-FINANCE INSTITUTIONS; AS QUALITY PRODUCTS FOR FOREIGN INVESTMENT

I have already proposed the model, presented as effective to address the retail banking sector for the MSME market from the previous paragraph. However, it is realized, there is an issue of quality finance product development to attract investment support, which most local financial institutions lack.

In other to address financial product as a quality retail banking services worth international funding, the following questions need to be addressed;

Q1. Do your financial product empirically incorporate into it a deep understanding of the type of SMEs businesses highly profitable in the economic market of Ghana?

Q2. Does it establish the Incubation period for the [Q1]-SMEs as a Start-up or existing business to attain a reliable profit circle of performance?

Q3. What is the required level of experience for the [Q1]-SMEs promoters or professionals to be efficient in delivery, in other to minimize the risk impact factor?

Q4. The average investment required to promote [Q1]-SMEs business to meet the expected investment rate of return (IRR), given any adverse economic climate situations exceed 0.5 in average?

Q6. As a financial house, how practicable and innovative is your monitoring, evaluation, and risk management model towards a successful credit recovery?

[NB]* Quality documentation of the above requirements, and more to meet, with the investors' expectations in terms of pitching capacity, will easily get such fundraisers access to funding.

E. FINANCIAL INSTITUTIONS AND FORIEGN INVESTORS

In the countries across the world, one of its most trusted industries which easily attracts investors' interest, is the financial sector design and development, based on market structure and a comprehensive developed legal regulatory system to promote incentives and protect private property. However, not all companies in the financial industry easily attract investment opportunities within a proper regularized financial sector in most fragile economies, because of the questionable competency of some of the institutional promoters, who sometimes go through the licensing process politically to influence the system. These cronyism styles in influencing the financial market have discredited the reputation of the financial market of some of these developing and underdeveloped countries in Africa. However, when an International investor seeks to invest in a particular market, there are two categories of factors considered, which are;

i. External Factors
ii. Internal Factors

External Factors:

In the external factor analysis, the study report is based on the sovereign credit rating of the country, which the potential business to invest in, is located, to guide the investors on the basis to establish their interest rate on the funds as the derived cost for the capital, to be transferred onto the beneficiary of the accessible funds.

Internal Factors:

In the nature of Internal factor analysis, the investor relies heavily on the use of corporate finance analytical metrics to examine the risk-level based on the documentation pitch of the Venture, to guide setting out an additional interest rate as a premium per the anticipated risk level on the investment products, either high or low depending on the estimated cost risk. Upholding the rule that the higher the sensitive test of the business to reality, the greater is the profit, the lesser the risk level.

F. PROPOSITIONAL STRUCTURE TOWARDS AUTONOMOUS OPERATION OF THE CENTRAL BANK IN DEVELOPING ECONOMIES

In any well-structured economy, the Central Bank activities either directly or indirectly affect the following actors of the economy;

- The Banking Sector

- The Financial House, which in this paper definition, encompasses all the micro-finance Institutions, rural development banks in Ghana, and related investment agencies as fund managers, brokers, fx traders, mobile money agencies, and financial advisers as in financial securities.

- All Industries excluding the financial sector

- The informal sector (if any)

Therefore, the paper recommends, instead of the appointment of the Governor of the Central Bank influenced politically, the following is a proposed procedure outlined below in favour of developing countries for a transparent banking and financial system.

Using Ghana as a case study, an instituted electoral college has to be formed to appoint a competent governor of the Central Bank every 6yrs as a term subject to renewal. And the Electoral College formation must follow this procedure;

1. Association of Bankers appointing (5) officials of their industry to represent their interest within the college

2. The Micro-finance Institutions do the same

3. The Economics-Finance Network of Private Universities and Colleges also do the same

4. Then the Economics-Finance Network of Government Universities and Colleges also do the same

5. Then various defined and formalize industries under unionized body, meaning, if it a commerce industry all unions in commerce both government and private agree of five (5) competent delegates on their behalf appointed per their own formula to join the Electoral College.

6. The Informal Economic sector under the supervision of the Ministry of Local Government (MLG), selects their qualified Electoral College representative.

Then the second stage will be a well-structured documented criteria as a legal guide in the choice of suitable, competent, and innovative candidates for governorship office of the Central Bank by the council of State to the electoral college election for the (6)years term of office, subject to renewal on performance. The paper, therefore, submits the governorship office should be open to only two terms per candidate depending on the performance and competency. With its election held by the Electoral College expected not to exceed fifty (50) in numbers as qualified applicants who understand economics-finance and central banking management skills.

Upon the governor of the Central Bank's appointment through an election, he/she will hold a consensus with the economic planning committee of the government, and proceed to appoint his deputies and board of directors through the Central Banks staffs and the Electoral College as deem-fit towards the success of tenure.

G. **REFERENCE**

1. Armour, J., Deakin, S., Sarkar, P., Siems, M. and Singh, A., "Shareholder protection and stock market development: an empirical test of the legal origins hypothesis". *Journal of Empirical Legal Studies 6(2009a): 343-380.*

2. Bending, T., Cali, C., Fenton, N. and Marchitto, B. (2016), "The European Investment Bank in Sub-Saharan Africa". pp. 165-171. ISBN: 978-92-861-2997-1, doi:10.2867/002264

3. Benhamdane, J., El Kourchi, A., and Hidane, S. (2016), "Development of the Banking sector in West Africa and Central Africa in an era of financial digitization", pp.85-115. ISBN:978-92-861-2997-1, doi:10.2867/002264

4. Bank of Ghana (November 2018), "Banking sector report." Retrieved from https://www.bog.gov.gh

5. North, D. (1990), "Institutions, Institutional change and Economic performance." Cambrige: University Press.

6. Panama Papers (2016), "Exposing the rogue offshore finance. Retrieved from www.icij.org

7. Salami I. (2011), "The Financial crises and a regional regulatory perspective for emerging economies in Africa". *Journal of International Banking and Regulation Vol.25; Issue 3:128-139*

8. Senzu, T. E(2019b), Theoretical perspective of dynamic credit risk analysis and lending model; effective to enterprises of fragile economy. Published by Munich University Library. Retrieved from https://mpra.ub.uni-muenchen.de/id/eprint/91946

9. Senzu, T. E (2019c), A monograph report of informal economy of Ghana for the Chamber of informal economy published by Frederic Bastiat Institute, Africa. Retrieved from www.fbiresearchedu.org

10. Shiozawa, Y. and Fujimoto T. (2018), "Industrial competitiveness and design evolution". ISBN:978-4-431-55145-4, Springer Publication, Japan. Retrieved from https://www.springer.com/gp/book/9784431551447