Risk Factors and Efficiency Measurement in Togolese Banking Sector: the Case of ECOBANK-Togo

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Abstract: The economic growth of a country depends on several factors which can be both macro and micro economics. The financial sector and more precisely the banking sector contributes in a non negligible part to this growth. This paper starts by analyzing the performance and the part of the Togolese banking sector in the economy by pointing out the challenges and risks that the sector faced the last few years. The paper then examined and evaluated the performance and the risk factors of the Ecobank – Togo from the period 2005 to 2010 using 11 financial ratios divided into 4 groups namely profitability, liquidity, and risk and efficiency ratios. The results of the study shows that the banking sector in Togo is playing a very important role in the economy growth in term of the domestic credit and loans provided by this sector to support the private projects and the state activities, and also in term of the GDP growth. The results also show that ECOBANK-Togo performs well over the 5 past years in term of efficiency, profitability and liquidity although he has many risks to face.
Key Words: Banking sector; Financial ratio; Economy growth; ECOBANK –Togo; Risk

1 Introduction

The bank by its role and activity of mobilizing funds from the public breathes some life to economic activity. This results in upstream by injecting cash flow into the economy is perceived by the downstream operators. Before the beginning of the 90s, the banking sector of Togo has experienced unprecedented prosperity that earned the system to be one of the best performing in West Africa. The banking landscape was characterized by 3 types of financial institutions namely, savings and credit banks, and savings and credit cooperatives - domestic and foreign banks - and the Central Bank of West African issuance and investment banks [1].

The socio-political crisis of the early 90 has considerably weakened the Togolese economy. This has led to a widespread financial crisis that has affected the gross domestic product (GDP) and various branches that generate income without mentioning traders and other individuals who have seen their business decline. To plug the leaks and boost the national economy, coffers of the public treasury as well as companies must be replenish hence the involvement of banking institutions.

Following the above assumptions the purpose of this study is to assess the role and the efficiency of the banking sector and its contribution to the Togolese economy growth as well as the main risks affecting that sector. To achieve this objective a quantitative approach based on the analysis of the financial ratios is undertaken with Ecobank – Togo as a case study. The main paper is structured as for the first part we introduce the paper, the second part review the literature about the Togolese bank sector, the third part is related to the main risks affecting the banking sector in Togo, the fourth part concern the case study of Ecobank – Togo, the fifth part shows the results and discussion and the last part conclude the whole paper.

2 Literature Review

2.1 The recent evolution of the banking sector in Togo

The Togolese banking system is characterized by a strong state presence and a reduced foreign participation. Governed by the Banking Law of the West African Monetary Union (WAMU), the Togolese banking sector mainly comprises fifteen banks which comprised 05 state owned and the state is sole shareholder. It includes “Union Togolaise de Banque” (UTB), “Banque Togolaise pour le Commerce et l’Industrie” (BTCI) and “Banque Togolaise de Développement” (BTD), which are investment banks and then come the credit institutions which are the People's Bank for Savings and “Banque Régionale de Solidarité” (BRS). The system mainly consists of five commercial banks, one development bank, one savings bank, four nonbank financial institutions, six insurance companies and two public social security funds [2]. The Togolese banking system is dominated by the five commercial banks and the development bank with the highest nominal capitalization, credit offered and network of branches throughout the country. Before the year 2000, the government holds the majority stake in the largest insurance company GTA, which controls nearly 40 percent of the market. In most of banks owned by state, the government has a strong influence over the management and holds majority ownership.

In the early 2000, due to development of the market and the decentralization of the financial sector promoted by the government, many financial institutions have arises ranging from the mutual savings and loan institution, and credit institutions to the informal ambulant moneylenders. But still the contribution of those financial institutions remains very small compared to the commercial banking sector. Some international private banks also were established to boost the financial sector of the country, and despite their small number, they compete strongly the public sector. Indeed they mobilize more funds in the private sector. It is no longer owned enterprises or parastatals and government officials who constitute the majority of their customers but the range is expanded to all social strata. Moreover, the presence in the financial sector of international banks is a considerable advantage especially in the financing of state projects and activities both at the macroeconomic level as in the private sector. The poor conditions related to the rapid growth of the credit in a context of stagnating economy activity, the limited access of the Togolese banks to the refinancing window and the liquidity problems in the Franc CFA zone, cause some banks to be unable to fulfill their engagement towards their clients and the central bank. It leads to severe losses in the Togolese banking system and cause the withdrawal of deposit by the clients and firms who sought to place their funds outside the country [3].

