CAUSES OF FINANCIAL FDI INFLOWS INTO SUB-SAHARAN AFRICA (SSA): EVIDENCE FROM GHANA

ABSTRACT

The main aim of this paper is to examine the factors that influence the inflow of financial FDI into SSA; to understand foreign investors' perceptions of the role of institutional factors in facilitating financial FDI inflows and the extent to which the post-reform business environment has been successful in attracting financial FDI inflows into SSA. An in-depth qualitative study was adopted for the research. Using two financial MNCs as case studies, the environmental factors which influenced their decision to choose Ghana as an investment destination are examined, as well as the institutional and regulatory factors that affect their current operations and future investment decisions.

Keywords: Foreign direct investment (FDI), reforms, multinational Corporations (MNCs), environmental factors, regulatory factors, and sub-Saharan Africa.

INTRODUCTION

In the early and mid-1980s, FDI inflows into developed countries were divided almost equally between America and Europe. Over this period, the USA received 51% of total FDI inflows and Western Europe received 43%; the remaining 6% was shared among other economies (Dunning, 1998). Currently, the United Nations Conference on Trade and Development (UNCTAD, 2010) has recorded that developing and transition economies received more than 50% of the world's FDI and for the first time have outperformed developed economies. Moreover, FDI inflows into the developed world contracted by 6.9% (UNCTAD, 2010). In a related development, PricewaterHouseCoopers (2011) also indicate that the E7 emerging economies (China, India, Brazil, Russia, Mexico, Indonesia and Turkey) are likely to overtake the G7 economies (USA, Japan, Germany, UK, France, Italy and Canada) before 2020 if the current trend of FDI flows continues.

On the other hand, a recent research produced by Muhlberger for Deutsche Bank (2012) indicates that SSA accounts for 12% of the world's total population, 60% of the world's uncultivated arable land, 60% of the world's diamonds, 5% of the world's oil and 30% of the world's cobalt resources. In spite of these resource advantages, the SSA accounts for only 2% of total world trade, 2% of total world GDP, 1% of total world manufacturing and just 3% of total world FDI inflows. In view of this trend, it is obvious that the Sub-Saharan African countries (SSACs) seem to have lost much of their attractiveness regarding inward FDI inflows. This study argues that financial

FDI supports the growth of all sectors within an economy, as it encourages the provision of the needed capital, infrastructure and technology required to pursue private sector development initiatives which is seen as a major driver of economic development. Muhlberger (2012) cites the lack of access to finance and inadequate infrastructure as the main obstacles to SSAs economic growth initiatives.

Thus, the primary motivation for this study is the evident paucity of research on factors influencing financial FDI inflows into the SSA region. In view of this, empirical evidence to guide policies to increase FDI inflows into Sub-Saharan Africa is long overdue. Publications concerning financial FDI concentrate on FDI in advanced countries such as the USA, Western Europe and China (Goldberg and Johnson, 1990; Focarelli and Pozzolo, 2008; Buch and DeLong, 2004; Sun, Tong and Yu, 2002). Most of the research findings have been inconclusive with respect to the role of financial sector reforms and other institutional factors in attracting financial FDI inflows (Borrmann, Busse and Neuhaus, 2006; Zeng, Tong and Qian, 2002). In addition, Asiedu (2006) and Zeng, Tong and Qian, 2002) have intensified the call for more research by arguing that the drivers of FDI in the developing regions of Asia and Latin America do not necessarily match well with the case of Sub-Saharan Africa. The aim of this study, therefore, is guided by the following key research questions.

- What are foreign investors' perceptions concerning the role of institutional factors in facilitating inflow of FDI to Ghana (i.e., private sector initiatives–legislation, access to information, taxation and incentives, and bureaucracy)?
- To what extent have Ghana's economic reforms and the post-reform business environment served as determinants in attracting FDI inflows into Ghana?
- What factors account for the attraction of FDI to the financial services sector in Ghana?

This study proceeds as follows. The next section discusses the conceptual background followed by an overview of the Ghanaian financial sector and factors affecting financial FD inflows into Ghana. The third section deals with the research method used to collect the empirical evidence. The fourth section discusses the background information on the case studies and explores the pertinent inward FDI issues. The final section presents the discussion of the empirical evidence, conclusion and future areas of research.

CONCEPTUAL BACKGROUND

The growth of foreign banking activities in emerging economies is not an isolated phenomenon. Rather, it is a part of recent increases in FDI flows towards developing countries. The relative increases in FDI inflows into economies in SSA have largely been as a result of economic reforms and the privatization of SOEs (Debrah and Toroitich, 2005). SSACs embarked on several economic reform/structural adjustment programmes (SAP) dating from the 1980s. Debrah and Toroitich (2005) observed that the major aim of the shift towards economic reforms was to sustain economic growth objectives by attracting multinational corporations (MNCs).

In an attempt to understand the reasons for *general* or manufacturing FDI flows, UNCTAD (1998) combines Dunning's (1993) OLI framework with host country factors to try and create a new concept by asserting that economic factors are the main reasons for FDI. These economic factors could be classified as *Market*-seeking, Resource-seeking, Efficiency-seeking and Strategic asset-seeking. The market-seeking factors include market size and growth, access to regional and global markets, country-specific consumer preferences and the structure of the market. The resource-seeking factors are comprised of the availability of raw materials, low labour costs, technology and infrastructure. In their most current research, Ezeoha and Cattaneo (2011) indicate that recent FDI trends show that Africa's share of financial FDI inflows is still relatively minimal. Besides, inflows still remain focused on resource-seeking FDI due to its abundant natural resources.

The efficiency-seeking factors consist of cost of inputs and regional integration. On the efficiency side, MNCs expand abroad in order to utilize resources to maintain or improve efficiency (UNCTAD, 1998). The strategic asset-seeking might be motivated by a desire to improve the international competitiveness or to increase the market power of the firm. It takes place through mergers and acquisitions (M&A) and aims to acquire firms with strong market positions and advanced technology (Piggott and Cook, 2006). Since the advancement of the UNCTAD theoretical framework, empirical studies on the determinants of FDI across the developed world have been remodelled to include macro-economic factors, institutional factors and financial development factors (Kinoshita and Campos, 2004).

In the past two decades, however, the sector composition of FDI has shifted away from extractive industries and manufacturing (*general* FDI) towards the services sector (Hill, 2007). In addition, UNCTAD (2004) asserts that outward FDI from the Triad countries (USA, EU and Japan) in service industries was 47% in 1990, and by 2003, this figure had increased to 67%. In fact, Hill (2007) indicates that the composition of service sector FDI is largely concentrated in the financial services. Furthermore, Goldberg (2009) argues that financial FDI remains the largest source of external finance for many developing countries. It is anticipated that financial sector FDI will continue to grow as globalization contributes to the free movement of financial resources across continents. But as more emerging economies enter into the sector through financial sector liberalization and deregulation, attracting financial FDI will become more competitive.

Macro-economic and general financial conditions have been hardly analysed at all in the literature on financial FDI. A few studies, such as Froot and Stein (1991), focus on the effects of exchange rate movements in general FDI flows. Stein (1991) cites that a depreciation of a local currency increases the relative wealth of foreign investors, allowing them to outbid local rivals for profitable projects. Considering this fact in line with the work of Froot and Stein (1991), this could be the result of the depreciated exchange rate by SSACs during the reforms to attract significant FDI inflows and also could be amongst the reasons for the far-reaching economic reforms and private sector development initiatives in Ghana. This lower cost of capital would also result in making the expansion of the financial activities into foreign countries easier. In another instance, Klein, Peek and Rosengren (2000) offer an alternative explanation of financial FDI based on differences in the huge availability of credit to financial MNCs *versus* local financial institutions.

This study, therefore, classifies macro-economic determinants of FDI into two major groups: *Push* (home country-related factors) and *Pull* (host country-related factors). Among the push factors, the home country’s economic cycle has recently attracted considerable attention (reported in the FDI literature) but there is no clear consensus.

