COMPARATIVE ANALYSIS OF PROFITABILITY OF LOCAL AND FOREIGN BANKS IN GHANA

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ABSTRACT

The implementation of the Financial Sector Adjustment Programme has beckoned to a number of foreign banks to flock into the country to do business. This has brought about intense competition in the banking industry with its attendant implications for profitability in the industry. In the light of this, the study seeks to make a comparative analysis of the profitability of foreign and local banks in Ghana. The study uses a sample of six banks of which three are foreign banks. Financial statements of the selected banks from 2008 to 2014 are used for the analysis employing profitability ratios such as Return on Assets (ROA), Capital Adequacy (CA), Return on Equity (ROE) and Management Efficiency (ME). We find wide fluctuations in the profitability ratios of the banks. Again, the foreign banks are found to have outperformed the local banks in ROA, CA and ROE. The local banks however, performed better than the foreign banks in ME, except in 2009. We conclude that, the foreign banks are more profitable than their local counterparts during the period under study. It is therefore recommended that, protective measures be put in place to make the local banks more competitive. For instance, the local banks could be required to make less minimum capital requirements than the foreign banks.

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Contribution/ Originality

This study is one of very few studies which have investigated a comparison of profitability of foreign and local banks within the banking industry in Ghana, particularly, after the increment of the minimum capital requirement for commercial banking by the bank of Ghana in 2012.

1. INTRODUCTION

The banking sector plays a pivotal role in the economic development of every society by acting as intermediary between individuals with surplus funds and those with scarce funds. Banks are also said to provide delegated monitoring of borrowers on behalf of depositors (Diamond, 1984). In view of this, it is imperative on a country to have a very robust banking industry to provide the needed financial services that will enable the economy blossom.

In order to propel the economy into an accelerated development after a decade of economic decay, the government of Ghana implemented the Economic Recovery Programme (ERP) in the 1980s. During this period, the Financial Sector Adjustment Programme (FINSAP) was embarked upon in 1988. FINSAP was to address the weaknesses in the banking industry which was characterized by low competition, weak financials, and low profitability as a result of high non-performing loan assets, less liquidity, low capital base and low level of technology (Anim, 2000).

The implementation of FINSAP saw the progressive liberalization of the financial sector in Ghana. The financial sector systems liberalization included the relaxation of interest rate controls, credit ceiling, partial privatization of government owned banks, restructuring of public sector banks, capital markets developments, and deregulation of the prudential system (Brownbridge and Gockel, 1996; Owusu-Antwi, 2009).

A number of new banks have entered the banking industry since the reforms began. For instance, in 2011, there were 27 Deposit Money Banks (DMBs), 49 Non-Bank Financial Institutions (NBFIs) and 135 Rural and Community Banks (RCBs) (Obuobi, 2012).

Also, as indicated in the 2014 Ghana banking survey report, that the banking industry is fairly saturated and that the industry is comprised of 27 universal banks, 137 rural and community banks, and 58 non-banking financial institutions including finance houses, savings and loans, leasing and mortgage firms. Out of the 27 universal banks, 15 were foreign banks. Cumulatively, these 27 universal banks have 904 branches nationwide with 486 and 418 of these branches belonging to local and foreign banks respectively (Pwc, 2014). Currently GN bank is the latest entrant in the industry with about 192 branches nationwide. The above suggest that, intense competition in the banking industry is the heartbeat of profitability and other financials, with each bank striving to carve out its own niche in the industry.

Profitability plays a role in financial analysis and investment in stock (Driehuis, 2003). Kenkel (2001) suggests that, profitability ratios measure the profitability of the company for the past year and give indicators of how to further improve local profitability. Profitability indicates what a firm is earning. Profitability of firms with low capital intensity can be better approached by return on sales (ROS) than by return on capital investment [ROCI] (Mayor, 2004). Profitability ratios include local savings margin, local savings to local assets, return on assets and return net worth (Kenkel, 2001).

Empirical studies on the analysis of profitability of foreign and local banks showed marked differences. Employing Generalized Least Squares (GLS) with unbalanced panel data on seventeen Islamic banks, Muda *et al.* (2013) compared the determinants of profitability of domestic and foreign Islamic banks operating in Malaysia. The study found that, domestic Islamic banks were more profitable than foreign Islamic banks. The results of the study also indicated that, determinants of profitability of domestic Islamic banks were different from those of foreign Islamic banks, citing overhead expenses, loans, efficiency, gross domestic product growth rate and bank size as having significant effect in determining the profitability of domestic Islamic banks, while gross domestic product per capita was the driver of profitability of foreign Islamic banks.