2.2 The Part of the Banking Sector in the Economy Growth in Togo

The banking sector has always played a very determinant in economic growth in Togo. Its part of contribution in the realization of large development projects and the financing of private sector activities has steadily increased over the years 90's with a growing share in GDP. The credit is the primary service offered by banks to their customers which are the state, businesses, private, individuals and shareholders. The most affected among the lot of those concerned are small and medium enterprises or industries (SMEs) who are the most entrepreneurial credit applicants. In Togo, the activity of banks consist therefore of the lending operations in the short, medium and long term to businesses and individuals, then in the clearance operations and the payment of deposits or withdrawals of money from its customers. As a primordial actor of resources distribution at the macro level, the bank is then behaving like a lending capital institution. Its granting financial assistance to businesses of any size for a specific period of time with a payment of interest in proportion to the amount loaned. The economic development of a country, whatever its situation inevitably passes through the banking institutions; in 2004 the domestic banking sector has financed all by himself the Togolese GDP by 16% or nearly 174 billion FCFA. And statistics are progressing until 2006 with 183 billion in loans which is offered to customers, and nearly CFA 273 billion of deposits and loans which is registered. In 2007, domestic credit to private sector reached 21 percent of GDP which is higher than countries at similar income levels [4].

In term of domestic credits provided by the banking sector, the percentage of GDP is increasing sawtooth with sometimes a standing period of stability. Those credits include all credit to various sectors on a gross basis, with the exception of credit to the central government, which is net. The figure below shows the evolution of the domestic credit in percentage of GDP over the past years [2][5].

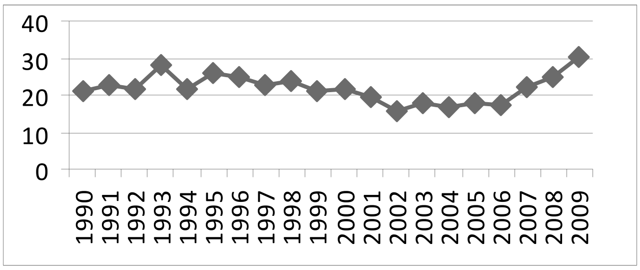


Figure 1 Evolution of Domestic Credit in Percentage of GDP (% GDP)

Source: International Monetary Fund, International, and World Bank and OECD GDP estimates

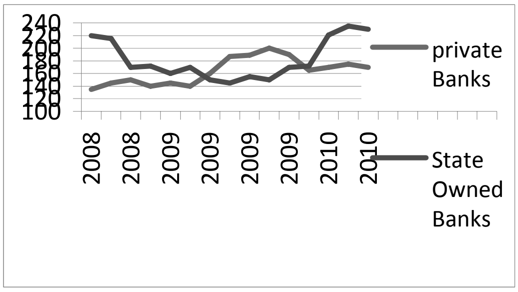


Figure 2 The Evolution of Togolese Banks Loans (Amount in CFAF billions)

Source: International Monetary Fund, country report No11/10 (2011)

As indication in the figure 1, the trend of the domestic credit in up and down showed a slight increase and decrease from the year 1990 to the early 2000. This can be explained by the socio-political crisis of the early 90 which has considerably weakened the Togolese economy. This has led to a widespread financial crisis that has affected the gross domestic product (GDP) and the various branches which generate income.

After a series of structural and banking reforms undertaken by the government, the financial sector has taken the breath that allowed the resumption of economic activity characterized by a significant increase in credit granted by the banking sector in term of GDP. This phenomenon is well illustrated through the table below which gives a key indicator of renewed growth [2][4].

Table 1 Togo's Financial Sector Development Indicators

years	2003	2004	2005	2006	2007	2008	2009	2010
Private Credit/GDP (%)	15	15	16	17	18	21.5	23.2	n.a
GDP (USD ml, current prices)	1,672	1,935	2,111	2,220	2,503	2,558	2,637	3,074
Liquid Liabilities (2000 USD ml)	361	403	407	500	564	572	n.a	n.a
Net Interest Margin (%)	5	0	2	4	0	n.a	n.a	n.a
Real GDP growth	4.8	2.5	1.5	3.7	2.1	2.4	3.2	3.4

Source: IMF and World Bank

As we can see through the analysis of this table, all indicators point to normalization of the economic situation and a resumption of the banking activities. This is reflecting into a growing evolution of real GDP and the private credit to GDP ratio.