For example, Thomsen (2000) shows that global FDI grows less when the US is in recession. In the same vein, Barrel and Pain (1996) find that growth in industrialized economies is positively related to US FDI. In addition, Albuquerque, Loayza and Serven (2002) found that world *per capita* growth positively affects FDI inflows to developing countries while it is not significant for developed ones. Focarelli and Pozzolo (2008) find economic growth to be a driving force of financial FDI.

For simplicity, this study applies the features of pull and push factors to explain financial FDI. The push factors include the existence of domestic regulations and restrictions which limit operations of financial MNCs at home (Buch and DeLong, 2004). This could be a major factor in financial MNCs looking for opportunities elsewhere. Looking at the proponents of pull factors, Barth, Caprio and Levine, 2000); Goldberg (2007); Ezeoha and Cattaneo (2011); Muhlberger (2012) agree that the openness of the host country to the establishment of new foreign branches and subsidiaries and tax incentives is key to attracting financial FDI inflows. In this regard, Focarelli and Pozzolo (2001) show that financial MNCs prefer to acquire equity interests in countries where either regulatory restrictions on the activities are low or the market is less concentrated. This could also be related to other institutional factors influencing financial FDI.

It is clear from the review of the literature that the impact of macro-economic and institutional factors for FDI is still inconclusive, let alone its application to financial FDI inflows into SSACs. Although some empirical work has been done on the *push* factors determining financial FDI, virtually none exists for *pull* factors, which focuses on the SSACs. This is partly as a result of meagre knowledge of the determinants of financial FDI into the region. There is the need, therefore, to explain the differences between operating in a developing country rather than operating in an industrialized country following Focarelli and Pozzolo's (2001 and 2008) tentative results. This study, therefore, fills an important gap in the literature by accounting for these factors and their impact on FDI inflows into the financial services sector for development in the SSACs, with Ghana as a case in point. The next section present the general overview of the financial sector reforms in Africa and the Ghana financial services industry, and the factors affecting financial FDI into Ghana.

FINANCIAL SECTOR REFORMS IN AFRICA

According to Inanga and Ekpeyong (2004) and Senbet and Otchere (2006), financial systems in Africa are noted for their marked variation and fragmentation. In other words, financial systems are different in countries in the same region. For example, Mozambique, Guinea, Angola and Tanzania have dominant state-owned financial institutions consisting mostly of a few commercial banks. There is a further sub-division into countries with rich varieties of institutions such as the ones found in Nigeria, Zimbabwe, Kenya and others with limited varieties of institutions such as those found in Malawi, Uganda, Ghana and other SSACs (Soyibo, 1994a; Inanga and Ekpeyong, 2004). But whatever the structures of the financial systems operating within the SSACs, African governments have adopted financial sector interventions based on thoughts of promoting economic growth. Principal among them were interest rate controls, directed credit to priority sectors and providing bank loans below market interest rates to finance their activities. These policies turned out, however, to weaken the various financial systems rather than promoting economic growth (World Bank, 1994). Controlled rates of lending, which were usually low, discouraged more productive investments and discouraged financial FDI inflows.

Aryeetey, *et al*. (1998) also observed that high default rates were partly attributed to the fact that, in some cases, subsidised credit did not reach their intended beneficiaries. In addition, most governments in the SSACs attempted to finance public sector deficits by creating money, but that also resulted in inflationary spirals and negative interest rates on deposits. Tied to this was the declining financial inflow into Africa since the 1980s. Roe and Schneider (1990) report that from a positive figure of US$ 35.2 billion in 1981, foreign capital inflows into SSACs declined to a negative figure of US$ 50.1 billion in 1988. At this stage, it became evident that African countries needed to liberalize their financial sectors to merit private investments. But Aryeetey, *et al*. (1998) and Brownbridge and Gockel (1998) argued that these blanket financial reforms were packaged and handed to African countries by the World Bank.

Therefore, Seck and El-Nil (1993) categorized African financial reforms into three areas based on their intended objectives for the reforms. Firstly, countries whose aim was to improve their monetary control included Botswana and Mauritius. The second category had aims to improve mobilization and allocation of domestic savings and included Zaire and Kenya. The third category had aims to improve the banking system and included The Gambia, Sierra Leone and Burundi. On the other hand, Ghana, Nigeria, Kenya and Zimbabwe had aims spanning across these three categories. But the economic and financial conditions of individual economies shaped the outcomes of the reforms. In Nigeria, Kenya and Ghana, reforms were carried out in conditions of severe macro-economic instabilities. In Malawi, Zambia, Zaire and Botswana, their banking systems were relatively good at the start of the reforms (Caskey, 1992). In Mauritania, banks were bankrupt prior to the reforms. Benin, Niger, Senegal, Côte d'Ivoire, Burkina Faso, Togo and Mali were all facing balance of payments problems. Thus, former French West African colonies (UEMOA) and the West African Economic Monetary Union (WAEMU) had inconsistent economic policies before the financial sector reforms were initiated (Plane, 1993). Although countries in the SSA have seen economic growth fuelled partly by reason of financial sector liberalization, the eventfulness of the growth could not be attributed to sound economic policies.

The tables below show the total capital flows into SSA countries listed in order of magnitude in 2011 following the financial sector adjustment programmes. Excluding FDI, net capital flows declined as a result of the ongoing banking sector deleveraging in Europe which had an impact on trade flows to SSA. The World Bank (2012) indicates that improved macro-economic and political stability in recent years are the two major reasons for the increased FDI inflows. There are three main sectors that received considerable inflows including extractive industries, communications and finally, financial services. Considering table 1.2, UNCTAD (2012) indicates that SSA drew FDI not only to its natural resources, but also to its emerging consumer markets. Political upheavals in North Africa, however, deterred FDI inflows into the region. Moreover, FDI flows to Africa were at $42.7 billion in 2011, marking a third successive year of decline. SSAs position in global FDI rankings diminished further from 3.3% in 2010 to 2.8% in 2011, although the picture of an overall declining trend does not reflect the situation across all parts of Africa (UNCTAD, 2012).

Table 1.1 Net Capital Flows to Sub-Saharan Africa in $ billions							
Year **e – World Bank Estimates** **f – World Bank Forecasts**	**2008**	**2009**	**2010**	**2011e**	**2012f**	**2013f**	**2014f**
Current Account Balance	-14.0	-31.8	-23.2	-15.7	0.0	-10.7	-18.6
Capital Inflows	42.6	47.2	53.5	49.5	56.6	49.5	82.1
Net Private Inflows	37.6	37.4	40.5	42.4	36.8	50.9	71.9
Equity Inflows	31.8	43.0	36.5	30.7	29.3	38.9	53.8
FDI Inflows	**37.5**	**32.8**	**28.8**	**32.5**	**31.2**	**35.9**	**46.8**
Portfolio Equity Inflows	-5.7	10.2	8.0	-1.8	-1.9	3	7
Net Private Creditors	5.9	-5.6	3.9	11.7	7.5	12.0	18.1
Bonds	-0.7	1.9	1.4	5	4	5	7
Banks	2.2	1.6	0.7	8.1	2.4	6	9
Short-term debt flows	4.5	-9.9	1.5	-1.4	1.0	1.0	2.0
Other Private	-0.1	0.8	0.4	0	0.1	0	0.1
Net Official Inflows	4.9	9.8	13.0	14.2	12.7	8.4	10.2
World Bank	1.9	3.1	4.0	4.3	N/A	N/A	N/A
IMF	0.7	2.2	1.2	0.8	N/A	N/A	N/A
Other Official	2.3	4.5	7.9	9.1	N/A	N/A	N/A

Source: World Bank Global Economic Prospects (June 2012 Estimates); African Economic Outlook data (2012)

