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THE EFFECTS OF FOREIGN BANK ENTRY ON FINANCIAL PERFORMANCE OF DOMESTIC-OWNED BANKS IN GHANA: A COMMENT

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ABSTRACT

The study comments on Acheampong's (2013) and finds that selective exclusion unit of analysis, estimation techniques errors and its justification cast a doubt on the results. This inaccurately represents the relationship between foreign bank entry and financial performance of domestic-owned banks in Ghana. Our overall evidence challenges Acheampong's methodology claim that foreign bank entry on the financial performance of Merchant Bank Ghana Limited (MBG) and Ghana Commercial Bank Limited (GCB) in Ghana from 1975 to 2008.

JEL: G1, G2

KEYWORDS: Foreign Bank Entry, Domestic-Owned Banks, Pooled Regression Analysis, Return on Assets

INTRODUCTION

The purpose of this commentary is to examine three important issues in the methodology on effects of foreign bank entry using Acheampong's (2013) study as a demonstration model. The first issue relates to the criteria for the selection of the domestic-owned banks in Ghana used in the argument in support of a positive influence of foreign bank entry on domestic banks' return on assets for the period 1992-2008; a period with a high influx of foreign banks into Ghana. The second is about the exclusion of macroeconomic or external variables in the model. In his article appearing in this journal, Acheampong (2013) used two bank specific (internal) variables as a proxy for soundness of a bank's capital or assets (Buchs & Mathisen, 2005) and the quality and adequacy of current assets to meet current liabilities as they mature (Fraser & Ormiston, 2009). Again, the effects of omitted variables in a model which the author admitted and concluded that, '….the main limitation of the study was using three quantitative variables and one key dummy variable. Other variables, for instance, debt ratio and market risk could have been added to the independent variables with the foreign bank entry dummy to increase the coefficient of determination (R-squared)' (Acheampong, 2013). Finally, the justification for the choice of pooled OLS regression over other methods like Fixed Effect or Random Effect to measure the impact of foreign bank entry on financial performance of domestic-owned banks in Ghana would be examined.

This commentary is an attempt to draw the attention of other foreign bank entry and banks profitability researchers to these issues so that the research design on the effects of foreign bank entry on financial performance of domestic-owned banks study can be made more rigorous. The rest of the commentary is organized as follows. The next section presents discussion on the selective exclusion of the unit of analysis and available data. The second section examines exclusion of external factors and the third section examines the methodology employed by Acheampong (2013).The final section contains the concluding remarks.

Selection of the Unit of Analysis and the Exclusion of Available Data

Acheampong provides justifications for the selection of unit of analysis and stated "out eleven domestic-owned banks in Ghana in 2008, only six were in operation prior to 1975. MBG and GCB were selected for the study because they were the only domestic-owned banks, out of the six, which readily had data needed for the study. The operations of these two banks are comparable to foreign banks. Therefore, the entry of foreign banks could have affected these two domestic-owned banks" (Acheampong, 2015).From a different perspective, this may not necessarily be the case. Incidentally, National Investment bank (NIB), (NIB, 2015) and Agricultural Development bank (ADB), ADB (2014) had already been established in 1963 and 1965 respectively. These banks were not only operating fully at that time but had operated for almost 12 years prior to 1975 used by Acheampong (2013).This seem to suggest that data was readily available for these two banks and they could have been conveniently included to the number of banks the author selected to be able to find a significant relationship between capital adequacy, liquidity, and a foreign- bank entry dummy on the ROA of the domestic banks. Acheampong failed to provide a justification for stating that the operations of these two banks were comparable to the foreign banks hence their selection. It is an undeniable fact that before independence there were a lot foreign banks in Ghana and notable among them were Standard Chartered Bank (1896) and Barclays Bank (1917) as confirmed in a study by Adams & John (2012) when they indicated the formal banking system in Ghana was dominated by the state owned banks. With the exception of two banks – Barclays and Standard Chartered Bank, the country could not boast of any other foreign banks in the entire financial system. The overall best performers in terms of deposits, assets, ROE, and ROA for the old and new banks are Barclays Bank and Standard Chartered Bank, respectively (all foreign owned). The presence of the foreign banks would have allowed some equally good domestic banks including NIB and ADB to learn the best practices from them and can be compared with the foreign banks.

Exclusion of External Factors

The model that was estimated began as

Profitability = f (foreign bank entry, capital adequacy, and liquidity) (1)

It was finally modified as

$$ROA = b0 + b1CapAdq + b2LiqRat + b3ForBankEntDum + ut \quad (2)$$

One major problem with the model is that, literature has suggested many possible factors that affect profitability, and their exclusion could amount to omitted variable bias, leaving the results highly doubtful. This problem was acknowledged as one major limitation of the study. Omitted variable bias is likely to cause an over-estimation or under-estimation of the effect of the variables used in the model (Wooldridge 2009; Barreto 2005 and Greene 1993).On the test for multicollinearity, Acheampong (2013) used a correlation matrix. Construction of a correlation matrix among independent variables only yields indication, as to the probability or likelihood that any given pair of explanatory variables are causing multicollinearity problems. Correlation values of 0.3 to 1.0 are sometimes indicative of multicollinearity problem (Gujarati, 1995). Thus, this procedure is highly problematic and cannot be recommended as an appropriate test for multicollinearity, since as a matter of intuition. Correlation describes a relationship between two variables, unlike collinearity which describes a relationship between three or more variables, and is, thus, a multivariate phenomenon. Within the correlation matrix constructed by Acheampong (2013) were found many figures within the suspicious range, with some as high as 0.8555 and 0.9593. This creates a high level of suspicion of the presence of multicollinearity. Perhaps a more robust test of multicollinearity would suffice.

METHODOLOGY EMPLOYED

More so, Acheampong (2013) employed pooled OLS regression to measure the impact of foreign bank entry on financial performance of domestic-owned banks in Ghana. This was done without providing any justification for the choice of pooled OLS. According to Schmidheiny (2014), pooled OLS has been shown to be biased in small samples and is only consistent in larger samples (when $N \to \infty$). In addition, Pooled OLS estimator is not efficient because the standard errors of it , are incorrect and tests based on them are invalid. Clearly, other methods like Fixed Effect or Random Effect could have proved worthwhile, unless the appropriateness of pooled OLS over other estimation techniques had been shown by the necessary tests. In conclusion, future research might examine the data using fixed or random effects models to provide evidence that the results are robust.

CONCLUSION

This commentary has examined the relationships between foreign bank entry on financial performance of domestic-owned in Ghana with particular references to issues raised by Acheampong (2013). The expressed intention of this note is to bring to the attention of other foreign bank entry and banks profitability researchers these three important issues which in my view have not as yet received rigorous treatment in the literature and the methodology on foreign bank entry and banks profitability. To highlight these points, Acheampong (2015) study was employed as a demonstration model. It should be emphasized that the points made are, however relevant to other studies in this area and should not be taken as an explicit and singular criticism of Acheampong's work.

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