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An Assessment of the Banking Regulatory and Market Framework in Ghana in the Wake of DKM Diamond Micro-finance Limited Financial Saga

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Abstract

The DKM Diamond Micro-Finance Limited (DKM) financial saga caused rapid loss of unprecedented amounts of money. One effect of this development is the fact that farmers in most of the places of its operations have stopped farming whiles many customers are under pressure to find a secure way through life. This portends a rather disastrous consequence on the country's already-battered agricultural sector. Many blame it on the banking and financial regulatory framework of Ghana. They argued that a sound financial system is indispensable for a healthy and developing economy. The purpose of this paper is to analyze the strength, weaknesses, opportunities and threats inherent in the Banking and financial regulatory framework of the Ghana Banking Act. Primary data was sourced from fifty (50) bankers using a multi-stage and convenience sampling techniques. Data was analyzed with the use of tables and percentages. Even though the banking sector is currently doing well economically, but based on the data gathered, we found that supervision of the activities of the various Micro Finance Companies is not timely enough to avert some of these challenges as witnessed in the recent DKM crisis. Our literature also found that formulation of regulation and supervision of the sector is lagging behind most countries. It is recommended that supervision of the activities of the various Micro Finance Companies should be strengthened whiles banks and other financial institutions in Ghana must formulate their domestic regulations in line with International regulations to encourage trading among other countries in the global community.

Key words: *Financial Institutions, DKM Diamond Micro Finance Limited, Financial Crisis, Regulations*

1.0 Introduction

Several crisis have hit banks and financial institutions lately, with the most widespread being the 2007/8 World Financial Crisis which has signaled the need for effective regulation and supervision of banks and the financial sector (Salami & Larmie, 2013). According to Salami & Larmie (2013) major financial scandals involving international banks like the Allied Irish Banks, the Bank of Commerce and Credit International (BCCI) and Daiwa Bank have been experienced globally, while banks like Bank for Housing and Construction (BHC), Ghana Co-operative Bank (GH CO-OP), BCCI and Meridian BIAO all in Ghana have also been hit by such crisis and have collapsed. The latest in Ghana is the DKM meltdown. In all these cases, jobs were lost, shareholders became worse off, and employees and customers lost their savings. Sowa (2007) indicated that the innovative and sophisticated nature revolving the operations of the financial sector in recent times makes it imperative to put in place the right checks and balances. As a result legal and corporate legislative frameworks are formulated to govern authorization and regulation of banking activities (Baker & McKenzie, 2012).
In Ghana, the financial sector has gone through series of changes in its legislative instruments. The legislative instrument that governs the authorization and regulation of the banking sector is the Bank of Ghana Act of 2007. The main objective of the Banking Act is to regulate and supervise the banking and credit system to ensure prudent financial operations in the banking and non-banking sector (Bank of Ghana, 2007). The purpose of this

paper is to analyze the strength and weaknesses, opportunities and threats inherent in the Banking and financial regulatory framework of the Ghana Banking Act. The rest of the paper will look at the overview of Ghana's banking industry, regulation and contemporary banking in Ghana, strengths, weakness, opportunities and threats of banking and regulation in Ghana, A brief history of DKM Financial services, discussion of findings, conclusion and recommendations.

2.0 Overview of Ghana's Banking Industry

The beginnings of the modern banking system in Ghana were in the late nineteenth century (Antwi-Asare & Addison, 2000). The banking sector started with the establishment of the first Government savings bank in 1888 (Agyemang, 2011), and served as a branch of the British Bank of West Africa. A decade later, the Government's savings bank metamorphosed into the creation of the first commercial bank purposely established as a depository banks (Mensah, 2015). The British Bank of West Africa, now the Standard Chartered Bank (SCB), was established in the then Gold Coast in 1896, followed by Barclays Bank DCO, now Barclays Bank Ghana Ltd (BBG) in 1917.

These banks were overseas subsidiaries of banks incorporated in the United Kingdom. Their operations were dominated by financing trade between the Gold Coast and the UK. Another bank thus the Colonial Bank was established in 1917 however, these banks operated over a long period of time without any formal regulatory system until 1957 when the Central bank was established under the Bank of Ghana ordinance of 1957 (Mensah, 2015).

After independence, Ghana left the West Africa Currency Board that was established by the British government in 1912 to issue currency of various denominations in the British colonies in West Africa (Gold Coast, Nigeria, Gambia and Sierra Leone) and redeem British currency and split the Bank of Gold Coast into two banks. The newly created Bank of Ghana was entrusted with Central banking activities while the Ghana Commercial Bank took on the commercial banking activities.