3 Risk Factors in Togolese Banking Sector: The Problem of Loan Recovery

The Togolese banking system is facing many problems, which exposes the sector to different levels of risk. Granting loans to finance both state projects and private activities being the main service offered by banks, the principal risk remains the recovery of the loans from customers and lending institutions. Add to that, Togo's banking system remains subject to strong government influence, with limited foreign participation and weak product diversification. The system suffers from a lack of solvency and liquidity, and management is inadequate in major public financial companies and many banks. A substantial number of loans issued to state-controlled companies or private businesses are considered to be non-performing.but as the banking sector goes, the amount of the nonperforming loans is diminishing subsequently as it's shown in figure 3 [5].

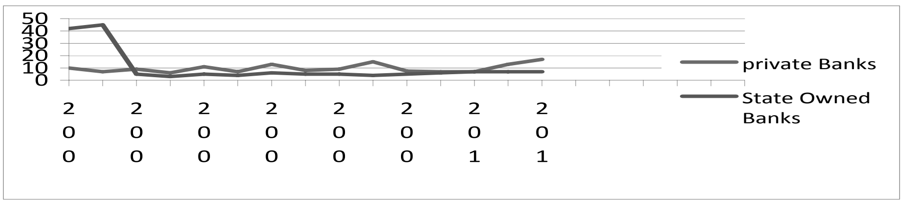


Figure 3 The Nonperforming Loans Trend (in Billions of FCFAF)

Source: International Monetary Fund, country report No11/10 (2011)

The bad financial situation of the banks in the late 90's and early 2000 was worsened by the increasing recourse of the state to bank credit to finance the budget deficits reflecting the persistent cash-flow difficulties of the government and some key public enterprises. The concentration of bank credits in a few major public enterprises, in contradiction of the prudential ratio on the dispersion of risk, and the failure of some of these enterprises to service or repay these loans, further increased the proportion of nonperforming assets.

Significant progress in reforms was achieved under the ERGG. Government moved quickly to implement public finance management measures: the elimination of unbudgeted payments, monthly monitoring of budget execution, allowing more time to analyze fiscal data and permitting better and more timely decision-making. A new General Inspectorate of Finance (Inspection générale des finances) was established to handle regular ex-post inspections of expenditures as well as specific investigative assignments.

4 Case Study: Risk Factors and Efficiency Measurement of Ecobank - Togo

4.1 Overview of the ECOBANK transnational incorporated

Ecobank Transnational Incorporated (ETI) is the holding company of the Ecobank Group – the leading independent regional banking group in sub-Saharan Africa and signs his presence in more African countries than any other bank. Established from inception as a regional bank holding company in 1985, ETI has grown to a group with 32 subsidiaries, over 500 branches, and over 8,000 employees across 25 west, central, southern and east African countries. The principal business of the company is the provision of banking and financial services through its subsidiaries. The Company enjoys special fiscal, exchange control and legal rights under an agreement with the Government of Togo. For the year ended 31 December 2007, ETI generated consolidated gross revenues of US$544.0 million and profit after tax of US$138.9 million from its wholesale, retail and investment banking businesses. At the end of December 2007, ETI had total assets of US$6,550.2 million and shareholders' funds of US$513.6 million. The Ecobank Group operates under the Ecobank brand name in all of its banking operations [6].

4.2 The main risks affecting ECOBANK – TOGO: a brief analysis

The whole banking sector in Togo is facing different kinds of risks. Ecobank Transnational Incorporated – Togo (ETI – TOGO) is not spare of those risks. Some of the risks below represent uncertainties which sometimes arise or have the likelihood to arise, but credit risks, operational risks and acquisition risks remain the most important risks the bank can face. Although the Group ordinarily estimates the net realizable value of collateral on the basis of which it provides for bad and doubtful debts, the absence of additional statistical, corporate and financial information may decrease the accuracy of the Group's assessment of credit risk. This may increase the risk of borrower default and decrease the ability of the Group to enforce any security in respect of corresponding loans. The lack of credit bureaus further reinforces this risk. Even though some countries, including Nigeria and Ghana, have taken practical steps to encourage the establishment of central credit bureaus, these institutions are yet to be fully operational to meet the needs of their major clients, including the Group. As the Group continues to pursue a proactive approach to expand its retail business, its credit risks could increase. Credit risks are higher in many African countries due to the greater uncertainty of their regulatory, political, legal and economic environment. Contract enforcement challenges could have material adverse effect on the quality of loans and expose the Group to higher risks and potential losses. Ecobank depends significantly on its information technology systems to process a large number of transactions on an accurate and timely basis, and to store and process substantially the entire Group's business and operating data. The proper functioning of the Group's financial control, risk management, credit analysis and reporting, accounting, customer service and other information technology systems, as well as the communication networks between its branches and main data processing centers, are critical to its business and ability to compete effectively. Any mishap to the Group's information technology systems could materially affect relations with clients and lead to direct or indirect financial losses, including missed opportunities for the Group.