Table 1.2 Distribution of FDI flows among African Economies by range in 2011	
Magnitude of Inflow	**Host Country in Africa listed in order of magnitude of FDI inflows**
Above $3.0 billion	Nigeria, South Africa and Ghana
$2.0 to $2.9 billion	Congo, Algeria, Morocco, Mozambique, Zambia
$1.0 to $1.9 billion	Sudan, Chad, Democratic Republic of Congo, Guinea, Tunisia, United Republic of Tanzania and Niger
$0.5 to $0.9 billion	Madagascar, Namibia, Uganda, Equatorial Guinea, Gabon, Botswana and Liberia
$0.1 to 0.4 billion	Zimbabwe, Cameroon, Cote d'Ivoire, Kenya, Senegal, Mauritius, Ethiopia, Mali, Seychelles, Benin, Central African Republic, Rwanda and Somalia
Below $0.1 billion	Swaziland, Cape Verde, Djibouti, Malawi, Togo, Lesotho, Sierra Leone, Mauritania, Gambia, Guinea-Bissau, Eritrea, Sao Tome and Principe Burkina Faso, Comoros, Burundi, Egypt and Angola

Source: UNCTAD (2012)

FDI inflows into Ghana in particular increased significantly. UNCTAD (2012), however, attributes these increases to the investments in the oil sector as investors are looking farther afield in search of oil and gas reserves in Ghana. Having looked at the financial sector reforms in Africa and its impact on FDI inflows, the next section will focus specifically on Ghana's financial sector adjustment programmes in order to analyse its impact on financial FDI inflows.

OVERVIEW OF THE GHANAIAN BANKING SECTOR

Prior to 1983, Ghana operated a tightly regulated financial system and the impact on economic growth was found to be dismal (Mmieh and Owusu Frimpong, 2004; Gockel and Brownbridge, 1998). When Ghana turned to the IMF for assistance to reshape the macro-economic structure, one of the policy packages which were part of the entire reform agenda was to reform the economy's financial sector. There is some evidence, however, that whilst there have been significant gains following the reforms, there are several structural factors that affect financial FDI inflows and need to be addressed (Aryeetey,*et al*., 2000). In addition, Steel (1997) argues that financial intermediation has been persistently limited, remains inefficient, and the formal financial services sector has been unable to make deposit and credit facilities widely available to support the growth of the private sector development initiatives in Ghana.

What is more, the shifts in the financial services sector régime in Ghana have also been propelled by a domestic dissatisfaction with the performance and efficiency of the system. According to Asante (2000) and Cobbina-Asirifi (1999), the dissatisfaction with Ghana's financial services sector has often coincided with the shifts in political régime, often a move from a civilian to military régime or the reverse. Liberalization has stimulated a greater search for competitiveness that is revolutionizing the financial services sector (especially in the banking industry) in Ghana. These include the new entry of financial MNCs with more efficient technology and resources. The removal of interest rates, controls, and credit ceilings has allowed banks greater flexibility to compete for customers. One of the most useful innovations is the establishment of the rural banks which further support the activities of the formal financial institutions. They numbered about 130 in 2010 (GIPC, 2010). At the end of 2011, there were 29 banking institutions operating in Ghana; foreign investors hold a majority of the shares in about 12 of these major banks in Ghana; there are 42 NBFIs; 7 major supporting institutions and 22 insurance companies (GIPC, 2010).

In spite of these developments, the financial sector remains highly oligopolistic. The advances were modest for the policies of competitiveness after the reforms. In order, however, to allow the entry of the private sector into the financial services sector in Ghana and continuously pursuing policies to attract FDI inflows, the state must retreat from influencing the sector and allow market forces to determine the allocation of resources as it did prior to the reforms. Currently, formal banking reaches only 6% of the total population of about 24 million people and about 35% of bank branches are concentrated in Accra, the capital city (Gockel and Akoena, 2003). But, the capital city represents only 13% of the total population (Ghana Banking Survey, 2010, www.gob.gov.gh). In a related development, Buch and Mathisen (2005) indicate that 50% of all bank branches in other regions belong to the Ghana Commercial Bank (GCB) which is state-owned. GCB still maintains the highest total assets in the industry of about 25% in spite of the reforms. It is against this background that this paper discusses inward FDI flows into Ghana using two case financial MNCs in addition to other relevant organizations. But before that, the authors of this study present an outline of the research method used to collect the empirical evidence.

METHODOLOGY

The data for this study were drawn from both secondary and primary sources. Secondary sources enabled us to assemble the necessary information on each firm before the data collection process. Data were gleaned from books, periodicals, newspapers, journal articles, press releases and magazines. The official documents used in this study were obtained from public sources including official documents from Institute of Statistical, Social and Economic Research (ISSER), the Ministry of Finance, the Ghana banking survey produced yearly by PricewaterhouseCoopers, sector profile information from the Ghana Investment Promotion Council (GIPC), and several policy documents from the Ministry of Trade and Industry. The list of banks operating in Ghana and their current business activities was obtained from the *Ghanaian Financial Times*. These documents were used to uncover patterns, policies and identifiable trends of FDI inflows into emerging economies, the SSACs and Ghana. This information provided good contextual and essential background information.

The study is qualitative in nature and draws from interpretive-constructivist and constructivist-phenomenologist traditions which stress a persons' lived experience (Saunders, *et al*., 2009). It also emphasizes the importance of an inductive approach to data collection (Bryman and Bell 2007). The rationale for this methodological position is that it provides an appropriate framework for the development of an in-depth understanding of a hitherto under researched phenomenon (Cresswell, 2007) and leads to the discovery of *richly detailed narratives of the lived experiences of individuals* (Saunders, 2009). Van Maanen (1979) argues that the term *qualitative* has no precise meaning. Rather, it is an umbrella term which covers a variety of techniques, which seeks to describe, decode, translate and otherwise come to terms with the meaning, not the frequency of certain more or less naturally occurring phenomena in the social world. The purpose of adopting the qualitative research approach was to emphasize the representation of reality through the eyes of the participants. We sought to focus on the respondents and it is their reflections and opinions that guided the research. This obviously provided a deeper understanding of the host country factors that influence a financial MNC to commit an investment in the country.

The sampling technique adopted was purposive. Ghana was chosen because it is representative of most countries in the sub-Saharan Africa which adopted similar World Bank and International Monetary Fund Structural Adjustment Programmes (SAPs) by deregulating most of the government-controlled businesses (State-Owned Enterprises –SOEs/Public Sector Enterprises – PSEs) and embarking on several supply side policies to attract financial multinational corporations (MNCs). The capital city of Ghana, Accra was chosen because it has a high concentration of bank headquarters and subsidiaries. Moreover, using Accra as the primary location for the interviews presented some matchless advantages, thus making it the most suitable choice to assess the relatively important factors influencing their investment decisions and other issues in their daily operations (Saunders and Lewis, 2009). This strategy also allowed for the assessment of more intricate interrelationships and other valuable information which was beyond the standard set of questions (Bryman and Bell, 2007).

The study mainly used interviews to collect the required data which primarily focused on financial MNCs, Bank of Ghana (BOG), Ministry of Finance and Economic Planning (MOFEP), Ghana Investment Promotion Council (GIPC), Private Enterprise Foundation, Financial Economic Consultants (SEM Financial), anon-governmental organization (NGO) focused on government macro-economic policy, Ministry of Trade and Industry (MOTI) and the Ghana stock exchange (GSE). Overall, 14 different organizations participated in this study. The interviewees were assured of confidentiality and anonymity. We interviewed 4 managing directors/CEOs, 17 departmental directors, 28 heads of departments, and 22 non-managerial staff from two major financial MNCs. Besides, 33 respondents were interviewed from regulatory bodies, government departments and economic policy analysts responsible for financial sector development.

