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The Unintended Effects of Bank of Ghana's Clean-Up Exercise on Unaffected Financial Institutions: Evidence from Yilo Krobo Municipality, Ghana

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Author's contribution

The sole author designed, analyzed and interpreted and prepared the manuscript.

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ABSTRACT

This paper seeks to analyze the unintended accompanying effects of the Bank of Ghana's financial sector sanitization popularly referred to as "clean-up exercise" which ended in August 2019 on the operations of unaffected financial institutions with ardent interest in customer deposits or investment and lending activities. The mixed-method approach thus, using both quantitative and qualitative methods of collecting data, was deployed for the study. The study population covered branch managers, credit officers, and cashiers of all financial institutions that were not affected by the Bank of Ghana clean-up exercise in the Yilo Krobo Municipality, Ghana. The findings of the study revealed that deposits have generally been low, whereas withdrawals have been very high, and these were due to fear and panic of losing funds or investments and loss of confidence among the banking population. On the other hand, lending activities have not been affected as customers of defunct financial institutions have shifted their loan demands or requests to the unaffected ones. However, some financial institutions are unable to meet loan request from their customers due to liquidity challenges arising from low cash deposits. The study recommends strict regulatory enforcement, periodic publishing of financial institutions in good standing, and timely education of customers of financial institutions in the event of any possible revocation of the license of any Financial Institution.

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1. INTRODUCTION

In August 2017, the Bank of Ghana embarked on a "clean-up" exercise in the financial sector to resolve or dissolve insolvent Financial Institutions whose continual existence was regarded as a threat to the interest of depositors. According to the Banks and Specialized Deposit- Taking Institutions Act 930 (2016), Section 123 (1), the Bank of Ghana has the mandate to withdraw the license any financial institution determined to be insolvent, to reestablish confidence in the banking and specialized deposit-taking sector [1]. Before the clean-up exercise, a comprehensive assessment of the savings and loans and finance houses in the country was conducted and this revealed threatening challenges faced by these institutions [2].

The findings of the assessment as underscored by the Bank of Ghana discovered that;

- The status of capital held by some savings and loans companies and finance house institutions were in defiance of the minimum regulatory capital required by Act 930. This made it unjustified for these institutions to linger to carry out the business of specialized deposit-taking institutions, given the threats they postured to their customers and other counterparties to whom they were exposed directly or indirectly;
- Some financial institutions indulge in extreme risk-taking without the obligatory risk management function to mitigate risk acquaintances;
- Some financial institutions use depositor's investments to fund private ventures or businesses on conditions that were not profit-making. This circumstances resulted either tiny or no profits accruing to the appropriate finance institutions thereby compounding their liquidity challenges;
- Majority of financial institutions operated under frail corporate governance systems, specifically in terms board oversight, accountability, and internal controls;
- Some institutions also misrepresented the true financial position to the Central Bank and other interested parties. This was however done through creative accounting methods and incorrect provisioning for diminished assets; and
- Most financial institutions persistently breached regulations of the Bank of Ghana, mostly with prudential rules, and also failure to execute the on-site examination sanctions by the Central Bank of Ghana.

Considering the tenacity of the above revelations among financial institutions which posed high level of menace to the entire financial system in the country, the Bank of Ghana hence resolved to proceed with its measures popularly dubbed "clean-up exercise" to sanitize the industry and to protect the interest and confidence of depositors after all efforts geared at rectifying the discovered lapses failed [2,3]. This action involved revocation of licenses of financial institutions that fell short of the Central Bank's solvency and corporate governance requirements. At the end of the exercise, a total of nine universal banks; 347 microfinance companies, of which 155 had already ceased operations; 39 micro credit companies of which ten had already ceased operations; 15 savings and loans companies; eight finance house companies and two non-bank financial institutions that had already ceased operations had their licenses revoked [4].

