A Financial Performance Comparison of Foreign VS Local Banks in Ghana

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Abstract

The banking sector is very important to the economy of nations and for developing worlds, it is extremely crucial. It is therefore important to understand all the parameters in the commercial banking sector so as to be guided in policy formulation. In this study we compare the performance of foreign and local banks in Ghana along the following dimensions; Return on Assets, Return on Equity, Asset Quality, Capital Adequacy, Management Efficiency, Earning Performance, Liquidity and Bank size using data from 2005-2010. We find various differences in ratios for the two types. It is important to note that this study is for academic purpose.

Keywords: Financial Performance, bank type, CAMEL, Bank, Ghana.

1. Introduction

The financial sector is very crucial to the economies of various countries. Banks are a core of the financial sector especially when it comes to developing economies where the capital market is not strong enough. In an economy where the capital market is still a developing one, banks serve as important sources of funds for businesses. For this reason, the survival and consistently good performance of banks is an issue of concern to all. Studies that seek to investigate the performance of banks and their various determinants are steps in the right direction to identifying the means of promoting the survival and growth of the sector that serves as the backbone of the financial system of developing economies. Notwithstanding the above, the great depression of the 1940s coupled with bank failures experienced in the United States drove considerable attention to bank performance. Since then, the attention on bank performance has grown from levels to levels (Heffernan, 2005).

Due to the importance of banks and the sensitivity of their performance to the economy of countries, various regulators put in place regulations to ensure that banks are well placed to guarantee continuity at least for the foreseeable future. In Ghana, the central bank after the discovery of the oil required all universal banks in Ghana to recapitalize. With this new regulation, local banks were to recapitalize to GHS 25000000 while foreign banks were to recapitalize to GHS 60000000. The question therefore is, to what need is this selectiveness of the policy? What are the differences in the performance in local banks and foreign banks that demand special treatment? In this study were investigate the differences in the performance of the local banks and foreign banks in Ghana taking into consideration data from 2005 to 2010. The differences between these banks are studied alone the CAMEL approach to assessing bank performance.

The rest of the study is organized along the following structure; Section 2 discusses brief literature on bank performance. Section 3 explains the methodology employed by the study. Section 4 discusses the findings of the study while section 5 concludes the study.

2. Literature Review

Studies into bank performance have been in literature since the late 1980s and the early 1990s where two organizations model were applied; the Market Power (MP) and Efficiency Structure (ES) theories (Athanasoglou *et al*, 2006). The market power theory posits that the market structure of the industry influences the performance of banks.

This theory consists of two distinct approaches; the Structure-Conduct-Performance and the Relative Market Power hypothesis. The Structure-Conduct-Performance approach posits that the profitability of a bank may rise with the market power that comes as a result of the concentration of the market. The Relative Market Power hypothesis on the other hand posits that bank profitability can be influenced by market share and that, only large banks can increase price and make more profit.

After the application of these theories in bank profitability studies in the late 1980s and early 1990s, there have been several other empirical studies in to the performance of banks as well its determinants. Bank size has been established in literature as a significant determinant of performance but the direction of its influence is still in debate. Ramlall (2009); Molyneux and Seth (1998); Pilloff and Rhoades (2002) all found that there is a positive relation between bank size and profitability. Even in recent times, Sufian (2009) confirms such relationship. On the contrary, studies such as Koasmidou, (2008); Spathis *et al*, (2002) also established empirically, a negative relation between bank size and profitability.

In an argument by Athanasoglou *et al,* (2006), profitability is believed to be influenced by both endogenous and exogenous factors. The endogenous factors are firm specific factors that result from the decisions and policies of management. Examples of such factors are efficiency, profitability, liquidity, capital structure and asset quality ratios. The exogenous factors are industrial structural factors such as ownership, market concentration and stock market development and other macroeconomic factors. For the purpose of this study, the endogenous factors are used since they are the areas that the banks are expected to differ in. The exogenous factors are not expected to be significantly different since they are not firm specific but affects all firms in the industry.

Baral (2005) asserts that CAMEL framework is the most widely used model and it is recommended by Basle Committee on Bank Supervision and IMF. CAMEL represents Capital adequacy, Asset quality, Management efficiency, Earnings performance and Liquidity. Capital adequacy measures the ability of the bank to absorb shocks. This requires banks to have enough equity in their financing mix (Kosmidou, 2009). According to Aburime (2008), the profitability of a bank depends on its ability to predict, evade and monitor risks, possibly to cover losses brought about by risks that comes about. Although it is important for banks to be liquid to avoid a run on it, Kamau (2009) argues that when banks hold high liquidity, they do so at the opportunity cost of some investment, which could generate high returns. Again, Sufian and Chong (2008) draws a very strong relationship between firm performance and the management efficiency through management of expenses.

