KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY

THESIS ON THE TOPIC

THE IMPACT OF LENDING RATE ON THE FINANCIAL PERFORMANCE OF OIL MARKETING COMPANIES IN GHANA

BY

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DECLARATION

I, the undersigned do hereby declare that this research work is the result of my own original research and that no part of it has been presented for another Degree in any University. However, all sources of borrowed materials have been duly acknowledged.

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Name Signature Date

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Signature Date

DEDICATION

I dedicate this study to the glory of God Almighty for His infinite mercies, kindness and blessings bestowed upon me throughout my years of study at the Kwame Nkrumah University of Technology, Kumasi. I also dedicate this study to my lovely parents Mr.E .Y.Abankwah and Mrs.Kate Obeng for their support and encouragement throughout the pursuit of my Master's Degree.

ACKNOWLEDGEMENT

I sincerely express my profound gratitude to God Almighty for the gift of life, good health, knowledge and understanding, financial provision and the ability He has granted me to carry out this research work. I also express my heartfelt gratitude to my supervisor Dr Michael Adusei for the time spent in addressing all the concerns about my work.

ABSTRACT

The purpose of the research is to examine the effect that lending rates have financial performance of Oil Marketing Companies in Ghana. The study is carried out using two specific objectives which are to examine the effect of lending rate on financial performance of indigenous Oil Marketing companies in Ghana and to examine other factors that influence the financial performance of indigenous Oil Marketing companies in Ghana. The researcher approaches the thesis using quantitative design and depends on secondary data for its analysis. The results show that lending rates are negatively related to the financial performance of oil marketing companies. Based on this, the study concludes that an ineffective monetary policy that results in hikes in interest rates may be injurious to the financial performance of oil marketing companies. It is recommended that government should set up an Oil Marketing Capital fund to support all the oil marketing companies that are struggling with financial performance owing to high lending rate. To ensure the success of such a fund, the government should set up a committee which will scrutinize the performance of the firms for financial assistance. The study reveals that working capital management has a positive effect on financial performance. It is, therefore, recommended that management and board of directors of Oil Marketing Companies should pay attention to the working capital management. They should develop a strategic governance framework for working capital management to ensure that challenges confronting managing daily activities of them firms are addressed.

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LIST OF ABBREVIATIONS

BOG	Bank of Ghana
NSE	Nairobi Stock Exchange
OMC	Oil Marketing Company
ROA	Return on Assets
ROE	Return on Equity
SSA	Sub-Saharan Africa

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The economic reality facing indigenous companies operating in the Ghanaian economy is that most of them are going through hardship and are struggling to survive due to macroeconomic factors prevailing in the economy. According to Asamoah & Adu (2016), though there is low inflation and lower prime rate as declared by the Bank of Ghana, most companies operating in the Ghanaian economy are at the verge of collapse and are barely surviving as a going concern. The cause of this challenge is presumed to be due to lending rates being charged by financial and non-financial institutions on facilities taken by the indigenous companies.

Amuakwa-Mensah & Marbuah (2015) reiterate the above statement by expressing that lending interest rates charge by financial institutions in Ghana remains a source of worry to companies, SMEs, potential entrepreneurs, individuals and not excluding policymakers. It is imperative for policy makers to make necessary efforts to curb the prevalence of high lending rates which is adversely impacting economic growth and also impeding the growth of private sector (Mensah & Abor, 2014). It is important for the central bank to ensure that lending rates are reduced to stimulate private sector development. An effective policy development requires an in-depth insight into how lending rate influences the performance of most indigenous companies. This motivates the researcher to study the impact of lending rates on the financial performance of organisations.

Furthermore, Sheriff and Amoako (2014) in their study express that performance of any company depends largely on the availability of cash to manage the day to day activities of the firm. However, owing to economic conditions, some business organisations resort to using loans solicited from financial institutions to finance their activities but that is describe to make worse the plight of such organisations due to perceived lending rates that is charged on the facilities taken from banks which puts so much financial burden on the organisations.

Sayedi (2013) defines lending rate as the price paid by a borrower for using money borrowed from a lender/financial institutions or debenture holders. From a different view lending interest has been described as the cost incurred in securing capital from other sources which cannot be considered as owners' equity. Lending rates are usually expressed as a percentage of the loan facility within a financial year but however it is allocated within the period for which the loan facility may be agreed upon (Sayedi, 2013). Usually lending rates which depicts cost of capital reflects the macroeconomic information prevailing in the economy and it has an influence on purchasing power of money in an economy (Ahokpossi, 2013). So, it is imperative to examine the influence of the lending rate on financial performance of firms.

