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The Financial Services Sector and Economic Growth in SSA: Insights from Ghana

Abstract

This paper examines the role of financial services sector in the economic development of sub-Saharan African (SSA) countries and the myriad of factors inhibiting the sectors contribution to economic growth. It unpacks how regulatory inconsistencies and restrictions in West Africa have curtailed capital formation in Ghana and less than optimum contribution of the sector to economic growth. The paper suggests that excessive regulations and weak enforcement of rules, government bureaucracy and corruption, negatively affects a country's financial system. It is, therefore, necessary to balance the need for stronger regulation with appropriate levels of sector involvement in the regulatory process that supports the growth of the financial system. Participatory regulation requires that regulators proposing regulatory changes should hold consultative forums involving individuals from the private sector, corporate and private users of financial services, experts and service providers (including accountants, auditors, consultants, commercial lawyers) who can add value to the regulatory process. These issues present a number of implications that are discussed.

Introduction

Scores of studies have examined the main drivers of economic growth in sub-Saharan Africa (SSA). Accordingly, these drivers ranged from human capital development, infrastructure development, improved communication systems and economic and land reform programmes (Sahn and Younger, 2004, Calderon and Serven, 2008 and Cleeve, Debrah and Yeheyis, 2015). Records have also revealed different levels of economic growth across countries in the region with some achieving high-income status while others remain at lower levels (Akinboade & Kinfack, 2014). This body of economic growth scholarship has however not adequately captured the role of the service sector in the economic growth of SSA region. More importantly, the contribution of the financial sector to economic growth of countries in the region has not been well integrated into this body of literature in recent times. This is notwithstanding the established wisdom that improvement in financial systems contributes to efficient resource allocation and sustainable economic growth (Stiglitz, 1994; Fry, 1995; Levine et al. 2000; Beck et al. 2000).

The aim of this paper is therefore to examine the financial sector contribution and potential contribution to the economic development of SSA. Moreover, the paper seeks to identify some innovative ways through which countries in SSA can strengthen their financial system to support private sector development initiatives and to create the relevant advantages needed to compete for capital inflows from international financial institutions. The paper highlights that SSA development challenges require the integration of Africa's financial sector into the global trade and financial system. Whilst effective macro-economic and public sector management as well as private sector development agenda have been pursued by several countries in the region over the years, results have been less than expected or disappointing (Aryeetey, 1998; Abor and Quartey, 2010 and IMF, 2012). Notwithstanding the importance of prioritising investments in human capital development, infrastructure, health and environmental management, integrating Africa economic system into the global trade would require a buoyant financial services sector that provides capital to drive the growth of other sectors. The financial services sector can deepen collaborations aimed at boosting inclusive and sustainable path to economic growth and development in the SSA.

The rest of the paper proceeds by first examining the factors influencing financial sector development. The section that follows explores how these factors can enhance the international competitiveness of SSA. This leads to the conclusion and implications for future research.

The financial services sector and its development

The financial services sector plays an important role in supporting the achievement of economic growth and development objectives of nations. This paper draws on the work of McKinnon (1973), Shaw (1973), Stiglitz (1994) and Fry (1995) which emphasise that countries with strong financial systems tend to achieve sustainable growth. This is because

financial services sector has the potential to provide several benefits that enhance the degree of competitiveness of the domestic economy. Primarily, it serves as a source of capital, technology transfer, supports effective macroeconomic and public sector management, promotes human capital development, strengthens the infrastructure base, generates new employment opportunities, and increases productivity. In relation to this, Epstein and Heintz (2006) indicate that the structure of the financial services sector and the implementation of policies to attract significant financial FDI (Adams, et al, 2014) directly impact on employment and automatically creates an outward shift of the demand and supply curve (increased productivity). It is also seen as a highly desirable sector that both developed and developing economies seek to improve.

Besides providing a medium of exchange and payment system, the financial system can contribute to savings, investment and growth by mobilising and allocating investible resources to support private sector development initiatives through risk sharing (Akinboade & Kinfaek, 2014). Moreover, savings via the financial systems are channelled into productive uses and facilitate investment diversifications (Bencivenga & Smith, 1991). In this regard, Goldsmith (1969) demonstrated an empirical association between economic growth and efficiency of the financial services sector. Gertler and Rose (1994) further argue that economic growth and financial services sector development are mutually dependent. Galbis (1977) also suggests that financial sector development is a prerequisite for take-off into sustained economic growth and development. Whilst all this suggest unanimity on the vital contribution of strong financial system to economic growth and development, researchers are generally divided on the appropriate policies to foster financial sector development, particularly in SSA, given the contextual realities of the region.