1.1 Research Problem

Clearly, the envisioned motive for Bank of Ghana's action is to restore sanity, stability and confidence in the banking sector [2]. However, other reports suggest that, there may be some accompanying aftermath effects on society and the banking society which were not intended. For instance, a report by Banking Hall24.com in 2019 [5] estimated that, about 20,000 people directly or indirectly lost their jobs due to the Bank of Ghana's clean-up exercise. According to the same report, the exercise poses a security threat to the Ghanaian national security. This is due to the obvious reason that, the masses that are rendered unemployed following the clean-up exercise by the Bank of Ghana, may resort to various social vices for survival. Furthermore, regarding unaffected Financial Institutions and their operations, the report postulated mistrust in the financial sector or industry, increased unbanked population and a high level of struggle among legitimate financial institutions for survival [5]. Dr. Lord Mensah of the University of Ghana Business School also articulated the action by the Central Bank's would have adversarial consequence on the informal sector of Ghana and this is due to the reason that, the informal sector are mainly the beneficiaries of these Financial Institutions. In his opinion, the present happenings would weaken the economy since the economy is largely made up of this sector [6]. According to Dr. Mensah, the universal banks cannot serve the informal sector as the microfinance companies do [6].

Even though many scholars have expressed their opinions on how the Bank of Ghana's exercise will or could affect the banking sector and the Ghanaian economy as a whole, little can been said about scholarly researches conducted to unravel the impact of the recent Bank of Ghana's financial sector clean-up exercise on the operations of unaffected financial institutions which is in contrast to the original intention for the exercise. It is against this background that this research has been conducted to unravel the unintended effects of Bank of Ghana's clean-up exercise on the operations of unaffected financial institutions in the Yilo Krobo Municipality of Ghana focusing on the financial intermediation function of the banking sector.

1.3 Research Objectives

The principal objective of the research is to unravel the unintended effects of Bank of Ghana's financial sector clean-up exercise on the operations of unaffected financial institutions in the Yilo Krobo Municipality. In a bid to achieve the principal objective stated above, specific objectives have been formulated which are:

- ❖ To ascertain the unintended effects of Bank of Ghana's clean-up exercise on customer cash deposits of unaffected Financial Institutions in the Yilo Krobo Municipality.
- ❖ To ascertain the unintended effect of Bank of Ghana's clean-up exercise on lending activities of unaffected Financial Institutions in the Yilo Krobo Municipality.

1.4 Research Questions

- What is the effect of Bank of Ghana's clean-up exercise on customer cash deposits of unaffected Financial Institutions in the Yilo Krobo Municipality?
- How is the Bank of Ghana's clean-up exercise affecting lending activities of unaffected Financial Institutions in the Yilo Krobo Municipality?

1.5 Significance of the Study

The findings of the research will be significant to the Ghanaian community as they will empirically reveal the aftermath impact of the Bank of Ghana clean-up exercise on the operations of existing legitimate financial institutions contrary to the widely known motive upon which the exercise was carried out. Furthermore, the findings of the research will be significant to policy makers in the financial industry, specifically the central bank who are the main regulators of financial institutions in the country in developing other alternative mitigating solutions to future banking sector crisis. Finally, the research will also contribute to the scholarly grid as far this subject matter is concerned. It will form the basis for further research to be conducted in other areas, municipalities, regions across Ghana.

2. LITERATURE REVIEW

First and foremost, this chapter reviews the financial sector of Ghana and the history of its instability that led to the rigorous actions taken by the Bank of Ghana to conduct its clean-up exercise. Furthermore, this chapter reviews existing literatures from articles, journals and scholarly works locally and internationally on the subject matter with ardent focus on how the Bank of Ghana's financial sector clean-up affected the financial intermediation function of unaffected financial institutions in Ghana.

2.1 The Financial Sector of Ghana

Ghana has a definite financial sector set out by the Bank of Ghana or the Central Bank and this is mainly made up of the Capital Markets, Banks, Rural and Community Banks, Non-Bank financial institutions, Insurance Companies, Pension and Provident Funds and Microfinance Institutions [7]. Subjugated by the banking industry, the financial sector, through its intermediation process, transfers limited resources from those members of society in excess (depositors) to those in shortfall (borrowers). Usually, banks perform this intermediation function by converting small liquid deposits into larger illiquid loans [8]. It is said that the intermediation process is proficient when demands depositors and borrowers are satisfied moderately in terms of cost, whereas amassing reserves for ventures that offers the prospect to provide heightened economic growth [8,9].