In total, 104 participants were interviewed. Chief executive officers, directors, managers and non-managerial staff and policymakers were the key respondents for this study. In every financial MNC and all parastatals which were chosen for the study, we ensured that key personnel with authority to influence investment decisions, or who were part of the initial investment decision, were interviewed. This is because their perception was deemed extremely important to gather enough evidence about the factors influencing or affecting financial MNCs in Ghana. In addition, the research questions sought to gain a detailed understanding of how managers, non-managerial and other decision-makers observe the *world* within which they invest, in order to move towards a generalisation and ideas for theory. The views and ideas of managers regarding their processes and their personal experiences were paramount to establish why SSA lacks access to overseas finance to pursue private sector development initiatives. The duration of the interviews was between 1 to 2 hours. The interview questions were mainly open-ended and were divided into four major sections which covered: (i) external factors affecting financial FDI inflows; (ii) size of Ghana's formal/informal economy; (iii) political interference; (iv) banking infrastructure and technology services (BITS); and, (v) macro-economic determinants of financial FDI inflows. The interviews were conducted in English and they were held at the respective organization site or other preferred location.

The principal investigator commenced the interviews by explaining to the participants the aims and objectives of the research. Some of the interviews were tape-recorded and transcribed word-for-word while other interviewees' responses were recorded in a hand-written format. Some of the in-depth interviews were conducted on a one-to-one basis, while others were group interviews which established the general consensus on the effectiveness of the institutional and regulatory systems. The research strategy adopted was driven by the research objectives, time and the philosophical underpinning surrounding the research process (Saunders, *et al*.,2007), To this end, 2 anonymous case financial MNCs were selected to gauge how each of them assessed the regulatory requirements in the financial sector following the reforms. A content analysis technique was employed to analyse the interviews in order to identify patterns in the information provided by the interviewees, and in turn facilitate comparison in the similarities and differences in the causes of financial FDI inflows to Ghana (Miles and Huberman, 1994). The next section provides the findings of the empirical evidence.

CASE STUDIES

FINANCIAL MNC D

Firm D, which was established in the 1990s, is from a neighbouring West African country. As of 2007, it is the largest company in its home country and the rest of West Africa with total assets of US$21 billion. In addition to numerous branches in its home country, the bank has branches in Ghana, Gambia, Sierra Leone, South Africa and the UK. In Ghana, firm D was incorporated in the mid-2000s (under the Ghana Banking Act 2004) as a private limited company and commenced universal banking operations in the same period. Firm D has won several awards including *Bank of the Year* within its first year of operations (*Financial Times*, London); *African Bank of the Year* in late 2000s (*African Investor*); *Best Bank* in its home country in 2008 (*Euromoney*); and *Best Global Bank* in 2008 (*African Investor*). In an industry with an average of non-performing loans ratio of 14.9%, firm D had only 6.3% in 2009.

Currently, financial MNC D operates in 22 branches and agencies in Ghana and has an objective of making banking easier and better than anything customers have so far experienced. Firm D has played a major role in the transformation of the banking industry into an intensely competitive, customer-orientated, more efficient and technologically inclined industry. Prior to commencing their operations in Ghana, relationship banking was novel, e-banking was restricted to ATMs, banking was limited to a few hours in the day and weekend banking was almost non-existent. In view of these initiatives, it can be argued that firm D has, to some extent, helped redefine standards in the financial services sector in Ghana through the introduction of mobile banking, electronic payment systems, and Visa payment systems as well as many other products and programmes that provide customers with greater speed, accuracy and options. In spite of all this, firm D still lacks specialist banking staff and stakeholders are sometimes hesitant to commit to undertaking larger investments due to a certain degree of political interference during and after the 2008 elections in Ghana.

FINANCIAL MNC E

Financial MNC E is one of Africa’s largest banking groups with operations across the continent of Africa and other parts of the world. Firm E was established several years ago in its home country. Firm E became the first foreign bank to open a branch in a mining town in the southern part of Africa to provide banking and other financial services to the businesses in the area. Firm E was subsequently listed on the stock exchange in its home country in the early 1970s and in the late 1980s. Besides this, Firm E divested its operations by selling almost 40% of its shares to existing shareholders to increase its market capitalization in the 1990s. A year after that, firm E began to establish links with several countries within Sub-Saharan Africa. Financial MNC E appears to be committed to undertaking financial investments in developing countries. Currently, financial MNC E operates in 17 Sub-Saharan African nations and has a presence in several emerging economies including Russia, Brazil, Argentina and Turkey. Recently, financial MNC E has acquired operations of a major financial institution in the UK. In addition, financial MNC E acquired a public sector financial institution in Ghana to increase its asset base. The acquired financial institution had made losses when it was run as a wholly domestic bank. This signifies the role that financial MNCs can play in transforming state-owned financial institutions (that are financial loss-makers) into profitable ventures. It could be argued that the acquisition of this bank is supporting the effective delivery of financial services to businesses and individuals in Ghana.

The case financial MNCs revealed the current challenges they face investing in Ghana as identified below. The most critical ones are further examined in detail to recapture the views of the respondents, such as the size of Ghana's economy, political interference, country and regional effects, the lack of infrastructural facilities and other factors.

SIZE OF GHANA'S FORMAL/INFORMAL ECONOMY

Results from the interviews conducted in Ghana suggested that one of the most significant challenges that foreign financial MNCs face in Ghana today is the size of Ghana's informal economy which (according to the BOG, 2009) and all the sampled firms) stands at 70% and the formal sector at 30% respectively. This means that only 30% of Ghana's population (7.3 million out of 24.5 million) use the services of a financial institution. As most Ghanaians do not have bank accounts, especially those living in rural areas, this makes it difficult for new banks to come to Ghana and invest. The individual incomes of at least 70% of the population are too small for high street banking. A senior economic analyst from the Ghana Stock Exchange states:

> *If you have an economy that employs around 70% to 80% of the informal sector, and these do not pay proper taxes, most private sector businesses have no accounting framework to measure the output, and the banks are not in a position to mop up even 40% of the value of this country. It means that there are real structural issues that need to be addressed continually until the solution is found. Existing banks have failed to deliver in this regard and we obviously need new ideas.*

Furthermore, due to the informal nature of businesses in Ghana it is difficult to assess their commercial feasibility to make a credit decision. A bank enters into another country to provide credit and also to invest money on behalf of their stakeholders but if there are only a few customers being competed for by many financial MNCs it becomes a tight market. Interestingly, a relative comparison of several indicators of financial development for some selected ECOWAS countries produced by the IMF (2007) indicates that credit given to the private sector has decreased consistently between 1975 and 2007. In their most current article, Adeniyi, Omisakin and Egwaikhide (2012) also argue that although Cote d' Ivoire seems to have the most sophisticated financial system, availability of credit to the private sector, however, has consistently declined.

Sierra Leone and Nigeria face similar credit constraints as the private sector is deprived of credit to support development initiatives. Although these countries share general characteristics of their financial sector in terms of size and deposits, credit to the private sector, which is capable of stimulating growth and further investment, has declined. These findings support the argument that the size of the formal/informal sector and the nature of operations prevent the formal financial institutions from making credit available. Using the information provided in appendix 1, the selected indicators varied across individual countries, however, the total domestic bank credit to GDP ratio from 1975-1984 ranged from 26.3% for Ghana and 44.3% for Gambia. Furthermore, using the same countries as proxies for the ECOWAS region from 1995-2005, bank credit to GDP ratio was 10.87% for Ghana and 12.58% for Gambia (IMF, 2007 and Adeniyi, *et al*., 2012).

This study argues that one main contributing factor to the phenomenon, therefore, is the difficulty of tracking down businesses due to the lack of credit reference bureaux and/or agencies coupled with an inefficient addressing system. In this regard, a director at firm D equivocates that sometimes the bank gets disappointed with the behaviour of certain businesses.