Financial sector development refers to the “improvement in the quantity, quality and efficiency of financial intermediary services” (Akinboade & Kinfack, 2014, p. 814). Such improvement leads to high degree of monetisation and consequently positive economic performance (Akinboade & Kinfack, 2014). Moreover, financial sector development should imply that financial resources are made available for private sector development initiatives. In most developing countries, including SSA, the financial services sectors are underdeveloped to play this vital role of intermediation and hence the quest to bridge the gap between demand and supply of credit. For example, Wolf (2003) and Aryeetey and Duggleby (1994) cites that in East Africa, only small segments of the private sector receive credit. Arguably however, they are not necessarily the most efficient users of capital: partly because, the disorganised nature of the financial services sector and system of credit allocation make it difficult for the sector to fulfil its potential. A fragmented financial services sector is indicative of having little interaction or flow of funds and information between its various participants. As a result, it presents a difficulty in intermediating between savers and investors, thus, limiting the funds available for investment. According to the World Bank (1994) and Epstein (2007), explanations for a fragmented financial services sector is because of various structural and institutional constraints including inadequate complementary institutions such as insurance and legal contract enforcement, poor supervisory and regulatory systems.

Figure 1 depicts the circular flow of income and can be viewed as a system with five main players all linked by the actions and reactions of each other. In relation to this paper, it reinforces the concept that the main function of the financial services sector is to act as an intermediary between borrowers and savers. It works efficiently by reinvesting the savings of households in firms. As firms are able to access cheaper finance, they can expand and employ

more people from the household, reducing the burden of unemployment on the government, and increase revenues for the government. In addition, the government needs the financial sector to supplement any budget deficits. Furthermore, as the economy opens its doors (by deregulation or liberalisation of the financial markets) to financial flows from abroad, it will increase strong linkages with other financial exporting countries enabling firms and individuals to increase their wealth through investments (Adams, et al, 2015). Domestic residents can increase their wealth by being able to access international financial markets, then, economic growth emerges.

Insert figure 1 about here

To improve the private sector, Epstein and Heintz (2006) argue that the central bank policy must encourage employment-generating investment, facilitate sustainable economic expansion, and maintain macro-economic stability. In this instance, the private sector development initiatives and the financial services sector become the primary conduit through which all policies affect real economic outcomes. But, a financial services sector's contribution to the economy depends upon the quantity and quality of its services and the efficiency with which it provides them. The next section explores reasons for the financial sector reforms and how it influenced economic outcomes in SSA.

Reasons for the financial sector adjustment programmes SSA

Epstein and Heintz (2006) argue that the inherent anticipated efficiencies of financial sectors are hardly manifest in a tightly controlled financial system. Generally, in a repressed financial services sector where policies governing the system are the preserve of the government, it could also limit foreign direct investment (FDI) inflows into all other sectors of the economy. As Stiglitz (1999) further indicates, history does not offer many examples of highly

successful economies that did not allow market forces to determine competition, credit allocation and monitoring of capital for the development of the private sector. Throughout the development finance field, it has been widely advocated that financial liberalisation improves the efficiency of resource allocation into the private sector and ensures that economic development is sustained (Stiglitz, 1999; Fama, 1998). Arguably, liberalisation encourages competition for scarce resources and as such funds and resources would be available for beneficial projects. It is also possible that competition among the institutions becomes much keener and local financial institutions learn to develop and be able to compete in such an environment. Financial sector reforms are usually an important component of a country's strategy for achieving private sector development initiatives.

The work of McKinnon (1973), Shaw (1973), Stiglitz (1994) and Fry (1995) point out that a controlled financial system creates distortions of financial prices including interest rates and foreign exchange rates and has a negative effect on the amount of FDI inflows into a country's financial system, affects real rate of growth, real size and efficiency of a country's financial services sector. McKinnon (1973) and Shaw (1973) argue further that financial sector liberalisation would stimulate greater savings mobilisation and efficiency. Fama (1998), in his efficient market hypothesis, argued that in all cases a controlled financial services sector has stopped or retarded the development process of economies. Further evidence which gives credibility to these assertions is the stunted growth which has been the bane of developing economies too numerous to count in SSA. Against this background, there has been a wave of financial sector reforms across Africa, partly to gain the benefits of significant FDI inflows and/or as a response to international political pressures (Aryeetey, *et al.*, 1998) and the striving for globalisation which is believed to support the attainment of economic growth. Hence, the idea of Africa's economic reforms and privatisation was meant to create an economic atmosphere that would set the pace for the growth of the private sector

at a time when overseas development assistance (ODAs) was dwindling. In this regard, Debrah and Toroitich (2005), Estrin *et al.* (2009) and Estrin and Tian (2005) pointed out that reform to ownership makes the business environment favourable.