The Ghana Investment Promotion Centre which is a governmental agency responsible for promoting and encouraging investments in Ghana also categorizes the Ghana financial sector into three: Banking and Finance (including Non-Bank Financial Services and Forex Bureau), Insurance and Financial & Capital Markets. According to the same agency, the core mandate for the entire sector mentioned above is to provide financial management activities in Ghana. Reserve Bank of Australia in its submission to the Financial Systems Enquiry in March 2014, described the financial management role of a financial sector in four practical parts which are, first, value exchange, which refers to numerous ways of making payments, second, intermediation, which describes the methods of allocating funds between investors and debtors, third, risk transfers, which describe the means for valuing and apportioning risks, and finally, liquidity denoting the means of translating assets into cash without unwarranted loss of value [10].

2.2 The Origin of the Financial Sector Crisis of Ghana

The fright for this menace was signaled in December, 2015, following an audit conducted by the International Monetary Fund (IMF) and the Bank of Ghana on credits whereby some severe dysfunctions precisely; lack of regulation and control, lack of liquidity in the capital of some key banks, and fraudulent doings, were revealed [11]. The verdict of the audit was unquestionable whereby more than a few banks had significant supply shortfalls [12] and this affirmed a not so good picture of the banking sector concerning quality of its assets. Furthermore, the fund asserted that non-performing loan ratio shot up to 18.8% in 2016 from 11.2% in 2015, replicating the impact of exchange rate depreciation, distractions to energy supply as well as loan reclassification by some banks whereby banks increased gross their loans provisions from 5.1% to 7.9%. The ratio of regulatory capital to risk-weighted assets was parallel to the previous year at 16.2%, although system profitability declined, with return on equity falling to 23% in June 2016 from 29% in same period 2015 [11]. The Bank of Ghana in conjunction with the IMF hence agreed on a roadmap to restore banks equity capital. Two years after, in 2017, the Central Bank of Ghana, announced its approval for the takeover of two indigenous banks, UT Bank limited and Capital Bank Limited by GCB Bank Limited [13]. The Bank of Ghana cited the insolvency of the banks as the reason for their action. Barely a year after approval for the takeover by GCB Bank Limited, the central bank of Ghana yet again in a media statement publicized the consolidation of additional five indigenous banks to form a new bank called the Consolidated Bank Ghana Limited [14]. The five collapsed banks included Unibank Ghana Limited, the Royal Bank Limited, Beige Bank Limited, Sovereign Bank Limited, and Construction Bank Limited [15]. This brought the total number of indigenous collapsed banks to seven within two years, [16]. The exercise completed with a total of nine banks, and a total of 441 other financial institutions having their licenses revoked by the Central Bank of Ghana.

2.3 The Theory of Financial Intermediation

The theory of financial intermediation assesses, principally, the roles of financial intermediation, the influence of financial intermediation on the economy and the effect of government policies on financial intermediaries [17]. Additionally, the financial intermediation theory accentuates the role of financial intermediaries in an economy, and the influence of regulations on financial intermediation, heightening the role of the central bank in the regulation, supervision and control of financial intermediaries [17].

Essays UK, in 2018, explained financial intermediation as the process which had been carried out by the financial intermediaries as the mediators between the borrower (spender) and lender (saver) to smooth the movement of fund using indirect finance in the financial system, which is the principal method to transferring funds from lender to borrower. In this sense, investors who have excess funds will deposit these funds in financial institutions, who then lend these funds to corporate bodies, homes and even governmental agencies have shortage of fund [18]. The financial intermediation is carried out by financial intermediaries who are mainly financial institutions such as commercial banks, finance companies, merchant banks, Islamic banks; brokerage companies [18]. Scholtens et al. also asserted that, financial intermediaries, banks specifically, fill in as agents that monitor information breaches that occur between borrowers and depositors and this is due to the fact that financial intermediaries always have relative informational benefits above eventual borrowers and depositors [19]. Financial intermediaries screen and monitor investors on behalf of savers. This is their basic function, which justifies the transaction costs they charge to parties. They also bridge the maturity mismatch between savers and investors and facilitate payments between economic parties by providing a payment, settlement and clearing system [19].

Simply, it can be said that financial institutions borrow from depositors with short maturities and lend to borrowers at a longer maturities as echoed by Dewatripont et al. that, “Banks create liquidity by borrowing short and lending long” [20]. The financial intermediation theory was first developed by Gurley and Shaw in 1960 [21]. This research is therefore going to unravel how the financial intermediation functions of Financial Institutions have been affected following Bank of Ghana’s recent clean-up exercise.