4.3 Data and methodology

This case is aimed to assess the financial performance of the ECOBANK- Togo using accounting ratios. Data for each year have been compiled from the income statements and balance sheets of the bank from the period 2005 to 2010. Various indexes have been provided by financial management theories for measuring bank's performance, in our case 11 financial ratios will be used. These financial ratios are categorized into 4 groups namely profitability, liquidity, risk and efficiency ratios [7].

4.3.1 Profitability Ratios

These ratios are used to assess the ability of the business to generate earnings in comparison with its all expenses and other relevant costs during a specific time period. More precisely, they indicate firm's profitability after taking into account all the expenses and income taxes.

4.3.2 Liquidity ratios

Liquidity ratios indicate the ability of the firm to meet recurring financial obligations. These ratios measure ability of the firm to meet its short term obligations, maintain cash position, and collect receivables.

4.3.3 Risk and solvency ratios

These ratios measure the risk and solvency of the firm and determine the probability that the firm default on its debt contacts. The more the debt a firm has the higher is the chance that firm will become unable to fulfill its obligations towards its clients.

4.3.4 Efficiency ratios

These ratios measure how effectively and efficiently the firm is managing and controlling its assets.

Table 2 Summary of The Performance Ratios

Ratios	Definitions	Formulas
Return on assets (ROA)	Return on assets indicates the profitability on the assets of the firm after all expenses and taxes	net profit after tax / Total assets
Return on Equity (ROE)	Return on equity indicates the profitability to shareholders of the firm after all expenses and taxes	net profit after tax / Shareholders' Equity
Profit to Expenses Ratio (PER)	It measures the operating profitability of the bank with regards to its total operating expenses	Profit before tax / Operating Expenses
Loan to Deposit Ratio (LDR)	Loan to deposit measure the liquidity condition of the bank	Loan / Deposits
Cash & Portfolio Investment to Deposit Ratio (CPIDR)	It's also another measure of liquidity of the bank	Cash & Portfolio Investments / Deposits
Loan to Asset Ratio (LAR)	It measures liquidity of the bank in terms of its total assets.	Loan / Total assets
Debt-Equity Ratio (DER)	It measures ability of the bank capital to absorb financial shocks	Total Debt / Shareholders' Equity
Debt to Total Assets Ratio (DTAR)	It measures the amount of total debt firm used to finance its total assets	Total debt / Total assets
Equity Multiplier (EM)	it indicates the amount of assets per CFAF of shareholders' equity	Total Assets / Total Shareholders' Equity
Asset Utilization (AU)	It shows How effectively the bank is utilizing all of its assets	Total Revenue / Total Assets
Operating Efficiency (OE)	It measures the amount of operating expense per CFAF of operating revenue and the managerial efficiency in generating operating revenues.	Total Operating Expenses / Total Operating Revenue

In our study, Loans are considered to be the advances of the bank. The total revenue is considered to be the net spread before taking into account the provisions plus all other income. The total income is the net spread earned before the provision, plus all the other income of the bank, and the expenses are the total operating expenses. We also consider the operating revenue to be the net spread earned before provisions being made.