In a related study, Azam and Siddiqui (2012) analysed and compared the profitability of domestic and foreign banks based on quarterly data, with a sample of 36 commercial banks in Pakistan during the period 2004 and 2010. The sample was split into three categories, namely domestic banks under Government control, domestic banks under private control, and foreign banks. They found that foreign banks were more profitable than both types of domestic banks put together.

Again, Kouser and Saba (2012) compared the performance of Pure Islamic banks, mixed banks and conventional banks in Pakistan using CAMEL rating. The study revealed the following facts i) Islamic banks have adequate capital and have strong asset quality compared to other banks in the sample, ii) Islamic banks in general have more

competent management compared to conventional banks, iii) the earnings of Islamic branches of conventional banks are greater than other banks.

Ali *et al.* (2011) explored the profitability of commercial banks with the help of return on asset (ROA) and return on equity (ROE) models. It was found that, the efficient asset management and economic growth established positive and significant relation with profitability measured by ROA and ROE. It was also noted that, the high credit risk and capitalization led to lower profitability measured by ROA. The operating efficiency tended to exhibit higher profitability level as measured by ROE.

Beck *et al.* (2010) applied ratio analysis to compare interest-free and interest-based banks and found interest-free banks performance well ahead. In another study, twelve Islamic and twelve non-Islamic banks around the Islamic world were studied to ascertain their performance within the period 1990-1998 using ratio analysis and trend analysis. The results indicated that Islamic banks as a group outperformed the non-Islamic banks in almost all areas and in almost all years (Iqbal, 2001).

However, it has been found that foreign banks perform poorly in terms of profitability as compared to their domestic counterparts in developed countries. This assertion is supported by Demirguc-Kunt and Huizinga (1998). The study found lower returns on assets for foreign banks in the US, Canada, the UK, Germany, France, and in the Netherlands. Also, DeYoung and Nolle (1996) studied this for the US market and found evidence that foreign banks sacrificed profits in exchange for larger market share. In contrast, this phenomenon is different for developing countries where foreign banks enjoy higher profitability than domestic banks (Bonin *et al.*, 2005).

A comparative study of the profitability of foreign and domestic banks in Thailand was undertaken after the financial crises in East Asia using micro bank level panel data on financial statements. The study pooled cross-bank time series data with the major balance sheet and income statement ratios for domestic and foreign banks in Thailand for the period 1995 – 2000. The banks were found to have improved upon profitability during the period of the study and that the profitability of foreign banks was higher than that of the domestic banks albeit, a closer gap than before the financial crises. This performance, according to the study was due to the positive results of the financial restructuring programme (Boston, 2005).

Zuttah (2004) undertook a comparative study of the performance of Standard Chartered Bank Ghana and Ghana Commercial Bank Limited, over the period of 1990-2003. The results of the analysis indicated that the operational procedures of management of the banks had a significant impact on the financial position of the two banks studied. It was also revealed that the performance of Standard Chartered Bank Ghana and Ghana Commercial Bank Limited was a reflection of the good management and shows that both are highly competitive banks but Standard Chartered Bank Ghana was more competitive than Ghana Commercial Bank Limited.

In a related study, Ntow–Gyamfi and Laryea (2012) using Capital adequacy, Asset quality, Management efficiency, Earnings performance and Liquidity (CAMEL) framework as recommended by the Basle Committee on Bank Supervision and the IMF, compared the financial performance of foreign and local banks in Ghana. The study made the following conclusions:

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 (p. 87).

Studies on the financial performance of foreign and domestic banks have yielded varying results as different indicators have been used for the various studies. Besides, what works well for one bank here may not be so elsewhere (Siddique and Islam, 2001; Chowdhury, 2002; Nimalathasan, 2008; Ashraf and Rehman, 2011; Rehman and Saba, 2012).