To address the general regulatory and supervisory vacuum in the 1957 banking ordinance, the Bank of Ghana Act (1963) was established. This Act segmented banking institutions into investment banking (Ghana investment bank), Agricultural Development Bank; Merchant banking and Social security banking (Osakunou, 2009). To toe in line with the economic direction of the regime at that time, all these banks were incorporated as state-owned banks. The repercussions of the centralized system of operations were prevalent in the late 1960's when the country plunged into serious economic crisis leading to the overthrow of the central Government.

3.0 An overview of regulation, supervision and contemporary banking in Ghana

The first Bank of Ghana ordinance was passed in 1957 as a result of series of financial stability and instability of the economy since attaining independence 1957 (Mensah, 2015). This Act has undergone series of amendments (Lartey, 2012). As the banking industry witnessed development, the Bank of Ghana Act of 1957 was replaced with the Bank of Ghana Act of 1963. Further series of amendments were carried out culminating into the Bank of Ghana Act of 2000, Bank of Ghana Act, 2002, Bank of Ghana Act of 2007. The Bank of Ghana Act of 2007 was passed to amend the Bank of Ghana Act of 2004 to consolidate the law relating to the Bank of Ghana and facilitate the creation of an International Financial Services Centre (IFSC) (Mensah, 2015)

The Bank of Ghana (BOG) is charged with the banks regulatory and supervisory function. BOG (2012) stipulates that it shall have overall supervisory and regulatory authority in all matters relating to banking and non-banking financial business to achieve a sound and efficient banking system in the interest of depositors and other customers of financial institutions and the economy as a whole. The regulatory and legal framework within which banks, non-bank financial institutions as well as forex bureau operate in Ghana consists of: the Bank of Ghana Act 2002 (Act 612), Banking Act, 2004 (Act 673) Financial Institutions (Non-Bank) Law 1993, PNDC Law 328, Companies Code (Act 179, 1963), and Bank of Ghana Notices / Directives / Circulars / Regulations.

According to Salami and Larmie (2013) the BOG as a regulator has several objectives including the following:

- regulate, supervise and direct the banking and credit system;
- ensure the smooth operation of a safe and sound banking system;
- appoint an officer designated as the head of Banking Supervision Department, who shall be appointed by the Board; and
- Consider and propose reforms of the laws relating to banking business.

These objectives should ensure that BOG exercises its mandate to ensure the safety of depositors' funds; maintenance of the solvency of banks; good quality assets; adequate liquidity and profitability; enforcement of adherence to statutory and regulatory requirements; fair competition among banks; and maintenance of an efficient payment system. Enhancement of the legal and regulatory framework means that the BOG"s regulatory and supervisory functions are designed to be consistent with the Basel Core Principles for effective banking supervision (BOG, 2012).

The number of Deposit Money Banks (DMB) was 26 at the end of December 2010, of which 50% were foreign-owned. Rural and Community Banks (RCB"s) numbered 135 during the same period, and all these banks operated under BOG"s regulation and supervision.

Sustained financial sector restructuring and transformation in Ghana has succeeded in creating one of the most vibrant financial services centers in the sub region (Ackah and Asiamah, 2014). Improvement in banking profitability in Ghana as at the year 2014 has led into an increase in the number of banks to 27 banks, of which 15 are foreign-owned and 6 are African banks. According to PwC (2014), the present banking industry is fairly saturated comprising 27 universal banks, 137 rural and community banks, and 58 non-banking financial institutions including finance houses, savings and loans, leasing and mortgage firms, As at 2007, the number Non-Banking Financial Institutions (NBFI's) and Rural banks had increased to 41and 126 respectively. The period witnessed the increase of total assets of banks and NBFI's by 49.1% to GH¢8,588.3 million. The 2007 banking Act further provided a general framework for licensing Banks by categorizing this process into Class I Banking license, Class II Banking license and Class III Banking license. The Class I Banking license allows holders to conduct domestic banking business which is currently classified as Universal banking. The Class II license permeates the holders to transact business and investment banking with non-residents and allows foreign banks to establish branches in Ghana. The Class III license on the other hand, permits holders to transact business in both Class I and Class II banking business in and from within Ghana in November 2007 (Mensah, 2015).