Table 3 Ecobank Key Statistics (Amount in 000 CFAF) [6]

variables	2005	2006	2007	2008	2009	2010
Total assets	84 292 220	95 881 721	111 688 617	155 327 466	176 987 945	195 869 364
Shareholder equity	6 824 891	7 323 276	7 887 841	8 458 518	12 201 941	13 109 187
Profit before tax	3 249 751	5 195 601	5 212 609	7 733 000	4 398 522	4 960 512
Operating expenses	4 513 803	6 100 857	7 260 209	17 716 793	24 120 794	16 998 066
Loan	48 034 766	72 967 003	77 391 859	113 763 205	135 793 641	94 469 482
Deposit	61 413 507	65 026 057	81 438 814	105 231 286	143 154 526	144 971 412
Cash	2 205 184	2 088 462	2 692 460	5 286 491	4 844 571	5 419 367
Total debt	69 692 095	78 011 593	94 386 911	132 012 652	155 807 219	171 159 959
Total revenue	9 717 580	12 146 691	13 551 354	26 778 373	29 997 906	22 747 509
Total operating expenses	8 866 214	10 714 857	12 143 259	24 001 382	29 067 580	21 298 601
Total operating revenue	8 801 965	11 557 959	12 110 073	23 875 997	29 915 464	22 714 062
Profit after tax	2 398 385	3 763 768	3 804 514	4956151	3468196	3 511 665

Source: ECOBANK- Togo, rapport annuel 2006 -2010

4.4 The main indicators of ECOBANK – TOGO financial performance

As we can see on the graph below, all the keys indicators of Ecobank financial situation and wealth are in great evolution. This shows the remarkable effort it has made to maintain itself at the top of the leading financial institution across Africa. From 2006 to 2007 it total operating revenue has increased at about 9%, while a profit after tax of 3,805 million CFA francs in 2006 against 3764 million CFA francs in 2007 has increased at about 1%. The total deposits have an increase of 25% during this period. From 2008 to 2009 the total deposit grows at 36% and the loan granted at about 9.25% compared to a deposit growth of 1.27% and a loan growth of -1.64% in 2010.

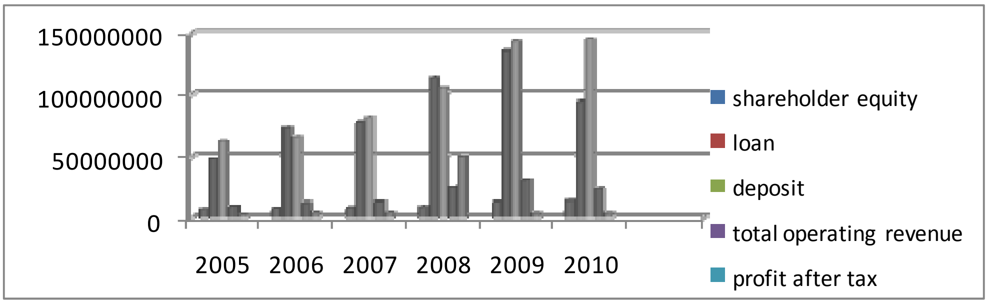


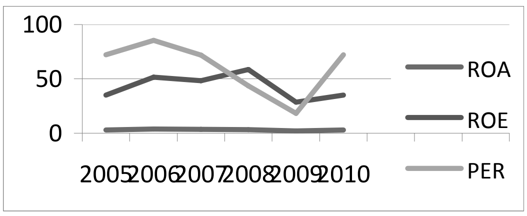
Figure 4 The Trend of ECOBANK –Togo Keys Statistic From 2005 To 2010

5 Findings and Discussion

The table below summarize all the ratios we've use to assess the performance of ECOBANK-Togo from the period 2005 to 2010.

Table 4 Statistic Results

ratios	2005	2006	2007	2008	2009	2010
Profitability ratios	%					
ROA	2.845322	3.925428	3.406358	3.1907757	1.9595662	1.7928608
ROE	35.14173	51.39459	48.23264	58.593609	28.423314	26.787817
PER	71.99585	85.16182	71.79696	43.647854	18.235395	29.182802
Liquidity ratios	%					
LDR	78.21531	112.2119	95.03068	108.10778	94.858084	65.164215
CPIDR	3.590715	3.211731	3.306114	5.0236875	3.384155	3.7382315
LAR	56.986	76.10106	69.29252	73.240881	76.724797	48.230862
Risk and solvency ratios	time					
DER	10.21146	10.65255	11.96613	15.60707	12.76905	13.05649
DTAR	0.826792	0.813623	0.84509	0.849899	0.880327	0.873848
EM	12.35071	13.09274	14.15959	18.36344	14.5049	14.94138
Efficiency ratios	%					
AU	11.52844	12.66841	12.13316	17.239947	16.949124	11.613613
OE	100.7299	92.70544	100.274	100.60099	97.165733	93.768349