Again, the over liberalisation of the financial sector has given rise to intense competition among banks in Ghana. In addition to this, was the increment of the minimum capital requirement for commercial banking by the bank of Ghana from GH¢60 million in 2008 to GH¢120 million in 2012. This move, which industry players have observed, may have far reaching implications for the profitability of the local banks, as foreign banks flock into Ghana to catch up with their major clients. It has been argued that foreign banks stand the chance of benefiting from their parent banks at home by way of technology, training and other support services and that, these could help them improve upon their financial performances at the detriment of the local banks. In the light of this, the main objective of this paper therefore, is to compare the profitability of local and foreign banks within the era of the new capital requirements for banks in Ghana.

The remainder of the paper is organised as follows: The next section outlines the methodology and the data used in the study. The following section presents the discussion of the results, while the final section summarises the results and makes policy recommendations.

2. METHOD AND DATA

Six banks were selected for the study of which three were local (domestic) banks, while the remaining were foreign banks. The foreign banks were Standard Chartered bank, Societe Generale-Ghana and EcoBank-Ghana; while the local Banks were Cal Bank Ghana, Ghana Commercial Bank and Agricultural Development Bank. The six banks were selected from a list of 12 banks whose financial statements were readily available. The study used secondary data extracted from the 2008-2014 financial statements of the selected banks. The data was mainly analysed using descriptive statistics.

We employed financial ratios in our analysis and these were measured as follow:

Table-1. Measurement of financial Ratios/Variables

Acronym (Ratio)	Interpretation	Measured as
ROA	Return on Assets	Net income/Total assets
CA	Capital adequacy	Total equity/Total assets
ROE	Return on equity	Net income/Total equity
ME	Management efficiency	Interest income/Total assets (as a proxy)

Source: Altman (1968)

Financial ratios are used as benchmark for evaluating the performance of the banks under study. Beaver (1967) first used financial ratios as predictor of failure at the company level. This was followed later by Altman (1968) who also used financial ratios model to envisage insolvency at company level. Thus, the use of financial ratios analysis in this study is in tandem with previous studies as cited above.

3. RESULTS AND DISCUSSIONS

In this section, the results of the study are presented using ratios with the aid of charts. A descriptive statistics of the financials of foreign and local banks is presented on Table 2.

Table-2. Descriptive statistics of financials of local and foreign banks

Variables **Local banks**	Mean	S. Dev.	Minimum	Maximum
Interest income	103,801,965.4	158,507,716.2	328,504	426,553,708
Total equity	170,770,381	214,852,273.1	170,770,381	464,914,584
Total assets	1,335,490,252	1,682,836,994	4,469,685	3,611,973,159
Net income	29,389,923.86	42,394,661.23	90,225	109,218,333
Foreign Banks				
Interest income	462,631,325	342,986,028	16,294,827	1,032,340,601
Total equity	764,885,338	494,913,356.7	234,484,434	1,534,781,165
Total assets	5,570,857,213	3,457,992,346	1,521,404,121	10,851,876,364
Net income	234,485,498.6	156,674,887	76,929,697	552,948,552

Source: Computed from Price water house coopers Ghana, annual reports, (2008-2014)