3. Methodology

Data is collected from the financial statements of the banks under the study from 2005 to 2010. We employ a total of 25 on the basis of availability of data. We follow the work of Hassan *et al.* (2011). We compare the banks on the various dimensions of performance (determinants). The averages for the various ratios are calculated and compared on charts. The two classifications for the comparison are local banks and foreign banks in Ghana. Local Banks are those banks with majority of their shareholders being Ghanaians while foreign banks are those with majority of their shareholders being foreigners. For the purpose of the study, the following are the variables employed and how they were measured.

Definition of variables

	Variable	Measured as
ROA	Return on Assets	Net income / Total Assets
ROE	Return on Equity	Net income / Total Equity
CA	Capital Adequacy	Total Equity/ Total Assets
AQ	Asset Quality	Non-performing loans/ gross loans
ME	Management Efficiency	Interest income / total assets
EP	Earning Performance	Net interest margin
LIQ	Liquidity	Advances / Deposits
SIZE	Bank size	Log of total assets

4. Discussion of Findings

Table 4.1: Average Performance for the entire period (2005-2010)

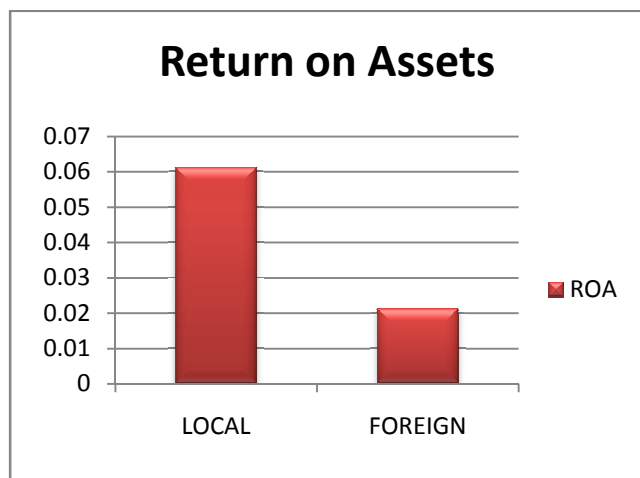| BANK TYPE	ROA	ROE	CA	AQ	ME	EP	LIQ	SIZE
LOCAL	0.0612	0.4654	0.1151	0.0523	0.1285	0.5515	0.8884	8.3551
FOREIGN	0.0213	0.2056	0.1302	0.0495	0.1037	0.6503	1.6847	8.4668

Figure 01

Figure 02
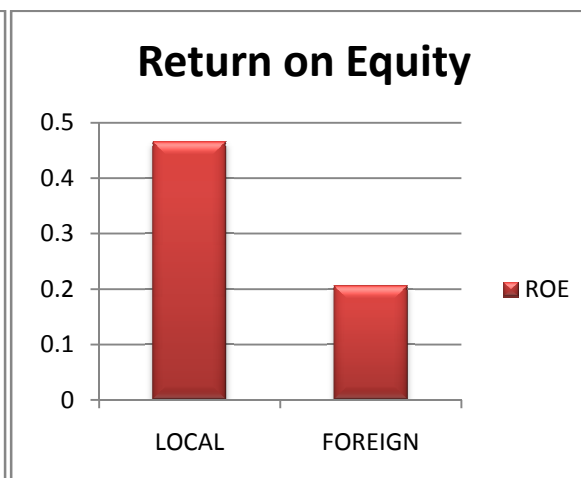
The study employed the use of two profitability ratios these ratios were the return on equity and return on asset. Findings revealed that local banks on both profitability ratios outperformed the foreign banks. With an average ROA and ROE of 6.12% and 46.54% respectively, local banks are shown to have performed better than foreign bank in terms of profitability.