Financial Sector Reforms in Ghana

SSA's financial services sector has been progressively liberalised which has included the removal of controls on interest and sectorial composition of bank lending, reforms to prudential regulation, and the introduction of market-based financial (Brownbridge and Gockel, 1998). The financial sector adjustment programmes (FINSAP) was launched with the initial objective of reducing state shareholding in national banks (Neu, et al, 2010). In line with the policy of liberalising the financial sector by reducing the state's direct involvement, governments embarked on a policy of privatising some state-owned financial institutions (SOFIs) which were identified as having high levels of non-performing assets (NPAs). The World Bank (1994), Hutchful (1997), Brownbridge and Gockel (1998) maintains that attention shifted from change of ownership to bank restructuring, strengthening the legal and regulatory framework and equipping central banks with supervisory capabilities. Banking laws were amended to provide a stronger prudential regulation in terms of minimal capital requirement, reporting and lending guidelines. Non-performing loans were removed from bank portfolios to separate recovery agencies. New laws were enacted to provide stronger regulatory and supervisory powers to central banks. Entry of new banks and non-bank financial institutions was encouraged, especially through new laws in 1993 to support the development of leasing, housing finance, and other categories of non-bank financial institutions. Reforms of non-banking financial institutions, restructuring of management structure and the development of technical expertise were also carried out as part of the reform agenda (Adams, et al, 2015).

We argue that financial services sector reforms were needed to encourage the development of the financial markets to encourage the creation of new instruments for the private sector investment and the establishment of new financial institutions which would make the economy much more competitive in the world economy. Further, governments pursued interest in small banks, which fostered another generation of specialised banks including: co-operative banks, the credit banks, social security banks and unit rural banks. All these banks were charged to direct credit to specific sectors. Government intervention to overcome the perceived slow pace of private banking also took the form of pressure on state-owned banks to increase the number of branches (Brownbridge and Gockel, 1998)

Objectives of the financial sector reforms

The primary objective of the financial sector reforms in SSA was to improve financial service delivery and facilitate the development of a monetary policy aimed at tacking inflation. For that reason, since 1990s, Ghana, for example, has witnessed entry of foreign banks currently undertaking a substantial role by introducing a full range of corporate banking services such as insurance, investments and other international transactions mostly required by foreign investors operating in different sectors. Furthermore, their presence has encouraged the entry of other foreign companies into various sectors (sometimes because of *follow-the-client*) in ways that is beyond just providing international financial services (Wezel, 2004). These banks have been serving as an important point of call for foreign investors in terms of information and facilitation, business advisory and consultancy services, informing prospective investors of available incentives, purchase of accommodation and transfer of assets. In addition, the sector has witnessed an improvement in the services available to domestic customers by offering a variety of product mixes tied with a good customer service which had previously been perceived as a luxury by many Ghanaians. Foreign banks have also introduced zero-based accounts, online banking and telephone banking which have

prompted domestic banks to improve their services. In addition, the financial services sector in Ghana is undergoing rapid change which is driven partly by technological changes and the growth of competing non-banking financial institutions (Ofoeda, Gariba and Amoah, 2014).

Despite the progress made following the reforms, the objectives of the reforms have not been achieved and this paper attempt to provide some explanations that might account for this. We argue that, so far, the current structural problems facing the financial services sector in SSA have not received due attention by either those who advocated interventionism in the 1990s or those who called for private sector development initiatives by formulating appropriate financial services sector development policies that meet the needs of the 21st century. It is, therefore, necessary to analyse and examine weaknesses caused by financial liberalisation in Ghana in context of weaknesses of the supervisory process, poor access and cost of information, legal and institutional frameworks and the lessons that can be drawn from other less developed countries in Africa.

Weaknesses of Ghana's financial services sector

Although SSA's financial services has the basic characteristics of what is needed to satisfy the features for the protection of investments, rising inflation, low rate of fund mobilisation and weak capital market are some of the main weaknesses (Ojiako, et al, 2013). Moreover, there continue to be several areas within the financial sector, which necessitate extra attention and support (Inoue and Hamori, 2016). First, the size of SSA's private sector in terms of gross domestic product (GDP) compared to most emerging economies is small. Furthermore, regulatory agencies are slow in responding to the fast pace nature of the financial markets resulting in a regulatory drag (Mensah, 2003; Ministry of Finance, 2003). This, to some extent, affects the degree and speed of innovation in the sector. High degree of market volatility, absence of a workable credit information system, lack of market confidence in

interest rates (because of government interference), the lack of a long-term debt market and a limited secondary market for government debt are some of the major factors affecting the free functioning of the financial sector in Africa (Adams et al, 2014).