Table 2 shows the descriptive statistics of the financials of the selected banks. It presents the combined financials for the local banks on one hand and that of the foreign banks on the other hand, during the period under review. It is observed from the table that, the foreign banks outperformed the local banks on the average in all the stated financials. For instance the foreign banks made over four times, seven times and five times more than that of the local banks in interest incomes, total equity and total assets respectively for the period under review. In terms of net income the difference between the foreign banks and that of the local banks was quite phenomenal; while the foreign banks garnered GH¢234,485,498.6, the   local banks made Gh¢29,389,923.86 which is about 700 per cent more than that of the local banks.
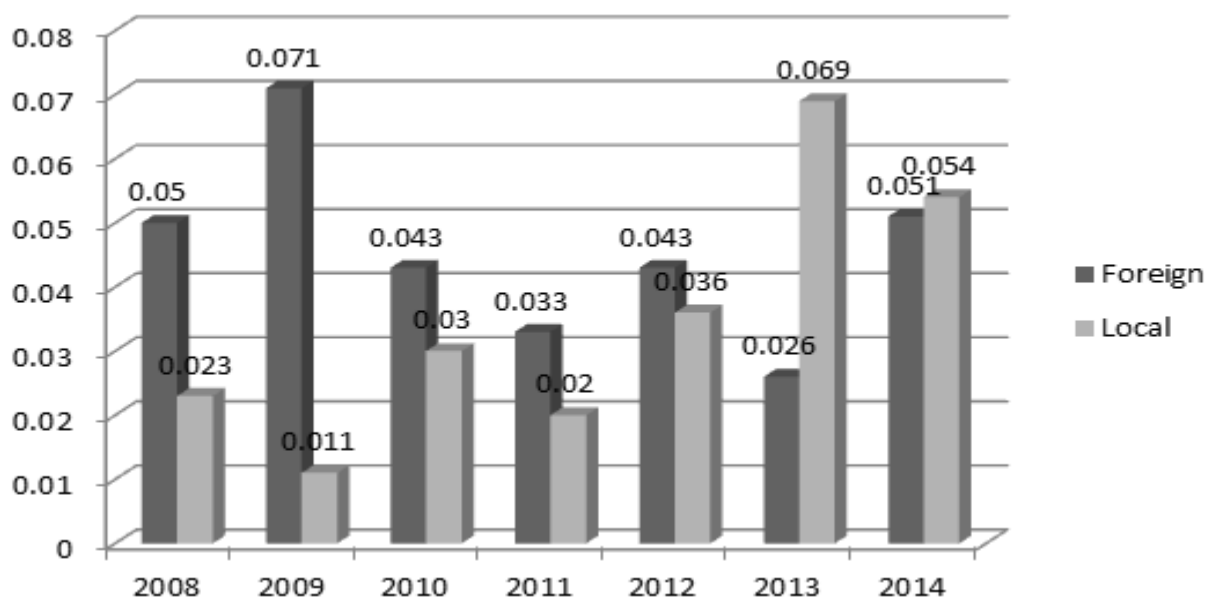

Figure-1. Return on Assets ratios

Source: Constructed from financial statements of banks, (2008-2014)

Figure 1 shows that, foreign banks had a better ROA than the local banks during the period under study. Although the ROA varied widely during the period, the foreign banks had better ROA from 2008 to 2012 with the highest performance year being 2009 during which the ROA stood at 0.071, while the local banks garnered 0.011. However, the local banks did so well against the foreign banks in 2013 and 2014 by recording ROA of 0.069 and 0.054 as against 0.026 and 0.051 in 2013 and 2014 respectively. It is also worth noting that the best three performances within the period of study were 2009, 2013 and 2014. During these years, the local banks had the best performances in two out of the three periods, but marginally above the foreign banks in 2014.

Another significant observation from Figure 1 is that, the local banks recovered from a lower ROA ratio of 0.011 as against 0.071 for foreign in 2009 [545.45% (0.071-0.11/0.011)] to attain higher ROA ratios against foreign banks in 2013 and 2014. Comparatively on the average, the foreign banks could be said to have performed better than the local banks in terms of the ROA ratio during the period under study. This is contrary to the finding of Ntow–Gyamfi and Laryea (2012) in which the local banks outperformed the foreign banks in ROA within the study period of 2005-2010.

Again, the performance of foreign and local banks was evaluated based on their Capital Adequacy (CA) ratios. Figure 2 indicates that, except for 2009, the foreign banks had higher CA ratios than their local counterparts. The banks posted the best performance in CA ratios in 2008 with 0.16 and 0.134 for foreign banks and local banks respectively.
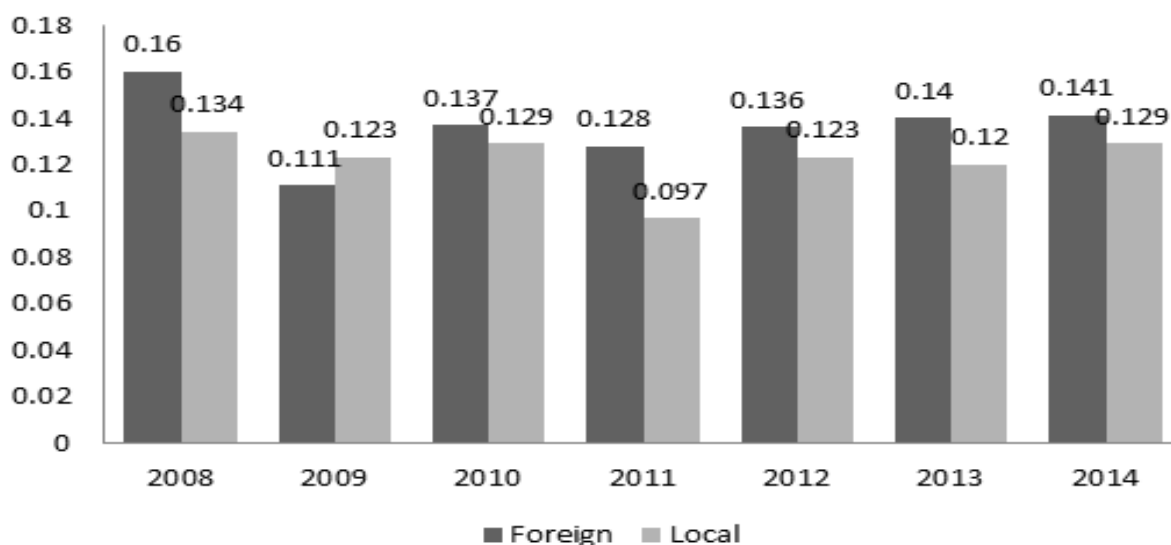