Figure 03
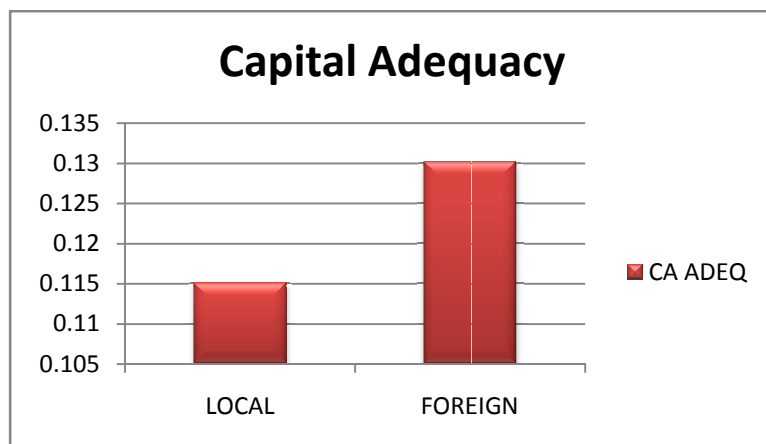
Assessing their capital adequacy ratio, the study found that foreign banks have a higher average capital adequacy ratio than local banks. This is partly because foreign banks in Ghana are able to access funding from their parent banks. Also the requirement for the award of banking license in Ghana sets high capital requirements for foreign bank than local banks. This presents the foreign banks an advantage to better deal with risk than the local banks.

Figure 04
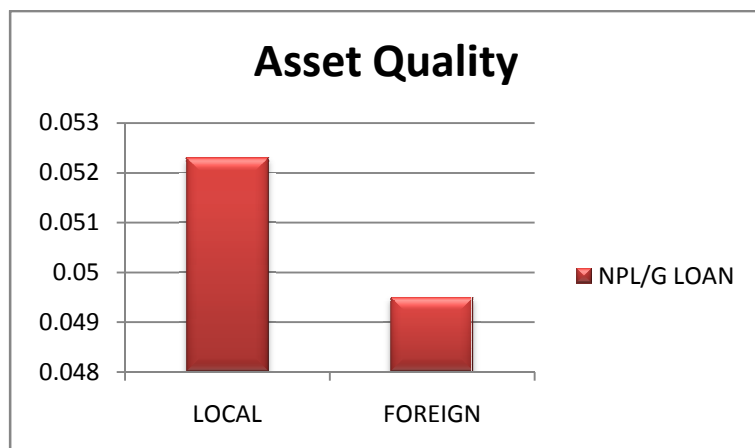
Asset Quality

In assessing the asset quality of the two types of banks in Ghana, the study found that on average, local banks have higher non-performing loans among their gross loan portfolio than foreign banks do.
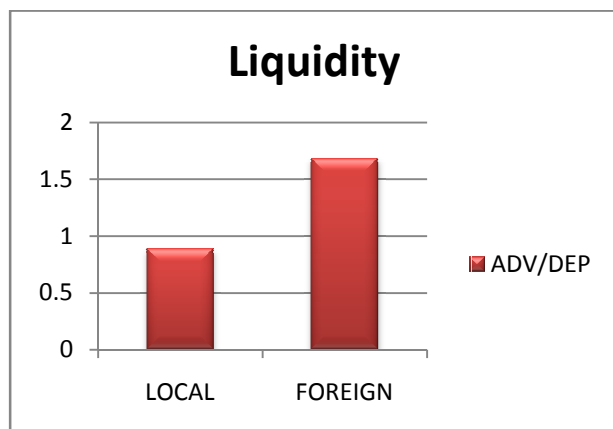
Figure 05

Management Efficiency
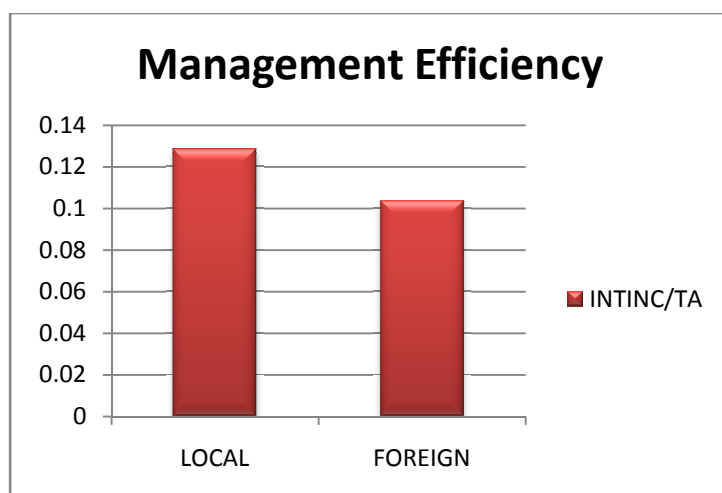
Management efficiency was proxied by the ratio of interest income to total assets. The study found that the performance of managers of local banks in mobilizing interest income given the total assets was better than that of the foreign banks. This is shown in the 12.85% and 10.37% of interest income to total assets by local and foreign banks respectively.