Weaknesses of the Supervisory Processes

Regulatory agencies in SSA need to improve the procedures of consultation with the regulated institutions and other stakeholders of the financial services sector. Whilst there is some degree of consultation, it is, however, limited to requests from the main regulatory bodies only when there is the need for them to propose certain changes (Mensah, 2013 and Ministry of Finance, 2003). This system does not allow for an effective discussion and the involvement of the major stakeholders who can affect or may be affected by proposed changes in the sector. Stakeholders mostly affected include individuals who depend on the sector for employment, corporations, SMEs and the service providers. Furthermore, the weakness of the participatory supervision feeds mistrust between regulators and the regulated. Most importantly, whereas the criteria for licensing financial MNCs are normally based on general licensing regulations and are based on a *written code*, assessments are commonly perceived to be non-transparent and biased and all these stimulate the perception of politicisation in the financial services sector (Adams, et al, 2012). In addition, a recent report by PWC (2016) indicates that the market concentration of six major banks in Ghana points to a tilted competition, best classified as oligopoly. This suggests that reforms in the financial services sector have not yet been able to stimulate adequate competition in the banking industry in Ghana. This means that new entrants have not been able to penetrate the top echelons. Preferential access to information by major players in the industry is an ongoing dilemma.

Access and Cost of Information

Whilst Anglophone West Africa is generally seen as an open economy and that getting information from regulatory agencies is comparatively easier than in most of the Francophone countries in the sub-region, unsurmountable bureaucratic systems abound. Most of the countries surrounding Ghana and Nigeria (including Benin, Burkina Faso, Mali, Côte d'Ivoire, Guinea and Niger) use French as their official language. The lack of regular access to information regarding changes to the regulatory systems and that some have an advantage in accessing information that others do not have make competition unfair. Most of the regulatory inefficiencies are because of the political persuasions of personnel in government agencies. This means that banks must show an inclination to the party in power to be able to bid for projects leading to information asymmetry and moral hazards and adverse selection (Meneghetti, 2012, Drever, et al, 2007, Akerlof, 1970 and Atrill and McLaney, 2011). These studies agree that information asymmetry, moral hazard, adverse selection and lemon problem can possibly affect the efficiency of the financial services sector.

Related studies on this subject by Tschoegl (1982), Grosse and Goldberg (1991) Buch (2000) and Agenor and Aynaoui (2010) indicates that high costs of information, accessing and evaluating projects, access to information about borrowers for monitoring purposes affect bank lending to the private sector. Furthermore, Micco and Sierra (2003 in Soussa, 2004) also found that access and costs of information are significant factors in determining where banks invest. Mody et al. (2003) conceded that information plays a major role in the development of a country's financial systems. A necessary precondition for an effective financial services sector, therefore, is that there should be readily available and accessible information about participants in the system. The absence of such information creates the conditions for moral and ethical malfeasance and, together with adverse costs, can also cause the financial sector to fail – which could be reflected in the unwillingness of lenders to extend credit at any price to borrowers. It is also a known fact that countries with advanced credit markets have

invested in an infrastructure for collecting, storing and retrieving information about participants in the sector.

Information and Communication Technology

Essinger (1999) and Abor (2005) point out that the use of ICT in banking is to give customers access to their bank accounts *via* a website and to enable them to conduct transactions on their account, given compliance with stringent security checks. Developments in technology and the rapid growth of Internet-based banking and brokerage services have transformed how financial services are delivered in SSA, but not without complications and regulatory difficulties. IT is revolutionising the financial services sector in SSA (Adams, et al, 2014). The technological landscape in the industry has observed tremendous progress with the telecoms industry being the driving force, even though still expensive. In 2010, there were six internet service providers in Ghana (Ghanaweb, 2010). Currently, there are eighteen major providers (GISPA, 2017) three of which are mobile phone companies and the acquisition of Ghana Telecom by Vodafone has also led to an expansion of mobile internet usage whilst other providers continue to expand their services throughout SSA.