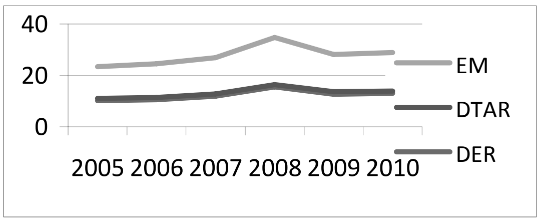


Figure 5 The Evolution of ECOBANK –Togo Financial Ratios

As we can see from the results above, many important elements have to be pointed out concerning the performance and the risk environment of ECOBANK-Togo.

The results about the profitability ratios show an increment of both the ROA, the ROE and the PER from 2005 to 2006 and a slight decrease from 2006 to 2007 from 2007 to 2009 the bank ROA decrease from 3.4% to 1.96 % while the ROE decrease from 48.23% to 35.14% between 2007 and 2010. At the same time, the PER ratio decrease from 74% (in 2007) to 18.23% in 2009, but increase again to 29.18% in 2010. This shows that the Bank profitability is fluctuating over the period but also that its profit has been increasing more than the equity and the assets, with a well management of the operating expenses in 2005, 2006, 2007 and 2010.

Analyzing the liquidity ratios, it's obvious that ECOBANK-Togo is doing very well in term of managing cash and receivable and attracting investors. From 2005 to 2008 the LDR ratio has increased from 78.21 to 108% and decreased to 65.16% in 2010. The CPIDR remain constant from 2005 to 2007 with an important increment to 5.02% in 2008, and has decreased the last two years to respectively 3.38% in 2009 and 3.74% in 2010. The loan to asset ratio (LAR) has increased from 56% in 2005 to 76% in 2006 and remains constant over the years 2006 to 2009.it declined drastically to 48.23% in 2010. These results show that the bank is facing liquidity risk and it ability to meet the short term obligations and maintain a cash position, with a good expectation to collect its receivable get worsened over the period 2005 to 2008.it also shows that the bank during this period has taken more financial stress by making excessive loans and take some risks towards depositors. But this position is getting better from 2009 with a remarkable decrease of the LDR and the LAR ratios to respectively 65.16 and 48.23%.

Taking a look of the result provided by the risk and solvency ratios, we can notice that the DER has increased drastically between 2005 and 2008 from 10.22 to 15.6 times with a slight decreased in 2009 to 12.7. At the same time the DTAR ratio also increase over the whole period from 0.82 to 0.88 in 2009 and 0.87 in 2010. The equity multiplier (EM) rose from 12.35 to 18.36 times between 2005 and 2008 and decrease to 14.94 in 2010. The whole risk and solvency ratios analysis suggest that the bank is more and more relying on debt financing rather than equity financing although the part of that debt financing is not so important compared to the total asset. This can be confirmed by taking a look to the DTAR ratio which is relatively small over the six years. The increment of the EM ratio shows that the bank is using more and more debt to convert into asset with share capital, and is therefore increasing it risk.

In term of efficiency, the analysis indicates that the bank is doing well since we can notice an increment of the AU ratio between 2005 and 2008 from 11.5% to 17.23%. it decrease to 16% in 2009 and reach 11.61% in 2010. At the same time the OE ratio remain very high during the whole period with respectively 100.73% in 2005 and 93.73% in 2010. The result shows that the bank is using effectively and efficiency it assets to generate revenues since its AU ratio is high and getting higher except in 2010 where we can notice a decrease relative to 2009.in the meantime the OE ratio is showing that that the operating expenses are not well controlled compared to the operating revenues.

6 Conclusion

This paper first analyzes the performance and the part of the Togolese banking sector in the economy by pointing out the challenges and risks that the sector faced the last few years. It's obvious that the financial system and especially the banking sector have a huge role to play in a country economy growth. In the case of Togolese economy, the part of the domestic credit in the GDP and the outstanding loans to the private and public sector clearly shows the importance of the banking sector in maintaining a substantial growth. Through the case of ECOBANK-Togo which shows how well the bank is performing in term of profitability, liquidity, risk and efficiency, the paper gives a well understanding of what can be the role of the banking sector in building a strong economy. But still much effort remains to be done on reforms and Togolese government has already realized that fact in view of all the structural reforms that have already been undertaken over recent years.

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