Figure 06

Earning Performance
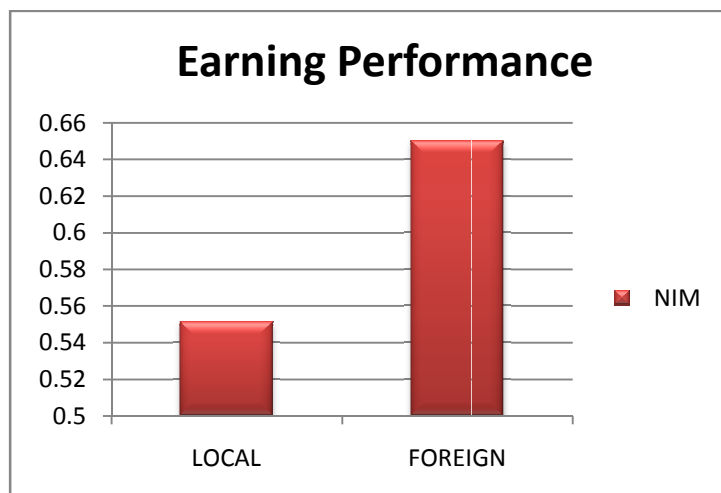
When their earnings power was assessed it was realized that on the average, foreign banks have higher earnings power than the local banks have. This is evident in the 55.15% average net interest margin recorded for local banks as against 65.03% recorded for foreign banks.

Figure 07

Liquidity

The study also found that foreign banks are more liquid than local banks. Averagely, foreign banks in Ghana have an advance to deposit ratio of about 1.68 as against about 0.89 recorded for local banks.

Figure 08
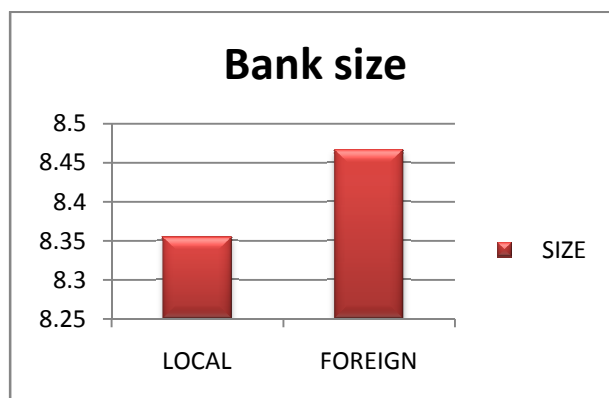
Bank size

The study proxied bank size by log of total assets and realized that foreign banks are on the average, larger than local banks.

5. *Conclusions*

Upon the comparisons made, the following conclusions are made between local and foreign banks in Ghana.

   i.   On both return on assets and return on equity, local banks in Ghana are doing better than foreign banks.
   ii.   Foreign banks have a higher capital adequacy ratio than local banks.
   iii.   Foreign banks have more quality assets(loans) than local banks do in Ghana
   iv.   The management of local banks are more efficient than that of foreign banks in Ghana.
   v.   Foreign banks have more earnings power in terms of net interest margin than local banks in Ghana.
   vi.   Foreign banks are more liquid in Ghana than the local banks.
   vii.   Foreign banks are usually larger in Ghana than the local banks.

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Appendix

	Mean	Median	Standard Deviation	Minimum	Maximum
ROA	0.042475	0.021531218	0.14106179	-0.20905	0.928152
ROE	0.343247	0.171425655	1.24053392	-0.99765	12.91831
CA ADEQ	0.122167	0.113473732	0.05876628	0.026655	0.359306
NPL/G LOAN	0.05103	0.028070779	0.07339228	0	0.636254
INTINC/TA	0.116851	0.113758244	0.03087227	0.035895	0.233705
NIM	0.597963	0.582215947	0.19767287	0.270908	1.664519
ADV/DEP	1.249781	0.651926815	6.07696464	0	69.83632
bank type	0.478261	0	0.50134696	0	1