> *Some Ghanaian businesses are not entirely sincere and more often than not they are the ones in the informal sector. In our opinion, we think the small and medium scale enterprises (SMEs) need access to credit to be able to function as a business and we want to support the private sector development initiatives introduced by the government, but they are a huge risk at the same time. They take loans and do not always want to pay. The economy may be suffering but you don't take loans with the view of not wanting to pay.*

In a related study, Buchs and Mathisen (2005) indicate that lending in Africa is risky as is reflected in the high level of past-due non-performing loans. In addition, the significant losses of state-owned financial institutions (SOFIs), also reflects the lack of any central credit information system coupled with the lack of co-operation among banks to share customer information (Buchs and Mathisen, 2005). Similarly, a director of the private enterprise foundation in Ghana argues that the formal processes of the financial MNCs affect available credit to the private sector:

> *Most of the banks ask for collateral which many of our small businesses do not have. They would also want to see that these businesses keep good books of accounts, but many SMEs do not have it because they just do their business just in their head and we have to inculcate that habit and culture in the SMEs in Ghana. So, several things have happened over the years. In terms of SMEs not keeping books, we have made attempts to support them; we go out there and help them how to keep their books based on the available funding. One area we've been focusing on is providing them with good financial management. In fact, last year, we did some across four centres in Ghana for small businesses.*

Aryeetey, *et al*. (1998; 2000) in their study of the informal financial sector indicate that the private sector in Ghana needs government financial support to provide employment and increase economic activity. Based on their recommendations, the government has set up what is known as the Venture Capital Fund to support commercial banking institutions aimed at providing loans to SMEs. This study also found that there are structural problems which remain and need to be addressed before the Venture Capital Fund can work successfully. This is because most of the businesses are unable to produce a business plan which will demonstrate their financial projections and also cash flow potential, making it almost impossible for the financial MNCs to support these initiatives by providing them with credit.

In addition, the banks are not secured enough when giving loans to the informal private sector because of the poor identification system. This means that businesses can take loans and relocate to a new city or even set up a new company elsewhere in the country and take further loans and cannot be traced. These factors contribute to the smallness in size of the Ghanaian economy which somewhat confirms the reason why Lagos commands bigger businesses than the whole of Ghana. At least, a relatively good number of businesses in Lagos are formal with a relatively proper system of address (Rakodi, 1997). An economic analyst at the Ministry of Finance also reiterated that:

> *The main issue here is that the size of Ghana's economy is not that big and that really affects other aspects of our economy and the amount of FDI that we can expect. As we speak, we have over twenty international airlines that have applied to come to Ghana, but the question is do we have the ability to absorb the services that will be provided by these international airlines? If we look at the number of people who fly into Ghana, it's insignificant and I think similar issues apply to the financial sector.*

For foreign banks, their motive is to maximize profits and increase shareholders' wealth (Claessens and Horen, 2007) and their decision to enter a country to invest never deviates from this reality. The factors identified above will, therefore, affect their operations in the medium- and long-term and this may be one of the many reasons why many foreign banks in Ghana restrict their future investment decisions to the formal sector. It can be argued that the traditional foreign banks in Ghana have done little to support the growth of the private sector in terms of providing business consultation services for the informal private sector and that is why Ghana needs quality financial FDI. According to Davis (2006) and Alfaro, *et al*. (2006), determining the value of FDI is based on four major fundamental principles which include the following: capital that sticks and grows; employment that builds and upgrades skills; technology and *know-how* that transfers; and, competition that encourage efficiency.

Market size and growth measured in terms of GDP affect the size of financial FDI inflows as well. This is because a growing economy provides increased opportunities for more profitable investments. The size of Ghana's economy is relatively small compared to Nigeria and Côte D'Ivoire. Ghana has a relatively small domestic market, low *per capita* income and relatively low potential for growth. This is a constraint on Ghana's ability to attract huge investment. In relation to this, an economic researcher at a regulatory body notes:

> *I recently attended a meeting with the IMF and one of the arguments IMF raised is that our GDP might be the reason for our relative low FDI inflows. It was also stated that Ghana's GDP is undervalued, and they might be right. This is because we have persistently run high fiscal deficits which necessitate high public sector borrowing requirements and thus high treasury bills. Our GDP is small and the prospects for future growth are not absolute. So in a nutshell, you don't expect the JP Morgan's and the Morgan Stanley's to increase their investments in Ghana given that their annual returns is bigger than Ghana's entire GDP. Where would they invest all this money?*

This finding is consistent with most studies, such as Agarwal (1980), Brewer (1993) and Haufler and Wooton (1999). They conclude that there is a dependent relationship between market size and FDI. Kening (1997) cites the average annual growth as a key factor in drawing in FDI. Furthermore, the size and activities on the Ghana Stock Exchange (GSE) are relatively small. Also, the amount of listing and the entire market capitalization on the GSE is negligible. For instance, as of 24/02/2011, there were only 38 listed companies on the GSE compared to 198 companies listed on the Nigerian Stock Exchange.

POLITICAL INTERFERENCE

According to Debrah and Toroitich (2005), Mmieh and Owusu Frimpong (2004) since independence, most countries in Africa have not been able to attract FDI due to political instability and excessive government intervention. Dahl (1989) also indicates that the political system of a country is a persistent pattern of human relationships, which involves control, influence, power or authority. Luostarinen (1982) argues that any stable and predictable political system would attract financial FDI inflows. This argument is supported with evidence of China's political system. Ghana's political system has swung from the authoritarian to the democratic. Ghana's experience has been mixed as financial MNCs complained. Even though repressive financial policies and lending to the priority sector have been abandoned, there are still occasions when the government or other influential officials pressure them to lend to businesses they consider as not creditworthy borrowers. In most cases, political parties borrow a lot of money from these major foreign banks to fund their political campaigns.

Policies introduced by the government may also have a replicating impact on the process of financial deepening. In 2009, the Ghana government publicized in the budget statement that plans were in progress to introduce a domestic content bill which would request foreign firms to use some minimum proportion of their inputs (especially labour) from the domestic economy (Government of Ghana, 2009). For financial MNCs that needed banking specialists and consultants which may not be available in Ghana, this has had an effect on financial FDI. Most banks indicated that they bring their own staff from their country of origin to set up their business and implement their corporate values and organizational culture before posting these staff to other locations, therefore this quota will reduce the amount of qualified staff and the degree of capital the parent company is prepared to put at risk. Such a bill does not appear to be appropriate as a means of attracting financial FDI. The bill has rather acted as a deterrent for huge capital inflows, not benefiting the internalization process of firms already in Ghana. A senior business development official at a financial MNC muses:

> *I think the current government does not support businesses like the previous administration. The previous administration encouraged banks to come into Ghana and it is clear by looking at how many banks were currently in Ghana during their time of administration. They supported many foreign banks to be established and provided the needed resources and assistance to expand our investments in Ghana. The current administration is not as honest and friendly as the previous one and this makes us cautious when it comes to making future investment decisions.*

A division manager of firm E indicates:

> *One of the major disappointments with this bank lies with political interference. Politics has influence on every major business activity in Ghana and that scares away financial MNCs. The acquisition of ADB was all politicized. Stanbic Ghana faced its own political challenges when setting up in Ghana. the politics involved in every facet of serious business activity makes doing business in Ghana somewhat fragile and therefore it makes investors become cautious of where they invest and eventually it's the private sector that suffers the most and when the private sector suffers you know all other sectors also suffer.*

These comments confirm the assertion made by Ziorklui, *et al*, (2001) that political pressure to lend to un-creditworthy borrowers was the main reason why government owned-banks incurred substantial levels of non-performing loans in Africa. In a related development, Nwankwo and Lwiza (2002), Gockel and Brownbridge (1998) indicated that state-owned financial institutions (SOFIs) in Tanzania and Uganda accounted for about 60% to 80% of the total non-performing loans. Most of these banks were not profitable, but due to political demands which were backed up by government loan guarantees and collateral, forced commercial banks to provide credit to unprofitable SOEs as observed by Debrah and Toroitich (2005). What is more, a recent study conducted by Shen and Lin (2012), further confirms that *political banks* exhibit clear underperformance in terms of return on equity and have high non-performing assets. Using bank data for 65 countries from the period 2003-2007, Shen and Lin (2012) concluded that political interference depresses bank performance and reduces the impact the financial sector can have on private sector development initiatives in developing countries.