Kiptui (2014) opines that when lending rate are set to be too high, it adversely influences the operations of financial intermediaries as well as companies that patronize loan facilities from the financial institutions consider the lending rates to be abysmal. It is also considered to dispirit savers due to low returns on deposits and hinders access to finance for borrowers, leading to a reduction in investment opportunities, therefore curbing the growth prospects of the economy. Specific areas in the economy which are influenced by the challenge of high lending rates include unemployment. The rate of employment will diminish as businesses will not be willing to borrow at high lending rate to expand their businesses. This transcends to influence living standards of individuals (Kiptui, 2014).

According to Agyemang (2018), manufacturing sector in an economy performs abysmally and that link to the high bank lending rate in the economy. The traceable influence of the high lending rate results into increased production cost, increase overhead cost and also adversely influences the turnover, working capital available for running the operational activities of an organization. Whiles Gideon focused on manufacturing companies, much has not been done regarding Oil Marketing Companies and how their pinched by high lending rate and that creates an avenue which this study seeks to delve into in terms of financial performance.

Onkore (2013) states that analyzing the performance of commercial banks in term of finances ever since the Great Depression Intern in the 1940's has received several attentions from research in the academia. Studies conducted in the past two decades' suggested that the profitability of commercial banks operating in the Sub-Saharan Africa (SSA) is better in comparison to the rest of the world, with a Return on Assets (ROA) averaging 2% (Flamini et al., 2009). This tremendous performance of commercial banks in the region is attributed to investing in high risk assets.

Oil Marketing Companies play a vital role in the oil and gas industry in Ghana. Directly the OMCs engage in supplying petroleum products to all motorists in Ghana. The company also generates tax revenue for the government and offers employment to 18% of employees in the private sector (Tawia 2018). However, recent economic challenges have adverse effect on Oil marketing sector. It has been asserted that the deregulation of the sector causes the situation of survival of the fitters to befall the Oil Marketing Sector where the OMCs with high capital bases such as the multinationals like Shell, Total and Puma are dominating the industry (Tawia 2018). The indigenous Oil marketing companies resort to loans for as source of working capital. However, the concern of the indigenous OMC is about lending interest rate. Henceforth, this study tries to find out how lending rates would influence the financial performance of Oil Marketing Companies.

1.2 Problem Statement

Ghana's oil marketing sector is one of the major sectors that contribute to economic growth in the economy. According to Adu and Asamoah (2016) the sector is mainly private sector oriented and offers employment to 12% of the employable labour force in Ghana. The sector consists of foreign multinationals OMCs and indigenous OMCs. Competition among these OMCs has been even until the implementation of the price deregulation.

Siakwah (2017) opines that implementation of price deregulation of the Oil marketing sector by government in 2015 which expects all OMC companies to fix its own prices rather than the National Petroleum Authority and also pay all petroleum taxes to the government with two weeks of every window has place so much pressure on the indigenous OMC companies that are not financially sound and that compel them to turn to banks for loan facilities to cushion their operation.

According to Panford (2017), indigenous oil marketing companies that are confronted with capital challenge that resort to lending money from commercial banks to support to their operations. However, the lending rates at which indigenous OMCs solicit capital which range between 27%-35% per-anum is considered a threat to their financial performance.

The concern is with such interest rates, how it will influence financial performance of the indigenous OMCs.

From the view point of Agyemang-Duah (2018), lending rates within the last decade contribute to the collapse of over twenty indigenous OMCs in Ghana due to financial challenges and poor performance. A disguise statement of Agyemang-Duah (2018) is that most of the OMC exist to work and enrich the banks owing to the huge amount of interest they pay on loans solicited from the financial institutions. This lending rate situation is considered to adversely influence financial performance of indigenous Oil Marketing Companies. Though some studies look at lending rate and banks performance (Sheriff & Amoako, 2014; Amuakwa-Mensah & Marbuah, 2015), the focus did not extend specifically to lending rate and how it influences financial performance of OMCs and that create a gap. This thesis seeks to fill the gap by examining the impact of lending rates on financial performance of indigenous Oil Marketing Companies (OMCs) in Ghana.