Despite the progress made, Adams, et al (2014) indicate that political influence is even stifling the entry of other internet providers to drive down costs as government have failed to issue operating licences for some Technology multinationals. As a result, the BOG has set up a National Information Technology Agency to provide a framework for the use of internet-based banking. All banks in Ghana use VSAT and SWIFT technology introduced and regulated by the National Communications Authority. According to the BOG E-zwich Report (2009), internet-based banking in Ghana is facilitated by an automated clearing house system supervised by the Ghana Interbank Payment Systems (GHIPPS) under the regulation of the

BOG and deals exclusively with the development of electronic banking. E-zwich is the brand name for a common platform, whereby all connecting payment systems are linked to the financial institutions in Ghana licensed by the BOG.

The growth of the sector has indeed supported the achievement of several economic outcomes as it has positively influenced the growth of other sectors within the Ghanaian economy. This is because the progress made in promoting electronic and mobile banking platforms to some extent, has created an enabling environment to increase internet usage at a very swift rate. With the use of the internet, access is fast, convenient and available 24/7 irrespective of customer location. There are currently at least over 500 ATM machines in Ghana, however, most of them are centred in Accra (BOG, 2015). The electronic and mobile banking revolution has assisted in the delivery of banking services to customers in the remotest areas in Ghana at a lower cost. This has also paved the way for foreign and domestic banks in Ghana to strategize in certain matters such as joint planning and syndications, capacity co-ordination, interbank payments, interest rate determination, pricing of banking services, business payments systems, lending, bill payments, account alerts to customers, account to account transfers, account opening, secure messaging systems and imaging of cheque payments which were formerly constrained. Compared to the years before and after the financial sector reforms in Ghana, there is clear evidence of technological leapfrogging in the banking industry in Ghana and several systems of electronic delivery of banking services have been spearheaded by financial multinationals currently operating in Ghana. Irrespective of these progress, the sector faces severe interest rate disparities which has been difficult for the application of uniform and consistent banking sector regulations by the BOG's. The next section explores the reasons for the interest rate disparities and implications for policy.

Effect of interest rates disparities on the private sector

The Ghanaian and Nigerian banking industry in particular, has witnessed an increase in interest rates because of capital injection by existing banks to meet the minimum capital requirements introduced by the BOG (BOG, 2010 and CBN, 2010). In addition, the entry of sub-regional banks and growth in the branch networks of existing banks has created a relative level of growth. Despite the growth, high interest rates remain a major concern for borrowers and lenders alike since there is no uniform rate of interest and, as a result, the banks (including multinational banks) have been challenged to justify those high interest rates. Moreover, the new capital requirements have affected availability of credit to the private sector and, at the same time, increased rivalry. Increasing customer demands and rigid regulations appear to continue to add complexities to the business models of financial MNCs and the emerging trend of mobile and e-banking. These complexities have not been easily unravelled by neither the regulator nor the industry players and is leading to the inability to capture and react successfully to other external investment opportunities in the sub-region. Ghana and Nigeria intended to implement the Basel II accord in January 2011, but it rather presented a significant challenge in the supervision of banks and the management of risks. In this regard, it is critical that financial education programmes are introduced and supported by the regulators to organise financial literacy programmes to educate the private sector regarding the formal ways of accessing credit.

Financial Literacy and the Future of banking in Africa

This paper argues that the lack of personal financial literacy education programmes in SSA is another major hindrance to the development of new products and future investments. Most consumers lack the financial literacy skills to even make informal financial decisions relevant to their individual needs. This is evidenced by the absence of consumer groups who would question the banks regarding the huge disparities in their interest rates. In more advanced

countries like the UK and US, financial literacy is given a high priority. In 2003, the financial services authority (FSA) in the UK started a national financial education campaign to provide the public with knowledge in finance that will enable them make sound, informed financial choices. The FSA is further supported by the Financial Ombudsman Service which encourages customers to complain about financial services received. The Institute of Finance Studies (IFS) in the UK is also set up to encourage and support early financial education through the integration of financial concepts into other core subjects at school level (Guardian, 2009).

Financial illiteracy is currently one of the major factors that restrict future investment possibilities in the region. As SSA countries lack the financial education machinery, economic growth is affected because the financial sector is hampered in many ways, such as citizens being able to: plan savings, plan for spending, invest to meet current and future financial goals, handle credit, and manage financial risks and, more importantly, use the services of a bank. Financial literacy supports new investments because it facilitates savings mobilisation by bringing a larger percentage of the society into the formal economic system, which is currently estimated to be just 30% in Ghana (Ghanaweb, 2012).