Figure-2. Capital Adequacy ratios

Source: Constructed from financial statements of banks, (2008-2014)

A study of the CA over the period indicates fluctuations between 2008 and 2011. This could be attributed to the directive by the bank of Ghana to banks to recapitalise to a minimum of GH¢60 million in 2008. The banks, however, made a steady growth in CA from 2011 to 2014. The CA ratios were 0.128 and 0.097 in 2011 to 0.141 and 0.129 in 2014 for foreign banks and local banks respectively. This shows 10% and 33% growth for foreign banks and local banks respectively from 2011 to 2014. There was also stability in the CA ratio relative to the ROA where there were wide fluctuations throughout the period under review. Therefore, it could be said that the foreign banks outpaced their local counterparts in CA.

The results of the Return on Equity (ROE) as a measure of the profitability of the banks are presented on Figure 3. Similar to the ROA ratios, Figure 3 shows that, the local banks posted better performance only in 2013 and 2014. The local banks showed strong performance in 2013 by moving up from 0.29 in 2012 to 0.51 indicating a 75.86% growth between 2012 and 2013. Whiles the local banks improved their performance in 2013, the foreign banks however dipped to 0.19 from a previous ROE ratio of 0.32 in 2012. The local banks however, declined slightly to 0.42 in 2014. Although the ROE of local banks declined in 2014, they still posted a higher ratio compared with the foreign banks within the same period.
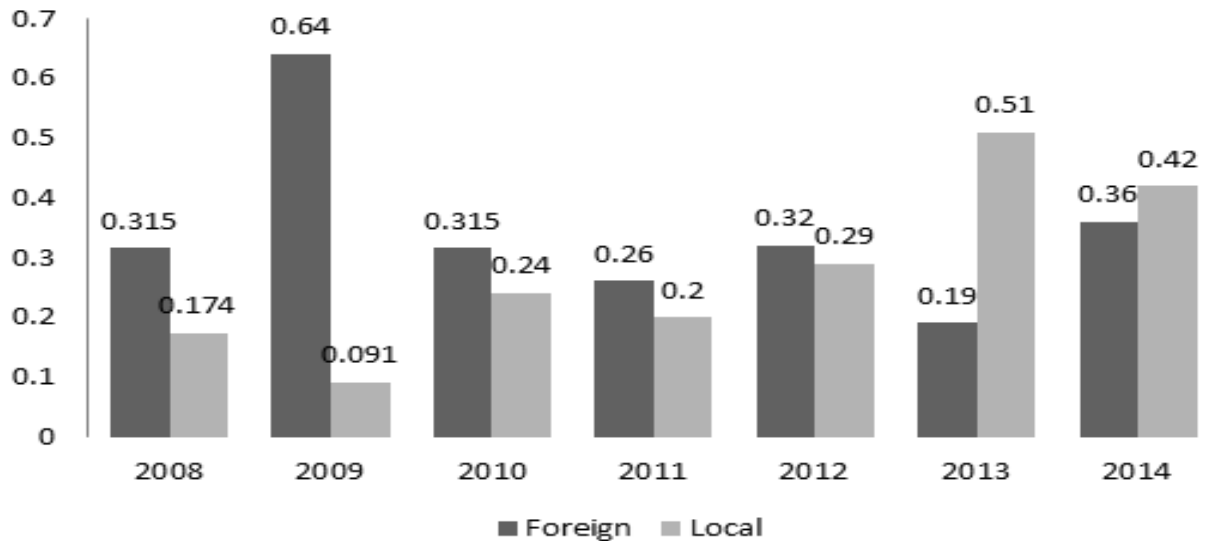
Figure-3. Return on Equity