1.3 Purpose of the Study

The purpose of the study is to evaluate how lending rate affects OMCs financial performance in Ghana.

1.4 Objectives of the Study

The main objective of the study shall be to assess how lending rate affects financial performance of Oil Marketing Companies in Ghana. This will be studied under three main specific objectives as stated below.

- To examine the effect of lending rate on financial performance of indigenous Oil Marketing companies in Ghana
- To examine other factors that influence the financial performance of indigenous Oil Marketing companies in Ghana

1.5 Research Questions

- What influence does lending rates have on turnover of indigenous Oil Marketing Companies in Ghana?
- What are the factors that affect financial performance in indigenous Oil Marketing Companies in Ghana?

1.6 Significance of the Study

The recent struggle for survival of many indigenous Oil Marketing Companies most is very alarming. The problem has been attributed to access to source of financing and Lending rate or cost of capital for soliciting funds to carry out their operations. Whiles lending rate in general is considered to be high in Ghana as compared with other surrounding countries its effect has not been analyse as cause of the financial struggle being experience by OMCs in operating as a going concern. In this regard, the study will be significant to the Board of OMCs as well as their management to understand how the lending interest rates on the facilities solicited from banks affect the operations of the OMCs with much emphasis on financial performance. The research will help provide a direction of how lending rates on loans covers the profits made by the OMCs and what could be done to help reduce the high level of lending rates.

The regulatory authorities of banks with special reference to Bank of Ghana will find the study relevance in the sense that it will give them an idea of the effect that lending rates that are charged in economy have on indigenous organisations and how that affects economic growth. It will help the central bank to identify prudent way of fixing prime rates and also controlling interest rates that are fixed by banks and financial institutions to reflect the low prime rates and for that matter enhance high financial performance of Oil Marketing companies in the economy.

The banks will also find the study significant since it will enlighten them on the influence that interest charged by most of them have on the profitability of indigenous OMCs in Ghana. Knowledge derived from the findings of the study will further assist banks to bring down their lending rates for economic development and sustainability of indigenous OMCs that solicit funds from the banks for their operations.

Researchers who wish to carry out a study on a related area using the financial performance and lending rates in other sectors will also use this study as a reference point.

1.7 Brief Methodology

This aspect of the study provides a brief introduction on the methodology the researcher plan to use in carrying out this study. The researcher plan to use the methods express below:

Research Design

The study will use quantitative research design to explain the existing link between lending rate and financial performance of indigenous Oil Marketing Companies in Ghana. Every research requires an appropriate research design methodology in order to achieve the necessary a desired output. The prime aim of this thesis is to determine the influence of lending rate on performance of OMCs and the study will use secondary data to quantitatively test the cordiality existing among the variables. In this study, data will be gathered on lending rates from the data archives of the Bank of Ghana and financial performance indicators computed from the data collected from the financial statements of the Oil Marketing companies.

Data and the Regression Model

The study will gather panel data from the period of 2008 to 2018 on lending rates and financial performance of the OMCs. The researcher will solicit lending rate data on commercial banks from the Central Bank of Ghana. In addition, the data on the performance of the OMCs will be collected from their financial records.

The model for analyzing the study will consist of a panel regression model which will show how financial performance is related to lending interest rates. Aside the main model the study will introduce some control variables which can also affect the performance of the OMCs financially. These variables shall include working capital and firm size.

1.8 Definition of Terms

Lending rates in this study refers to the amount that financial and non-financial institutions charge on a loan solicited from the banks by individuals and business organizations. It is in other words the cost of capital.

Financial performance in this study refers to various factors that increases a firms' liquidity position, makes it meet its daily cash flow management targets and makes it more profitable in its operations.

Oil Marketing Companies refers to various firms in the downstream of the Oil and gas industry that retail petroleum products at the pumps to consumers.

1.9 Organisation of the Study

This study will be carried out in five chapters as detailed below

Chapter one which will be the introductory chapter that will discuss study background, statement of the problem, general and specific objectives, research questions and hypothesis, significance of the study, definition of terms, and organisation of the study.

The second chapter (2) will touch on literature review from the perspective of theory on financial performance and lending rate, conceptual framework on the variables and empirical review on the subject.

Chapter three detailed on the methodology of the thesis and specific areas shall be the study design, the data and data collection, the model specification and the technique of analysis.