Evidence with respect to the public's attitude towards Ghana government index-linked bonds shows that the level of public awareness about financial instruments is extremely low in Ghana (Ghanaweb, 2017). This has resulted in limited public patronage of several financial instruments introduced by the financial service firms in Ghana. A limited public literacy has resulted in limited public awareness and, therefore, patronising financial instruments like bonds has always been a challenge in Ghana (which for many banks has rather superior features because of its guarantee to a fixed real rate of return). Consumer education

programmes geared at educating the public on characteristics of the products and services offered by the industry in addition to remedies available to consumers with grievance against a bank or their practitioners is lacking. An illustration of the importance of savings mobilisation in Ghana and how it influences economic outcomes is depicted in a diagram (figure 1.1). This paper suggests that intensive financial literacy campaigns are needed to educate the populace on the important role the banking system plays and how products are designed to support them and increase their wealth. Banking in Ghana is still limited to a relatively small section of the population.

In dealing with the issues of information asymmetry, the emergence of complex IT software that make regulations difficult, disparities in the rates of interest and problems associated with financial literacy, participatory policy making approach could be adopted. This approach allows industry players to engage in the formulation and implementation of financial sector regulations to consolidate the free market credentials that appear to be lacking and affecting the efficient operation of financial markets in Sub Saharan Africa.

The case for participatory regulation

The financial sector is subject to much closer regulation and supervision than any other sector because financial institutions are critical to the smooth operation of SSA's economies. Banks are important in a way that no other kind of firm is important (Mayes and Wood, 2009) because no economy can function without a functioning financial services sector. This makes it imperative to provide closer supervision due to the long-ranging effects their failure represents to all stakeholders. Regulation is effective when it addresses external and internal effects whilst maintaining competitiveness and innovation (Adams, et al, 2011). SSA's current system of regulation is rigid and prohibitive and stifles innovation as several studies

cite instances when the regulators have been antagonistic to product lines they are not quite familiar with (Adams, et al, 2014; Mmieh and Owusu Frimpong, 2009). This paper argues that there are significant regulatory inefficiencies as industry players are ahead of the regulators. In this vein, the Bank of Ghana needs to take steps to develop their human resources to be able to regulate different product suits as well as introduce programmes to gain deeper understanding of the changing nature of the sector. Moreover, the BOG needs to improve its understanding of the financial industry by attaching staff to regulated institutions and by recruiting from the industry. This will enable a two-way exchange of experience between regulators and practitioners and will bring the regulators up-to-date on current industry practices.

FDI Inflows into the financial services sector in Ghana

Asante (2006) and Asiedu (2006) indicate that since the 1970s, Ghana has had a long and modest history of FDI in the services sector. SSA countries have attracted the resource-seeking types of FDI. Dunning (1998), argues that a country attracts resource-seeking FDI if inflows into the host country are highly dependent on the availability of certain mineral resources in the host country of which an MNC would like to take advantage. Asante (2006) also indicates that the major categories of FDI attracted into Ghana, for example, have been lured by natural resources and active promotional campaigns coupled with economic reforms and private sector development initiatives. Over the past two decades, the service sector has expanded rapidly and has come to play an increasingly important role in SSA economies. UNCTAD (2006) indicate that services accounted for large shares of production and employment in most economies around the world. Furthermore, the share of services in the world trade and investment has been increasing and the structure of FDI worldwide has also shifted towards the services sector (UNCTAD, 2005). Consequently, the attitude of the

Ghanaian Government towards the attraction of FDI inflows into the financial sector has changed over time with a more favourable climate now than in the early 1980s when state banks stifled the inflow of financial FDI (Gockel and Akoena, 2002).

As part of the measures taken to make credit available to the private sector, Ghana liberalised its financial services sector which, according to PricewaterHouseCoopers (2011), can be classified into three main categories, i.e., banking, insurance and capital markets. As a result of the financial sector adjustment programme (FINSAP) and a number of institutional and policy reforms which were carried out (Harrigan and Killick, 2000), the response of FDI inflows into the sector was a moderate inflow between 1989 and 1992 and significant inflows between 1993 and 1996 (Asante, 2006). FDI inflows into the financial services sector increased relatively causing overall FDI inflows into Ghana to reach US\$233 million in 1994 (Asante, 2006). In addition, the sector has shown further significant development over the past decade. Furthermore, the expansion in financial services has encouraged unprecedented private sector participation (Harrigan and Aryeetey, 2000).