3. METHODOLOGY

This research is an investigative research and therefore the mixed method approach was used to collect and analyze data. The mixed method involves the use of both qualitative and quantitative method of collecting data. According to Creswell & Clark, the mixed method is an approach to inquiry that combines or associates both qualitative and quantitative forms. It involves philosophical assumptions, the use of qualitative and quantitative approaches, and the mixing of both approaches in a study. Accordingly, it is more than merely gathering and evaluating both kinds of data; but further, encompasses the usage of both methods so that the overall strength of a study is greater than either qualitative or quantitative research [22]. Mixed method approach provides strengths that offset the weaknesses of both quantitative and qualitative research. Besides, it provides more broad evidence for addressing a research problem than either quantitative or qualitative research alone [23].

The research targeted a population of 120 for the study. This comprises of 50 cashiers, 50 credit officers and 20 branch managers of unaffected financial institutions in the Yilo Krobo municipality. The population of a study refers to the specific participants of the study. It generally refers to the whole individuals of interest to a researcher [24]. Although the entire population usually does not partake in a research study, the results from the study are generalized to the entire population [25]. The sample size of participants of the study was 64 comprising of 12 Branch Managers, 24 cashiers and 36 credit officers. The Cashiers and Credit officers of the financial institutions were selected using the purposive sampling method whiles the Branch Managers were selected using the convenient sampling method. Questionnaires and interview guides were used in collecting data for the study. The purpose of using the two main instruments was to satisfy the principle underlying mixed methods approach. Separate questionnaires were issued to the cashiers and credit officers.

Questionnaires was divided into section A, B and C. Section ‘A’ and ‘B’ sought responses on how the Banking sector cleanup has affected customer cash deposits and withdrawals and this was answered by cashiers of the Financial Institutions. Section ‘C’ was designed to seek responses from credit officers of financial institutions not affected by the cleanup exercise on how lending activities have been affected. Data from cashiers and credit officers were obtained by using the questionnaires whereas interviews were conducted with the branch managers of the financial institutions selected for the study. The study adopted closed ended questions, which was mainly used mainly to limit the category of response by giving alternative responses, the open-ended questions were also adopted to enable respondents to be expressive in connection with the topic understudy and the five point likert scale to increase response rate and response quality.

Reliability of the instrument was established using the Cronbach’s Alpha. The Reliability coefficient (α) was used to measure the internal consistency. The value was estimated to be (α) =0.78 which indicate an acceptable level of reliability. The quantitative data collected were analyzed using Microsoft excel, simple tabular and graphical presentations whiles qualitative content analysis was used to analyze information’s obtained from interviewing the Branch Managers of the selected financial institutions.

3.1 Profile of Yilo Krobo Municipality

According to the 2010 Population and Housing Census, Yilo Krobo Municipal area is made up of 87,847 Ghanaians representing 3.3 (3.3%) percent of the region’s total population. Males constitute 48.2 (48.2%) percent and females represent 51.8 (51.8%) percent. About seventy percent (70%) of the population is rural. The Municipality has 47.4 % of its population in the youthful age representing a comprehensive base resident’s pyramid which ends with an insignificant number of aged individuals 8.7 % [26]. The entire age dependence proportion for the Municipality is 77.1, with the age dependency ratio for males higher (70) than that of females (62) [26].The District capital for the municipality is currently Somanya.

Verifying from the list of registered Financial Institutions with the Bank of Ghana and the Yilo Krobo Municipal Assembly, Yilo Krobo Municipal area could boast of three (3) commercial banks, two (2) rural banks, two (2) savings and loans companies, ten (10) microfinance institutions, one (1) finance house, two (2) credit unions and one (1) microcredit (money lending) company before the clean-up exercise. However after the exercise, the municipality is left with two (2) Commercial banks, two (2) rural banks, two (2) Savings and Loans companies, One (2) Microfinance Institutions and two (2) Credit Unions. This study will further reveal how their core financial intermediation function has been affected following the central banks move to sanitize the financial or banking sector.