In addition to the above, this study agrees with the above studies as an economic analyst at the Ministry of Finance cites an instance where there has been undue political influence:

> *...other problems include the removal of people from key institutions whose influence and hardwork brought in huge FDI inflows but have been removed for political reasons. There are cases where licences for contracts which were already approved by the previous administration were revoked due to political bias. All of these factors contribute to the low FDI inflows Ghana is experiencing at the moment.*

All case firms believe that there is the possibility of a government policy change during and after the elections which will to some extent adversely affect their operations and returns of capital employed. This finding is in line with Dahl (1976) and Henisz (2000) who agree that political vulnerabilities faced by financial MNCs could emerge from changes in government regulations. Furthermore, all case firms quote that there have been discontinuations of previous policies which were deemed favourable, and *vice versa*, by the present administration; there is also slow implementation of policies, unwarranted bureaucratic processes involved in gaining rights to expand activities, and the presence of other undue government influences.

These influences from the political spectrum considerably reduce the likelihood of high investment due to uncertainty surrounding the implementation of the economic reform programme (ERP).

All these factors affect the range of business opportunities that can be pursued in Ghana. In addition, the institutional environment has adversely affected investments due to uncertainty surrounding the implementation of the financial sector reform policies by restricting the financial MNCs' activities to invest in existing product suits that the existing provisions permit them to do. For example, the current provisions do not allow financial MNCs to invest in housing development and mortgage services and they are also unable to sell certain kinds of bonds. The size of investment is therefore affected due to institutional barriers which are unstable because the political party in power can easily alter the goal-posts to their advantage. The over-politicization of polices in Ghana has also drifted the focus of the government from the development of infrastructural facilities which promotes FDI attraction. In another study conducted, Mijiyawa (2012) concludes that political interference and régime changes in Africa cause repudiation of former contracts which causes increases in expropriation risks which significantly affects the volume of financial FDI. Considering the evidence above, this study argues that less political interference is a key requirement for a thriving financial services sector in Africa.

LACK OF BANKING INFRASTRUCTURE AND TECHNOLOGY SERVICES (BITS)

Muhlberger (2012) indicates that a major constraint on financial FDI inflows into SSA is the lack of appropriate infrastructure. Anyanwu (2012) also cites weak infrastructural development as an important factor that affects financial FDI inflows into Africa. Furthermore, Kinda (2010) found a positive correlation between infrastructure and financial FDI inflows. One of the major problems facing financial MNCs is identification of customers who need credit to develop their businesses. Lack of proper accounting procedures and openness of such businesses really restrict the ability of the financial MNCs to provide credit for the development of the private sector. If the businesses were to formalize their activities, it would enable the banks to support the private sector. Consequently, the formalization of the informal businesses also requires adequate infrastructures. How can a formal bank support an informal business? That is the problem Ghana's private sector faces. Moreover, the architectural design of the capital city of Ghana has several flaws which makes addressing and identification of customers difficult. Also, electronic means of assessing the credit reference of customers is non-existent and banks in Ghana do not communicate with each other, for competitive reasons. A manager of Strategy and Finance at firm E indicates:

> *...The addressing system in the country is very poor. People can take loans from all the banks as long as they can show that their business has reasonable inflows. So it is difficult to trace where customers move to live after borrowing money from the banks; it becomes impossible to track them and that is the reason why we had to write off a huge bad debt last year. It means that the Non- Performing Loan (NPL) ratios were very high for many financial MNCs in Ghana last financial year and many financial MNCs made huge provisions for bad debt/loans.*

Interestingly, a director in the department of Global Markets at firm D complained by echoing similar sentiments held by a manager in firm E:

> *The lack of infrastructures that enables the easy communication between different financial institutions makes it very difficult to access the credit rating of customers. This is very important because many people take advantage of using the same money by depositing it in different banks in order to get the credit they need and once they have it, some even run away with that money to live in different regions without us being able to trace them. Unfortunately they go to other banks and because there is no credit history available they borrow large sums of money without paying them back. This has led to a high default rate which also adversely affects the provision of credit to genuine businesses.*

An informant from the Investment Promotion Centre also noted that the lack of an effective postal addressing system allows customers to borrow money and refuse to pay.

> *...So you see Ghana lacks infrastructure in terms of the addresses and the postal system; these structural problems need to be dealt with before foreign financial institutions would feel comfortable to increase their investment. Private sector access to credit faces several challenges because we have a poor addressing and ID system. A lot of people start ABC Transport Services, today they are based in Accra, next month they move and go and hide somewhere in Kumasi who would find them?.*

There are several problems with title deeds of properties which most financial institutions normally accept as collateral for many private sector businesses that need to borrow from them. But the system of managing lands and properties in Ghana is poor. This is because lots of people could use the same collateral to secure a loan in the same capital city. The City of Accra was not designed with banks in mind in terms of the availability of business offices. The City is not suitable for banking halls so financial MNCs expenditure on renting properties runs very high. In addition, these properties need to be renovated to become suitable accommodation for international financial institutions. This is mainly due to many years of under-investment in infrastructure such as shopping malls or a financial centre with all the necessary trading facilities and other recreational facilities. A respondent from the Investment Promotion Centre cites an instance to express his passion for the need for infrastructural development:

> *We need to improve our roads, electricity and the utilities. We had a group of Tourists from the UK called the XXX London Business Group trying to set up a business in the tourist industry and I met with them. They requested me to spend one evening with them because they wanted to see evening life in Accra; they couldn't find anywhere to go. From the Hotel, they managed to go to a club in Accra Mall; the whole place was dark. Tell me – in the night, where are the street lights? Where is the night life here?...if an investor comes, he wants to know the country and the recreational facilities available for his/her family and somewhere to go for fun; we don't have it.*

Considering telecommunications infrastructure, whilst there has been rapid build-up of fibre-optic submarine cables over a short space of time – such as Seacom in 2009 which connects South Africa, Mozambique, Tanzania and Kenya, SSA still has the highest internet prices in the world. The International Telecommunications Union (2012) estimates that the average price of a broadband connection in SSA is about US $110 for 100 kilobytes per second. On the other hand, in Europe and Central Asia the price is US $20 whilst in Latin America and the Caribbean pays US$7 for 100 kilobit per second. A recent survey conducted by the African Economic Outlook - AEO (2012) and OECD (2012) indicates that in Burkina Faso, Tanzania, Ethiopia, Rwanda, Uganda and Mozambique, less than 10% of the population know what the internet is. In Ghana, Namibia, Botswana, Benin and Cote d'Ivoire, less than 30% know what internet is. Furthermore, there is currently only one submarine fibre optic cable off the West Africa coast (SAT-3), that provides a high quality international service and access is limited to members of the consortium which built the link in 2002 (OECD, 2012; OECD, 2012).

These factors support the evidence that the lack of communication systems required for banking (such as branch data circuits, fast speed internet systems, voice circuits, co-location services and an effective electronic trading floor at the stock exchange) and reliable networks affects financial FDI inflows into Africa. This study argues that Banking Infrastructure and Technology Services (BITS), which are well managed and supported by the government, can reduce the average costs of financial MNCs. All case firms complained that a lack of effective and functioning BITS affects their efficiency ratios thereby narrowing the profit margins and raising non-interest expenditure. One of the most captivating findings of this study was that overseas investments into the telecommunications sector have also faced several complications politically as a manager at the operations department of firm bank B cites an example of a dispute (one of many) between a foreign investor and the government which affects the operational activities of the bank:

> *There have been a number of investment disputes I am aware of some of which is not necessarily in the banking industry but concerns us because the operational activities of other foreign investors affect our efficiency. There is a dispute between a Nigerian communications company called Globacom and the investment authorities in Ghana. The company feels the authorities have failed to approve their operations after providing them with a licence to enter Ghana and also to protect their assets.*

Further evidence from the *Daily Graphic*, May 24, 2010 supported this (with the published article on the said dispute summarized below).