New institutions have been introduced with the aim of attracting FDI inflows into the sector and achieving efficiency in the provision of financial services. More importantly, the financial services sector now provides new financial instruments to meet the needs of the productive sectors. Expansions in the telecommunications sector with substantial FDI inflows to rehabilitate the telecommunication infrastructure, coupled with the withdrawal of the state monopoly in the provision of these services, have further led to the expansion of the financial services sector in Ghana. Even the provision of certain government services has been improved and expanded as a result of the recent FDI inflows into the sector (Gockel and Akoena, 2002).

Specifically, international banks in SSA provide a critical *gap filling* role by offering a full variety of corporate banking services vital for other overseas investors in handling most important international transactions. The presence of foreign banks in Ghana also encourages the entry of other foreign companies in ways that go beyond providing international financial services – in terms of advice, information and facilitation to other potential investors. Most of the foreign banks have integrated more deeply within the Ghanaian economy, with local offices taking local deposits and employing Ghanaian staff. The Ghanaian banking sector has seen some improvements and has also supported the development of modern facilities in the capital city (BOG, 2005). Furthermore, the overall outlook of the banking system is considered satisfactory in the short and medium term (BOG, 2009). Ghana's financial services sector continues to remain profitable and generally solid and developments as of January 2016 showed a continuous surge in asset growth resulting from credit expansion to the private sector by foreign banks (PWC, 2016). Most banks now employ new technologies to market their products to the Ghanaian customers. Banking halls are housed in ultra-modern buildings, staffed with well-trained staff.

Inter-regional financial services FDI inflows: an emerging trend

A new and emerging trend is the unprecedented inflows of financial FDI SSA countries. Banks from Sub-Saharan Africa have significantly increased their investment in their respective countries. Notable among them is Nigeria and South Africa. Nigerian and South African banks are well represented in the new financial sector in Ghana. There are currently seven banks from Nigeria operating in Ghana and as a result, they top the value of investments among all investing nations. Several businesses from Nigeria have also entered into Ghana as a result of the inflow of Nigerian banks. Nigeria has one of the largest banking

sectors in Africa with over eighty banks in operation and the sector is one of the most competitive among emerging market countries and is known for its innovation and resilience (GhanaWeb, 2009).

According to the *African Business Magazine* (2006), Nigerian banks make up five of the top twenty banks in Sub-Saharan Africa by capital. Currently, GIPC figures for 2010 show Nigeria as the country with the highest values of registered projects in Ghana totalling US\$191.83 million (GIPC, 2011). This is mostly because of increases in inflows of Nigerian banks into Ghana. Furthermore, the entry of the number one bank in Africa, Standard Bank of South Africa (Stanbic Bank Ghana) and the Nigerian banks—Guaranty Trust Bank, Zenith Bank, Intercontinental Bank, United Bank for Africa, amongst others, represent noteworthy FDI inflows into the financial services sector in Ghana. These developments in the financial services sector have supported the provision of credit to a burgeoning private sector in Ghana.

Discussion

One main objective of Ghana's reforms was to efficiently mobilise and allocate resources to the private sector. Although the reforms lacked proper planning and implementation, the regulators have failed to create supporting institutions aimed at meeting the changing and emerging needs of the financial sector that is constantly changing due to internal and external forces, some of which are global. The paper also argues that Ghana's financial sector reforms did not adequately consider the methods for formalising the informal sector for them to gain access to credit. Although interest rates were partially liberalised in 1987 coupled with the removal of maximum and minimum lending rates to enable banks to provide credit at rates more affordable by the SMEs, volumes of credit to the private sector are given to businesses

that are already doing well to avoid risks associated with the informal sector (PwC, 2016). Fry (1997) and McKinnon (1988) argue that liberalising interest rates would enhance the achievement of allocative efficiency. This suggests that there is some level of misallocation of resources in the financial sector in the SSA region. Moreover, prior to the financial sector reforms, there were great disparities in interest rates and which is still the case in recent times. In other words, although stakeholders of the financial sector have responded positively to interest rate liberalisation, interbank rates are still quite high and the regulators have no effective means of managing it.

There has also been a re-emergence of non-performing assets, limited credit facilities to the private sector, and a high rate of investment in government securities (designed to hedge against risk) compared to loans to the private sector, a low rate of savings and poor credit information. This implies that more banks would rather invest in government treasury bills and other short-term financial instruments rather than providing credit to the private sector because of the risk involved. Credit to the private sector relative to the growth of financial institutions reflects the poor performance of the financial sector in resource mobilisation. Furthermore, the bulk of the credit channelled to the private sector is mainly directed towards short-term investments and foreign exchange speculation. Part of the reason for this is the uncertainty surrounding lending to a private sector that is highly informal, has higher default rates and unpredictable business performance. In addition, the government has introduced an interest free credit which is given to support the growth of the private sector. This means that most banks/finance houses find it hard to match the interest rates based on market forces to that of free government grants to the private sector.