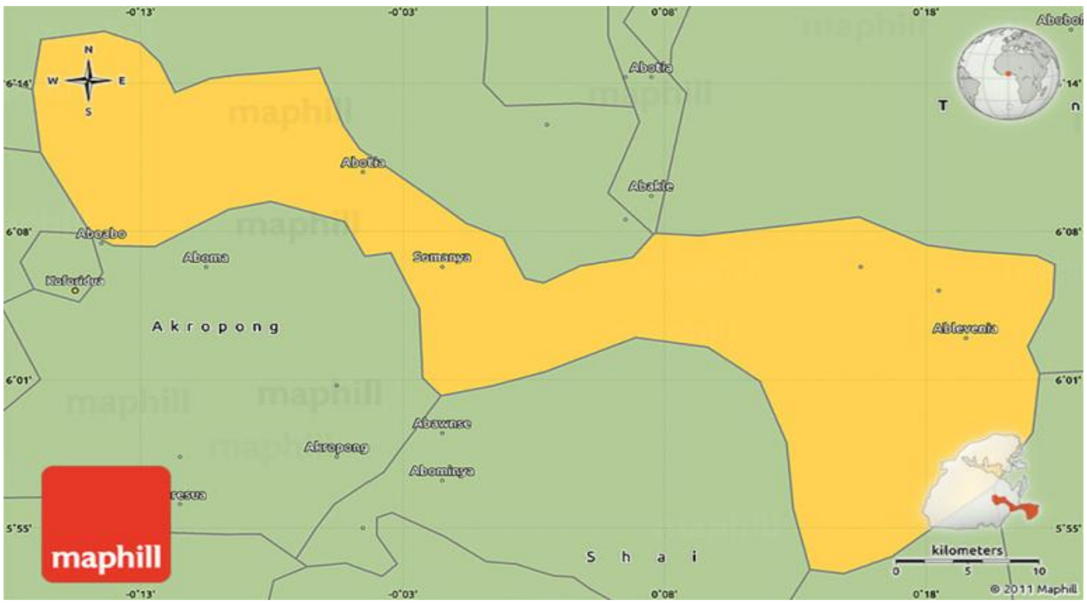

Fig. 1. Map of Yilo Krobo Municipal Area. Source: Maphill Ghana, 2011

Table 1. List of financial institutions before and after clean up exercise

Financial Institution	Before cleanup	After cleanup
Commercial Banks	3	2
Rural Banks	2	2
Savings & Loans companies	2	2
Microfinance Institutions	10	2
Finance Houses	1	0
Credit Unions	2	2
Microcredit Institutions	1	2

Table 2. Demographic characteristics of respondents – age

Variable	Frequency	Percentage (%)
Below 18	0	0%
18-25	3	5%
26-30	30	48%
31-35	9	14%
36-40	15	24%
41-50	6	10%
Total	**64**	**100%**

4. FINDINGS, DISCUSSION, CONCLUSION AND RECOMMENDATIONS

There was a response rate of 53% during the data collection. The respondents were largely within the age 26 to 30 years (48% of response rate) with few numbers between the ages 18 to 25 years representing 5% of the response rate.

Furthermore, the 62% of the respondents were made up of staffs who have worked with their financial institutions for more than 3 years. 14% have worked with their Financial Institutions within 2 to 3 years, 10% have worked within 1 to 2 years whiles another 14% have worked with their institutions for less than a year. This demonstrates that majority of the respondents have ample experience in terms of the information on the operational performance regarding deposit taking and lending activities before and after Bank of Ghana clean-up exercise.

On ascertaining the effect of the Bank of Ghana's action on customer deposit, 67% of the respondents mentioned that their institution have been affected negatively, whiles 33% reiterated a positive aftermath of Bank of Ghana's action on deposits.

Follow up interview revealed that, there was fear and panic among customers of the financial institutions during and after the Bank of Ghana exercise. In lieu of this, customers feared they will lose their investments and funds if they deposited their funds with the unaffected institutions. Deposits in terms of loan recovery from customers also declined drastically and this is because most of these customers have been waiting to hear if their financial institutions would be among the affected ones so they can keep their repayments. The 33% who stated that their deposit taking were not affected were basically the Commercial Bank and Rural Banks. They cited their good standing with Bank of Ghana's regulatory requirements, quality services to customers and customer confidence in them as the reason for not been affected. Similarly, within and after the Bank of Ghana clean-up exercise, withdrawal rate among some financial institutions were high. Again 67% of the respondents mentioned the Bank of Ghana action have affected customer withdrawal rate negatively due customers fear of losing their savings whereas 33% experienced otherwise.