The Bank of Ghana reviewed upwards the minimum capital required for new banks to operate in the country. New commercial banks are required to have a minimum stated capital of GHC 120m. Existing banks are only required to maintain a stated capital of GHC60m it set previously. The understanding was that existing banks would voluntarily grow their capital to the GHC120m in line with their business. Since then 4 existing banks have moved their capital voluntarily to over GHC120m. The recapitalization is aimed at empowering banks to undertake larger transactions to support the country's economic growth and also to make the banking industry internally competitive. As at August 2012 the number of banks operating in Ghana has increased twenty six (26) in spite of the recapitalization (Bank of Ghana, 2012). Financial analysts assert that it provided a favorable atmosphere for businesses thereby depicting the high number of banks being attracted to the Ghanaian banking sector. For instance, the Ghanaian banking industry recorded an average increase of 18.5% 2007 to 28.5% in 2008. The five top banks in Ghana had their market share increased from 51.6% in 2006 to 57.6% in 2008 (Bank of Ghana, 2008).

4.0 A Brief History of DKM Financial services

Established in 2005, DKM Diamond Micro-Finance Limited (DKM) is a savings and microfinance company based in Sunyani, Ghana. The organization forms part of the Ghana-based DKM Group that provides financial services, including insurance, microfinance and investment management. As of 2012, the organization served approximately 9 million clients, including sole proprietors and private individuals. In May 2015, the Bank of

Ghana, the central bank of the country, suspended the operations of DKM, for a period of 90 days, pending further inquiry on charges of violating the Ghanaian Banking Act. At the time of the suspension, DKM had GHC 107 million (approximately USD 24.4 million) in deposits. News investigation reveals many customers of DKM Micro Finance Company in Sunyani took loans from other banks and deposited the money for a 50 per cent return. Many customers who are bread winners of their families are now under pressure to find a secure way through life. Many of them now say they desperately need their principal investment to pay creditors and forgo interest DKM had offered to pay them.

The unorthodox methods and practices of some financial establishments are having telling effects on known and established banks and micro-finance institutions. DKM Financial Services and other financial services of its kind were enticing both customers and prospective ones of known banks with juicy rates of interests if they deposit their monies with them. DKM Financial Services, hitherto, offered customers a whopping 100% rate of interest within two months of savings. All one needs to do was to save your money with them, you would automatically be rewarded with a 50% interest on your savings in just two months.

Care for Humanity International, another financial service operating in the region, had taken banking to another level with its abnormal operations. This entity gives customers the super-normal interest rate of 70% on savings maturing for just two months.

Another financial service provider, Little Drops Financial Services, also indulges in acts which, if not checked, would spell doom for the region. This institution just asks prospective customers to dump a mere GH¢450 into their accounts for five months, after which they would be given GH¢5,000.00 with flexible terms of repayment.

One effect of these developments is the fact that farmers in most of the places in the region have stopped farming and invested their monies in these banks. This portends a rather disastrous consequence on the country's already-battered agricultural sector.

5.0 Methodology

The research employed primary data derived basically through the administration of questionnaires to elicit responses on strengths, weakness, opportunities and threats in the Ghanaian banking industry. Most of the open-ended questions enabled respondents to express their views on some issues under consideration in their own way thus allowing for flexibility and freedom (Fink, 2012).

5.1 Population and sampling Technique

Kumar (2006) explains that a sample is a sub-group of the population which is an ideal representative of the entire population. Researchers usually cannot make direct observations of every individual in the population they are studying. Instead, data is collected from a subset of individuals (a sample) and used to make observations and inferences about the entire population. The target population was bankers within the Tamale Metropolis. The multi-stage and convenience sampling techniques were employed to sample 50 bankers from five different banks in the Tamale Metropolis. All the 50 bankers answered the questionnaires.

6.0 Discussion of Findings

6.1 Years of Experience in Banking

Experience in Banking	**Frequency**	**Percent**	**Cumulative percent**
1-5 years	11	22%	22%
6-10 years	18	36%	58%
More than 10 years	21	42%	100%
Total	**50**	**100%**	

Table 1 Source: Field survey, June 2016

The survey disclosed that 22% of respondents indicated they have been working in the banking sector within five years, 36% of respondents have been in banking for 6 to 10 years whilst 42% have more than 10 years banking experience. We had concerns for this because the level of experience in the banking will add substance to the level of knowledge in the banking sector. The large percentage (42%) of respondents having more than ten years experience indicates that respondents view of the banking regulation reflect the reality.

6.2 Educational Background of Respondents

Educational background	**Frequency**	**Percent**	**Cumulative percent**
Higher National Diploma	9	18%	18%
First Degree	29	58%	76%
Masters Degree and above	12	24%	100%
Total	**50**	**100%**	

Table 2 Source: Field survey, June 2016

Of the 50 respondents only 18% were Higher National Diploma Holders, 58% had First Degree education, and 24% had Master degree and above. The strong educational background of respondents has complemented the significant level of banking experience to add credence to observations of respondents.