In Ghana, the introduction of new loan schemes by the government are usually politically motivated and such loans are given to the cronies of the ruling government typically to get votes or to prove that the regime is doing something to support the private sector. But many

years of such activities have proven ineffective and have also added to the national debt. *Political money* affects the development of the financial services and creates distortions of financial prices. Considering the work of McKinnon (1991) and Shaw (1973) and building on the work of Schumpeter (1911), they argue that government involvement and intervention on the banking system restrains the quantity and quality of financial FDI flows and other forms of investments.

Implications and Conclusion

This paper has provided a detailed understanding of the factors affecting SSA's financial services sector development and economic development. The paper articulates the overall importance of the financial sector in the economic development of countries in the region as well as the myriad bottleneck inhibiting the full contribution of the sector to economies in the region. Moreover, it unpacks the policy initiatives undertaken by a country (Ghana) in the region in an attempt to unlock the full potential of the sector with limited success. These issues captured in the preceding sections of this paper present several implications for the implementation of new initiatives and policies that would likely facilitate the growth of SSA's financial services sector. Financial services sector in SSA countries more than ever, require to actively participating in activities on the global financial markets. This would enhance the standards of performance on market participants but will only be so if local markets are also transparent with strong institutional and regulatory systems to monitor the sector (Soussa, 2004). Transparency from regulators and the provision of timely and accurate economic data to the public can reduce uncertainty, thereby improving the ability of foreign investors to assess the level of risk. This position will help financial MNCs to choose SSA as an investment destination. Regulatory bodies can improve these standards by undertaking

periodic reviews and encouraging other independent periodic reviews and reports on the observance of standards and codes that will improve the perception as to the value to them of locating in the region. Participatory regulations would mean that sector participants are able to operate in an environment that is devoid of political meddling and consistent with international standards (North, 1992).

These features could be met through: banking supervision; participatory regulation; policies for good corporate governance; implementation of acceptable accounting standards; and, monetary and fiscal transparency, amongst others. On the other hand, the private sector must be provided with literacy training and financial awareness that enables them to understand acceptable practices of formal banking and the general requirements for accessing credit. Banks could help the private sector formalise their activities through the provision of business consultancy services which may be supported by local government and successful companies.

Accordingly, 70% of loanable funds are raised from the informal sector (Ghanaweb, 2009; Ghana Business News, 2009). The BOG (2008) also indicates that 70% of Ghanaians do not use the services of a formal financial institution. Hence, as the informal economy currently stands at 70%, a regulatory system that supports the formalisation and growth of the private sector will ultimately increase savings mobilisation. Currently, there are 70% of Ghanaians who do not believe in keeping their finances with a financial institution and many customers are reluctant to utilise modern services that are cheaper and more convenient (such as electronic money transfer and payment systems) but instead prefer a traditional passbook. This is consistent with Lwiza and Nwanko (2002) who found that more than 60% of

Tanzanians prefer to keep their money under their pillows rather than using a formal financial institution.

There is the need to promote sound corporate governance that prevents corporate failure to boost investor confidence. Corporate governance, in this regard, is the organisational arrangement by which a company represents and services the interests of its stakeholders. From the policy point of view, regulators could insist that corporate participants in the financial services sector are transparent, accountable and performance-oriented. This is necessary to ensure that investors will be motivated to choose financial market in SSA as their preferred choice for more investments. A sound policy framework is required to improve a country's financial system (Goldberg, 2007). A sound policy framework for good corporate governance will strengthen the boardroom to support the development of policy that enhances the effectiveness of the institutional framework.

Limitation and recommendation for future research

Notwithstanding the contribution of the paper on the role of the financial services sector in economic development, there are a number of limitations that should be considered in future studies. First, this paper is based on literature available and secondary data and future studies could look to conducting primary data based on current events. This would further enhance our understanding of the issue and their generalisability. Secondly, the paper is more focused on the financial services sector of one country in SSA. Future studies could expand the focus to cover many countries in the region or carry out a comparative study to further enrich our knowledge of the financial sector contribution to economic growth. Despite these limitations, the study has provided insight into the role of financial services sector in economic development and the challenges inhibiting this in the SSA region.

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Figure 1.1: The role of the financial services sector in achieving economic growth