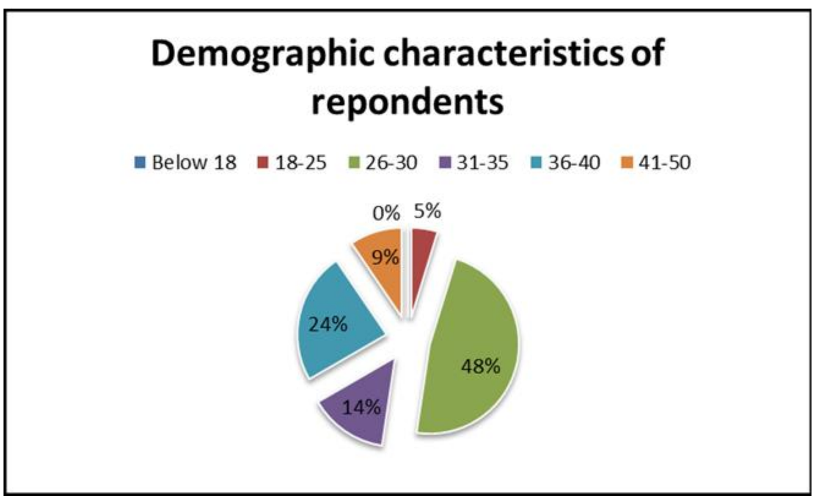

Fig. 2. Survey data 2020, demographic characteristics – Age

Table 3. Years of experience with financial institution

Variable	Frequency	Percentage (%)
Less than 1 year	9	14%
1-2 years	6	10%
2-3 years	9	14%
above 3 years	40	62%
Total	**64**	**100%**

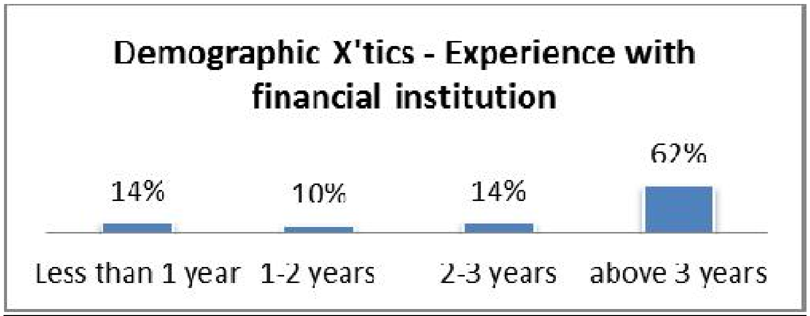

Fig. 3. Survey data, 2020; demographic - Years of Experience with Financial Institutions

Table 4. Bank of Ghana's cleanup exercise effect on cash deposits

Variable	Frequency	Percentage
positive	8	33%
negative	16	67%
Total	**24**	**100%**

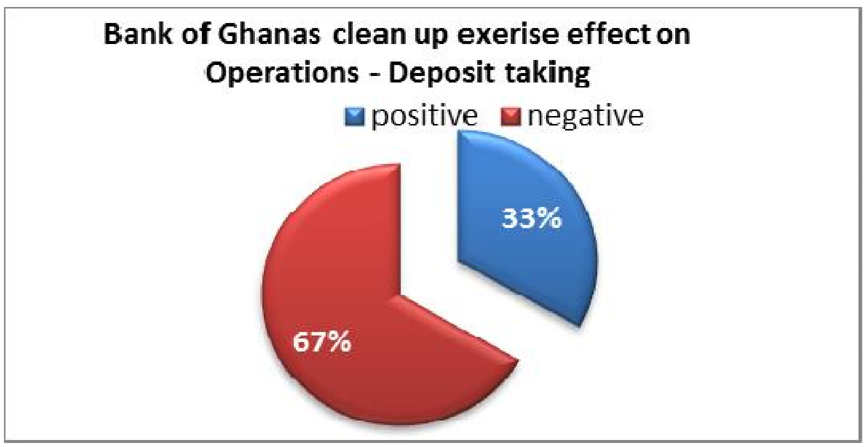

Fig. 4. Survey data, 2020; Effect of cleanup exercise on deposit taking

Table 5. Bank of Ghana's cleanup exercise effect on customer withdrawals

Variable	Frequency	Percentage
positive	8	33%
negative	16	67%
Total	**24**	**100%**