6.3 Strengths of the Ghanaian Banking Sector

Strengths	**Frequency**	**Percent**	**Cumulative percent**
1. Availability of knowledgeable staff.	50	34%	34%
2. Appropriate resources for monitoring	45	32%	66%
3. Availability of banking regulations	50	34%	100%
Total	**145**	**100%**	

Table 3 Source: Field survey, June 2016

Thirty four percent (34%) each of the respondents indicated availability of knowledgeable staff and availability of banking regulations as strength of the banking sector, while 32% believed that appropriate resources for monitoring as a strength of the banking sector. The sum of the number of entries in the frequency column of 50, 45, and 50 is more than the number of respondents of 50 because respondents were allowed to tick as many as they think were appropriate. Almost all the respondents believed that the Banking sector has strengths in the form of availability of knowledgeable staff, availability of banking regulations and appropriate resources for monitoring**.** This goes to confirm the observation of the work of Salami and Larmie (2013) who concluded in their studies that the Banking Supervision Department (BSD) has the appropriate resources in terms of adequate and knowledgeable staff and finance, and for that matter well equipped to respond to potential crisis in the banking sector

Opportunities	**Frequency**	**Percent**	**Cumulative percent**
1. Increased profit level of banking sector	30	25%	25%
2. Stable economic environment	42	35%	60%
3. Discovery of oil in commercial quantities	48	40%	100%
Total	**120**	**100%**	

Table 4 Source: Field survey, June 2016

Thirty percent (30%) of the respondents believed increased profits level of banking sector as an opportunity for the banking sector. Thirty five percent (35%) of respondents indicated stable economic environment as an opportunity of the sector, while 48% saw the discovery of oil in commercial as a huge opportunity for the banking sector. Again the sum of the number of entries in the frequency column of 30, 42, and 48 of 120 is more than number of respondents of 50 because respondents were allowed to tick as many as they think were appropriate. This indicated there are a lot of opportunities in the banking sector of Ghana as observed by (Lartey, 2012).

Weakness	**Frequency**	**Percent**	**Cumulative percent**
1. Lack of monitoring software	30	25%	25%
2. Lack of provisions to develop the derivative market	42	35%	60%
3. Inability to fully implement the requirement of Basel II	48	40%	100%
Total	**120**	**100%**	

Table 5 Source: Field survey, June 2016

Twenty five percent (25%) of the respondents believed lack of monitoring software to monitor activities of banks and other financial institutions is a weakness to the banking sector while 35% and 40% indicated inability to fully implement the requirement of Basel II and lack of provisions to develop the derivative markets respectively as weakness to the banking sector.

Treats	**Frequency**	**Percent**	**Cumulative percent**
1. Depreciation of the local currency	48	37%	40%
2. High cost of operations	42	32%	69%
3. High competition	40	31%	100%
Total	**130**	**100%**	

Table 6 Source: Field survey, June 2016

Thirty seven percent (37%) of the respondents indicated depreciation of the local currency availability was a treat of the banking industry. Further, 32% and 31% of respondents chose high cost of operations and high competition respectively as threats to the development of the banking sector in the country. Almost all the respondents believed that in spite of the tremendous opportunities and strengths exhibited in the Ghanaian banking sector, the sector is not devoid of weakness and threats.

What do you think the BOG can do	**Frequency**	**Percent**	**Cumulative percent**
1. **Intensifies its s**upervisory roles	50	35%	35%
2. Put the depreciation of the currency in check	47	32%	67%
3. Punishment of institutions that violet the BOG's regulations	48	33%	100%
Total	**145**	**100%**	

Table 7 Source: Field survey, June 2016

7.0 Conclusion and Recommendations

Effective regulation and supervision of banks and the financial sector is a necessary tool for averting the negative impact of financial crisis and scandals the world over Ghana not an exception. Even though Ghana is making great efforts to regulate and supervise its banking institution and the economy as a whole, it appears to be lagging behind the rest of the world when it comes to supervision. It is worth noting that some member countries including Ghana are yet to fully implement the requirement of Basel II (BCBS, 2009).

It is recommended that supervision of the activities of the various Micro Finance Companies should be strengthened. The BSD should invest in relevant and necessary software that can be used to interrogate the system of banks being supervised to be able to obtain an in-depth knowledge of the activities of these banks.
Also banks and other financial institutions in Ghana must formulate their domestic regulations in line with International regulations to encourage trading among other countries in the global community.

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