The local banks however, could not match their foreign counterparts prior to 2013. The year 2009 was their worse performance period with 0.091 ROE ratio as against 0.64 for the foreign banks. Ironically, whiles the local banks recorded their worse performance, the foreign banks recorded their best performance during the same period. Again, the foreign banks also recorded their worse performance at the time that the local banks recorded their best performance. Over the seven year period under study, the foreign banks performed better in ROE than the local banks within the first five years.
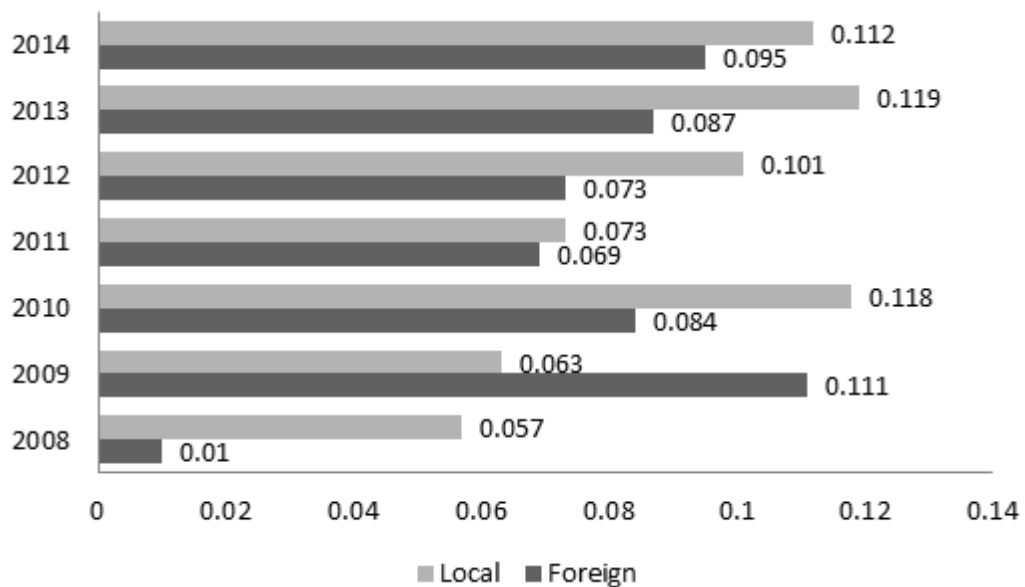

Figure-4. Management Efficiency

Management Efficiency (ME) ratio measures the proportion of the interest income to the total assets of the bank. Figure 4 shows the results of ME. The results indicate that, local banks had higher ME ratios than their foreign counterparts. Apart from 2009, the local banks had outpaced their foreign counterparts. However, 2008, 2011 and 2012 saw a relatively low ME ratios for both foreign and local banks. Also, 2011 was a bad year for both foreign and local banks. In all the ratios analysed, the trend is the same in 2011. Also, despite the power crisis in 2013 and 2014,

these years still proved to be the best periods in terms of performance for both foreign and local banks. The trend is same in the other ratios used in this study.

4. CONCLUDING COMMENTS

The main objective of the study was to compare the profitability of local and foreign banks in Ghana. Data from financial statements of six selected banks were used. Ratio analysis was used and we find wide fluctuations in the performance of both foreign and local banks in all the ratios. We also find that, the foreign banks performed much better than the local banks in terms of ROA, CA, and ROE. However, the local banks did better than the foreign banks in ROA and ROE in 2013 and 2014. On the other hand, the local banks outperformed the foreign banks in ME. On the average, it is concluded that, the foreign banks performed better than the local banks except in ME during the period under study.

The liberalisation of the financial sector has created a level ground for all industry players. However, given the expertise of the foreign banks and the enormous assistance they stand to get from their parent companies back home, this could make the local banks less profitable and throw them out of the industry. Thus, differential minimum capital requirements with the local banks requiring less minimum capital requirements will help protect them and make them compete favourably with their foreign counterparts within the industry.

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