> *Since Glo entered the country, it has invested huge resources to deploy a nationwide state-of-the-art infrastructure. It has further devoted millions of dollars to the sponsorship of the Ghana premier league and the national football teams. But Glo is losing the opportunity to make revenue because every day there is a delay in launching their network. The main area of concern for Glo is the ban on the erection of telecom masts by the Environmental Protection Agency (EPA). This has affected the company much since they are the only network building nationwide telecom systems from scratch. The issue needs to be settled to prevent other investors from leaving the country.*

These factors may account for some of the many reasons why SSA has the lowest internet penetration rates in the world. AEO (2012) indicates that internet user penetration rates are below 7% and for broadband, it is below 1% in SSA. Comparatively, Latin America and Caribbean, and East Asia and Pacific countries have a 20% penetration rate for internet users. Relatively, North African countries are in a better position than SSA as their rate stands at 40.4%. Their broadband penetration rate, however, is just 2%. Nevertheless, the entire African continent has a low speed dial up internet connection. In Europe, broadband penetration rate is over 15%.

The lack of (or poor) infrastructure remains a major constriction of the internalization efforts of financial MNCs in Ghana. Power cuts and fluctuations in hydro-electric current were also cited as one of the main problems affecting the industry and all other sectors in the economy. Without the requisite infrastructural development, most financial MNCs will limit the amount of investment they undertake in Ghana. BITS would assist to position Ghana as a financial centre for the regional market as enshrined in the Gateway concept and even to ensure the development of electronic infrastructure to enhance the effective functioning of the financial services sector.

MACRO-ECONOMIC DETERMINANTS OF FINANCIAL FDI INFLOWS

High inflation works against long-term investment as financial MNCs think about the effects of inflation on the purchasing power of capital. SSA in general and Ghana's financial sector in particular, is characterized by a high degree of volatility of the key economic indicators (such as how quickly the *cedi* depreciates against other regional and international currencies). As appendix 2 shows, since 2000, the annual inflation rate has been very high, inconsistent and unpredictable; this makes investment decisions by MNCs difficult. In addition, the degree of volatility of sector indicators adds to the perceived risks of investing in Ghana's financial services sector. Case financial MNCs had a widespread perception that the Treasury Bill auction conducted by the BOG is not a clean auction. It is widely believed that the BOG always has a reserve price and does not accept bids that fall below that price. Although there is no direct evidence of manipulation of the auction – and financial MNCs were hesitant to give definitive information – to achieve a pre-determined rate, the instability of the interest rates over long periods of time (in the face of exchange rate fluctuations) raises questions about the sensitivity of the rates to market forces. The finding is in consonance with Shaw and Fry (1973, 1995) who argue that interest rates and exchange rate fluctuations affect an economy's financial sector and may retard economic growth efforts.

Other factors include: high inflation and interest rate disparities; a high degree of market volatility; a lack of market confidence in interest rates (because most case MNCs indicated their concerns about overly intrusive government interference); inadequate systems to support financial innovation; the lack of a long-term debt market; and, a limited secondary market for government debt. Case MNCs cited inflation as one of the major factors affecting their operational processes and future investment decisions. An executive officer at firm D indicates:

> *There are major weaknesses in the sector: we work in an environment where things are constantly changing with inflation going up and down. This makes future investment decisions very difficult. The main fundamental issues have not been addressed looking at ways to increase the size of the formal sector. The thinking is to pump debt into the system. What are the paradigms of development–education: Get-fund, health: NHIS, what is left is the pillars of growth: which is agriculture, and that is risky because it depends on rain. Why can't we generate employment by creating systems to enhance the way we develop cocoa, or even use part of the 9% reserve requirement at the BOG to create a fund to subsidise any financial institution that will go into agricultural development. Fine, banks are not coming with huge investments but we can't allow the private sector to continue operating 100% debt at this high interest rate.*

In addition, this study finds that interest rate disparities affect the possibility future investments by financial MNCs in SSA. The Ghanaian banking industry has witnessed an increase in interest rates as a consequence of capital injection by existing banks to meet the minimum capital requirements introduced by the BOG. In addition, the entry of sub-regional banks and growth in the branch networks of existing banks has created a relative level of growth. But in spite of 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 financial MNCs) 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 the financial MNCs and are leading to their inability to capture and react successfully to other external opportunities in the sub-region.

SUMMARY OF MAJOR FINDINGS

- Domestic and foreign financial institutions in Ghana differ significantly from each other. The latter are very aggressive, competitive and forward-looking, employ better educated managers primarily UK- and US-trained and provide easy access to credit. Taking these advantages into account, the results indicate that their flexibility and forward-looking approach to banking give them competitive advantages over the domestic financial institutions. Foreign banks in Ghana have access to funds from their parent companies abroad that enables them to provide additional and quality services and therefore are able to command larger profits. This shows that domestic financial institutions in Ghana have the potential to increase their competitiveness under a new banking era which is more favourable.

- Foreign-owned banks (for example, Barclays, Standard Chartered Bank and Ecobank) are comparatively more profitable than the domestic banks. For example, Ghana Commercial Bank (GCB) lost its market share from 53% as at 1998 to 19.2% in 2005, and down again to 14.3% in 2009, whereas the three major financial MNCs (Standard Chartered Bank, Barclays Bank and SG-SSB) improved their market share.

- Even though Ghana has attracted considerable amount of financial FDI inflows especially into the banking sector, the size of business the banks can do is still minimal. For example, in 2009 all the banks in Ghana formed a syndicate to be able to raise finance for the purchase of cocoa from the farmers and crude oil for the Tema Oil Refinery.

- The combined capital of all the banks in Ghana is less than the entire capital of just two banks from Nigeria. Moreover, the size of business that banks in Lagos alone can do is greater compared to that of Ghana. It could be argued though that Nigeria's economy is bigger than that of Ghana; however, the depth of Ghana's financial services remains shallow and needs deepening.

- Besides, as positive technology spill-over effects from financial MNCs to domestic financial institutions are most likely to occur, the potential benefits of financial FDI have not yet been fully exploited. Staff costs and infrastructural costs (technology) are the main sources of high operating costs.

- The main reasons for low financial FDI inflows into Ghana are political influence, regulatory environment, availability of skilled labour, labour productivity, regional and country effects on the financial services sector, workable commercial law and justice that are focused on protecting investments, availability of good roads and other business facilitation measures.

CONCLUSION

This paper has demonstrated the main determinants of financial FDI inflows into Ghana. The paper also analysed the impact of Ghana's financial sector reforms. Specifically, it has examined the progress made so far in the transition from financial repression to reform and post-reform with a view to documenting the factors affecting the sector in view of the strengths and weaknesses of the policy shift and their impact on FDI inflows into Ghana. This empirical study recognizes that there are inherent shortcomings prior to and following the reforms which include the size of Ghana's formal/informal economy, political interference, inadequate infrastructure, and how *regional* and *country effects* influence major FDI decisions. In order to improve the perception financial MNCs hold about Africa, SSA needs to re-brand its global image. This is because whilst the majority of countries are committed to the implementation of favourable financial sector policies as enshrined in agreements in the West African Economic and Monetary Union (WAEMU), the slow pace of implementation and a certain degree of unpredictable political upheavals prevents such reforms coming to fruition.

Many years after the declaration of the Africa Union, ECOWAS and WAEMU, many countries are apprehensive about the consequences of full implementation of reforms that will support the functioning of the economic and monetary union among states. Whilst many politicians and economists have vouched for its implementation as a worthwhile journey, others disapprove of it in fear of an economic takeover. Other countries are unwilling to join the monetary union because European countries are not in favour of such integration. These factors adversely affect the size of FDI inflows into the sub-region and member countries must take responsibility for changing the way the world perceives them. Case financial MNCs noted that they are optimistic that their investments are protected in Ghana, however, they also believe that in Africa, anything can happen. This is because, at the regional level, there are past and current examples whereby a new régime has introduced a new policy which affects prices, terms of competition and taxation, and whereby even peaceful democracies have shifted to authoritarian rule.