Generally, in evaluating deposit taking and withdrawals among unaffected financial institutions during and after Bank of Ghana clean up exercise, 50% of respondents mentioned that Deposits taking from customers have been low, 17% mentioned deposit taking have been very low, 17% mentioned deposit taking have been normal whereas another 17% mentioned that deposit taking have been very low. Regarding withdrawals, we have 83% of respondents asserting that customer withdrawal rate have been very high whereas 17% mentioned that customer withdrawal rate has been normal.

On the contrary, 60% of the respondents among financial institutions stated that lending activities of their financial institutions have not been affected by the Bank of Ghana clean-up exercise. Further interview revealed that most of the customers of the affected banks (Banks with license revoked by Bank of Ghana) have fallen on the unaffected ones for loans.

Meanwhile, 40% of the respondents stated that their lending activities have been affected. This was mainly due to low level of liquidity resulting from panic withdrawals which affected their ability to meet loan request from their customers.

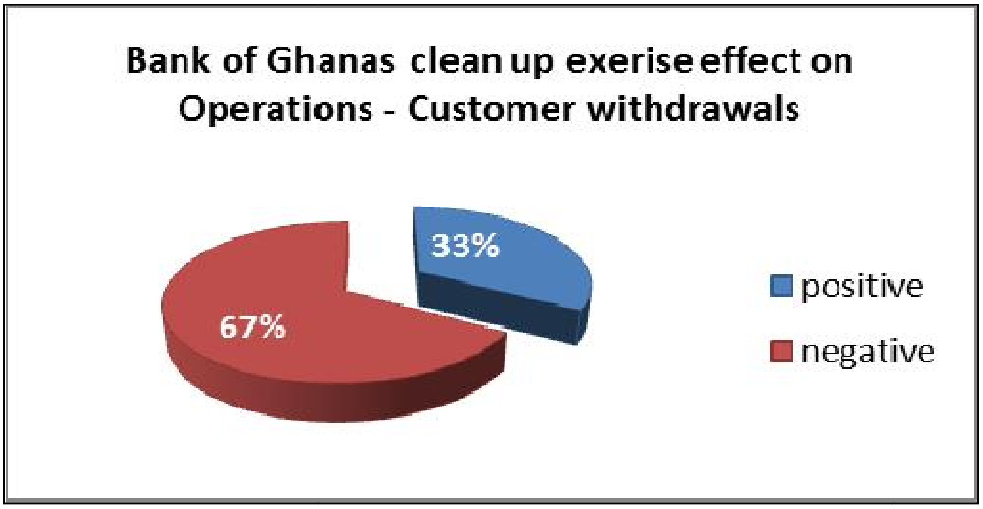

Fig. 5. Survey data, 2020; Effect of cleanup exercise on customer cash or fund withdrawal

Table 6. Evaluation of Bank of Ghana's cleanup exercise on customer deposit and withdrawals

	Customer deposits		Customer withdrawals	
Variables	**Frequency**	**Percentages (%)**	**Frequency**	**Percentages (%)**
Very High	4	17%	20	83%
Normal	4	17%	4	17%
Low	12	50%	0	0%
Very Low	4	17%	0	0%
No effect	0	0%	0	0%
Total	**24**	**100%**	**24**	**100%**

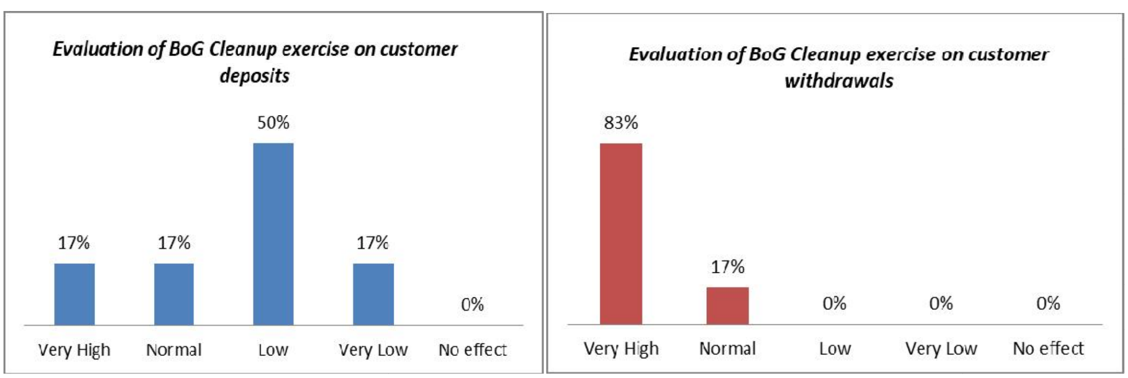

Fig. 6. Survey data, 2020: Evaluation of cash deposits and cash withdrawals

Table 7. Bank of Ghana's cleanup exercise effect on Operations – Lending

Variables	Frequency	Percentages
Affected	14	40%
Not affected	22	60%
Total	**36**	**100%**

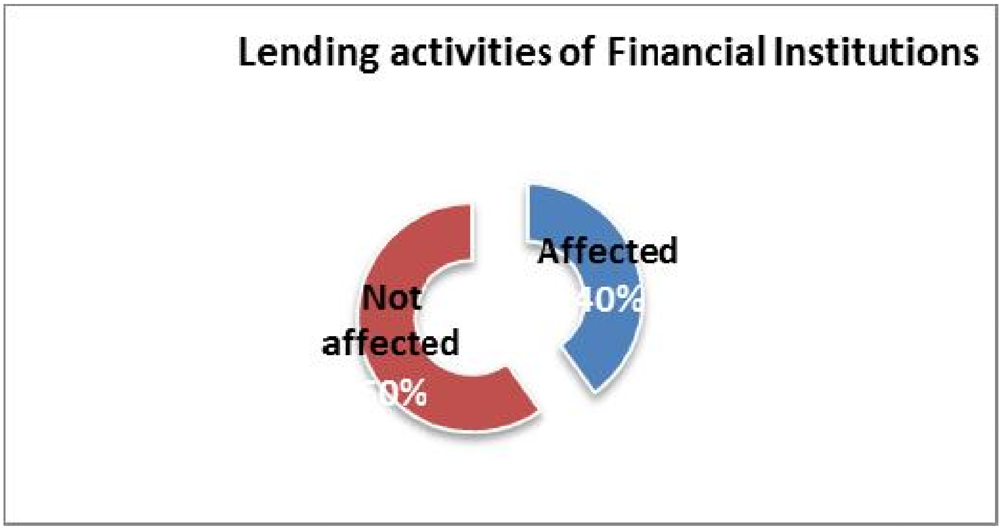

Fig. 7. Survey data, 2020; Effect of Cleanup exercise on lending activities

The study concludes that, even though the Bank of Ghana clean-up exercise was conducted purposely to instill sanity, stability and confidence in the banking sector of Ghana, there have been some associated aftermath effects on banking operations which is were not intended. Deposits have generally been low whereas withdrawals have been very high according to the findings. These situations were due to fear and panic and loss of confidence among the banking population in the Yilo Krobo Municipality of Ghana. On the other side, Lending activities have not been affected. The Financial Institutions that have been affected so far are those who suffered liquidity challenges as a result of fear among their customers. With these findings the study will recommend the following;

- That, the Bank of Ghana should conduct regular and stern supervision among financial institutions to prevent similar occurrences in the future;
- That, the Bank of Ghana should enforce the Banking community to adhere to their respective regulatory requirement and sanction immediate stiffer penalties for breach of these regulations.
- That, the Bank of Ghana should make appropriate time to educate customers of Banks if similar exercises will be conducted. The past exercise was conducted among Commercial banks and Microfinance Institutions. Therefore a similar exercise among the Rural Banks can have the same effect on banking operations in the municipality.
- That, the Bank of Ghana after its periodic enforcement of its regulations, should publish the names of Banks in good standing yearly. This will instill confidence among the banking society and enhance financial inclusion among Ghanaians. On the other hand, this will enable the public to really know their banks

COMPETING INTERESTS

Author has declared that no competing interests exist.

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