These regional and country effects also restrict a financial MNC's ability to increase investment in the host country. Overall, case financial MNCs argue that *regional macro-economic* instabilities affect the size of future investments at the country level. This is because the region has been characterized by occasional slippages in financial discipline which mostly lead to high inflation and increases in exchange rates. Recent examples of instabilities include the rising levels of interest rates combined with fiscal indiscipline which further resulted in inflationary pressures across the region. Macro-economic stability is fundamental to the development of a financial sector (Fama, 1998).

Finally, in terms of methodological contribution, this study has demonstrated the importance of qualitative inquiry in assessing the factors affecting financial FDI inflows into SSA. The findings of this study have provided new insights on a very critical topic but which have been largely ignored in the existing literature. In this respect we have obtained through our data an understanding of the causes of financial FDI inflows to the SSA region with a special reference to Ghana. For future research, it would be both important and interesting to examine the root causes of the administrative and institutional weaknesses of the financial markets in Africa.

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Appendices

Appendix 1: Financial Sector Indicators (in % of GDP) for Some Selected ECOWAS Countries from 1975-2005

Country	Number of Banks (2012)	Domestic Credit Provided by the financial sector			Liquid Liabilities			Credit to the Private sector		
		1975-84	1985-94	1995-05	1975-84	1985-94	1995-05	1975-84	1985-94	1995-05
Cote d'Ivoire	23	39.44	42.72	22.49	29.28	28.82	23.95	39.05	33.08	15.89
Gambia	15	44.34	15.00	17.17	24.74	32.30	35.66	20.51	12.69	12.58
Ghana	29	26.26	21.17	28.22	20.35	16.56	26.34	3.26	4.23	10.87
Nigeria	25	26.45	32.37	16.49	26.87	26.03	20.88	12.53	12.51	13.39
Sierra Leone	14	32.09	34.10	46.80	21.00	17.50	16..16	6.55	3.60	3.06

Sources: IMF Financial Statistics (2007) and Adeniyi, *et al*, (2012)

Appendix 2 – Distribution of Annual Inflation Rates from 2000-2010

Year	Rate of Inflation	Percentage Change	Date Information Available
2000	25.151	102.08 %	1999 est.
2001	32.906	30.83 %	2000 est.
2002	14.815	-54.98 %	2001 est.
2003	26.677	80.07 %	2002 est.
2004	12.629	-52.66 %	2003 est.
2005	15.113	19.67 %	2004 est.
2006	10.151	-32.83 %	2005 est.
2007	10.733	5.73 %	2006 est.
2008	16.522	53.94 %	2007 est.
2009	19.251	16.52 %	2008 est.
2010	10.64	-44.73 %	2009 est.

Source: Adapted from IMF various Issues, 2011

Appendix 3: Fastest growing Sub-Saharan African Countries in 2011

Country	Level of Percentage growth	Major Reason for Growth
Ghana	14.2	The production of oil and natural gas, democracy, agriculture and services sector. A diversified commodity exporter.
Eritrea	14	The adoption of market-driven policies. Exporting of gold, copper, Zinc and Silver
Rwanda	8.5	Strong financial sector, fuelled by Robust Financial Sector Reform and Strengthening Initiatives, also known as (FIRST), Exporting of agricultural Products
Ethiopia	8	Strong mining sector, agriculture forestry and fishing and hunting, wholesale, retail, hotel and restaurants
Nigeria	6.7	Crude Petroleum and natural gas, wholesale and retail trade, agriculture and banking (SSACs oil giant)
Mozambique	6.5	Exporter of metals and minerals such as coal and natural gas
Dem Rep of Congo	6.4	Oil production and exporting of metals and minerals, agriculture and forestry
Zambia	6.3	Mining, manufacturing and construction
Uganda	6.3	The production of oil and natural gas
Tanzania	6.1	Services, industry and construction

Sources: World Bank Global Economic Prospects (2012); African Economic Outlook data (2012)

Appendix 4: Performance of Selected Banks in Ghana from 2008-2011

Year Name of Bank	**2011**	**2010**	**2009**	**2008**	**Profit Before Tax**	**2011**	**2010**	**2009**	2008
GCB	11.6%	12.0%	13.7%	15.3%	Baroda	74.5%	28.8%	57.8%	39.5%
EBG	10.1%	8.7%	9.8%	8.2%	SCB	52.5%	46.6%	45.9%	37.4%
SCB	9.3%	9.5%	10.1%	9.2%	ABG	51.9%%	54.3%	11.7%	--
BBGL	9.0%	9.4%	10.4%	12.9%	BBGL	50.7%	38.1%	- 13.8%	-6.3%
ADB	5.7%	5.8%	5.3%	5.8%	EBL	48.2%	-	-	-
Stanbic	5.4%	5.1%	5.1%	4.3%	EBG	44.4%	49.9%	46.1%	41.9%
Fidelity	4.9%	3.7%	2.6%	2.0%	UBA	41.3%	29.7%	4.2%	- 64.9%
NIB	4.2%	4.1%	3.9%	3.8%	CAL	35.3%	22.5%	28.0%	31.2%
SG-SSB	4.0%	3.9%	4.1%	4.1%	GTB	35.2%	34.4%	43.7%	32.6%
CAL	3.7%	2.9%	3.2%	3.1%	ZBL	35.0%	26.0%	30.9%	40.5%
Intercont.	3.4%	3.1%	3.1%	2.8%	TTB	34.4%	33.5%	35.7%	35.1%
UTB	3.4%	3.0%	0.7%	0.4%	Stanbic	33.5%	29.3%	4.2%	39.9%
ZBL	3.3%	3.7%	4.0%	3.6%	ICB	31.1%	34.2%	5.7%	37.5%
TTB	2.7%	2.7%	2.2%	2.4%	SG-SSB	30.7%	27.7%	31.4%	30.6%
UBA	2.7%	2.3%	1.9%	1.8%	UGL	24.9%	20.3%	12.8%	12.4%
UGL	2.7%	2.3%	1.6%	1.1%	UTB	21.9%	26.6%	- 14.9%	- 64.7%
PBL	2.6%	2.3%	2.4%	2.6%	ADB	21.8%	15.6%	14.4%	18.3%
GTB	2.1%	2.4%	2.0%	1.6%	PBL	21.2%	14.9%	13.4%	24.6%
HFC	2.%	2.1%	1.9%	3.5%	HFC	20.0%	30.7%	23.8%	32.6%
BOA	1.8%	2.4%	2.5%	2.8%	Fidelity	17.9%	14.8%	9.9%	17.2%
ABG	1.3%	1.1%	0.7%	-	IBG	16.1%	15.7%	15.4%	36.8%
ICB	1.2%	1.2%	1.4%	1.0%	NIB	12.7%	1.6%	- 44.7%	- 57.8%
EBL	0.9%	-	-	-	GCB	10.3%	27.4%	9.8%	26.4%
FAMBL	0.9%	1.1%	2.1%	3.4%	BSIC	7.5%	- 56.1%	- 229.5 %	- 124.2 %
BSIC	0.5%	0.4%	0.2%	0.1%	FAMBL	6.1%	37.8%	-5.9%	22.5%
Baroda	0.4%	0.4%	0.1%	0.1%	BOA	-38.6%	- 51.7%	26.4%	34.5%
MBG	N/A	4.6%	5.0%	4.1%	MBG	-	7.6%	9.7%	37.6%
Industry	100.0%	100.0%	100.0%	100.0 %		30.6%	27.2%	17.7%	22.7%

Source: PricewaterHouseCoopers Ghana Banking Survey (2012)