Chapter four will focus on the presentation of data, data analysis and discussion of research findings. Chapter five will provide summary, conclusion and recommendation on the entire study and it will also capture propose area for future study.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

Chapter two of this thesis concentrates on reviewing existing literature on lending rates and the financial performance of firms including Oil Marketing Companies. The literature review discusses theoretical and empirical literature on the variables of concern to the study.

2.1 Lending and lending Rates

Lending in the operations of banks is considered one of the most vital activities and is pivotal in financial intermediations. Through the process of lending, banks are able to derive enough income in adequate forms even in times of high risk. According to Kadri (2012) lending rates constitute short, medium or long-term basis of fixing cost of capital. It has become one of the numerous services rendered by deposit money banks to their customers for utilization in their business operations and activities. From another perspective lending rates are the compensation that banks take from their client which are business organizations or firms, government and individuals for loan advance to the client to ensure they are able to undertake any development and investment activities towards achieving growth and also contribute immensely to the overall economic development of the country. Adu, Marbuah and Mensah (2013) express that, to banks risk is inevitable and in every activity and operations engaged in by banks, there is some level of risk. An effective control and institutions of risk mitigation strategies regarding financial reserves and credit competence therefore determines the success of banks'. However the effect of the rate at which banks lend is not examined on financial performance of other companies operating in the different industry. Adu et al (2013) further state that it is imperative for banks to ensure they survive despite the risk associated with lending. To be successful, there is the need for restructuring administratively in order to take responsibility of the financial needs of the economy in its entirety. The bureaucratic systems existing in banks often frustrate loan applicants making difficult for them to have timely access to credit facilities. The untimely access to credit facilities by from the banks therefore delays the project success of most applicants, resulting to increasing rate of lean defaults. Based on the risk being taken by the banks they charge a price for lending the money to the customers and this brings about lending rates. But to what extent will the lending rate affect oil marketing companies.

Sarpong, Winful and Ntiamoah, (2013) define lending rates to be the amount paid by a debtor or borrower to a lender for using financial capital given to the borrower within a stipulated period. Fabozzi and Modigliani (2003) also define lending rate as the fee charge for soliciting claims or financial assets from a financial institution. These financial assets solicited can be in the form of debentures or call loans, bills of exchange or bank overdraft and government bonds or company shares. Aboagye et al (2008) pointed out that as banks prefer increase in lending rates simply because higher lending rate depicts a rise in the profitability of loans given by financial institutions and their operations whiles business organisations prefer low lending rate since it helps in enhancing financial performance. This event becomes an ideal convergence for banks because of their lending activities in the long-term and borrowing in the short-term. The controversy of lending rate remains a concern for both academia and industry. In Ghana, high rates if interest has been a subject of discussion and a major concern to businesses, banks, investors and the government. The study followed a narrative enquiry research strategy and descriptive research design. The target population was Management personnel and loan customers of SG-GH. Interview technique was the research instrument used. The findings show that the reasons for high lending rates are high Monetary Policy Rate, high cost and risk of doing business, high cost of borrowing funds, and high default rate. It is recommended that commercial banks should focus their strategies on sourcing for cheaper funds so as to enable them offer attractive interest rates on their loan products; the Bank of Ghana monetary should adopt stringent measures to controlled its policy rate because it informs the interest rates to be applied by banks; and the Ghana Government should work on building a more robust economy where the manufacturing industry is vibrantly functioning to promote high exports and low imports.

According to Amonoo, Acquah, and Asmah (2015), lending rates charge for providing loan facility do not just happen in a vacuum but it is linked to a number of factors. Of those factors, risk and transaction cost the most prominent associated with determining micro-lending rates. The transaction cost related to microlenders is significantly higher than that of banks in developed countries, whether in relative or absolute terms. The costs associated with the process of lending are in three different forms, these include the cost of risk, funding cost for on-lending and administrative cost. The administrative cost however include the cost of client identification and screening, loan application processing, payments for disbursements, follow-up on loans defaults and collection repayments.

2.2 Financial Performance

Ongore (2013) defines financial performance as the level of productivity of an entity within a specified period of time, based on the overall profits and losses as well expenses and revenue within the stated duration. Amuakwa-Mensah and Marbuah, (2015) also define financial performance to be the overall assessment of how well a firm turns out its assets to generate a high income. Business strategies, activities and decisions taken by management of firms are well judge if the firm assess or evaluates its financial performance, giving them a concrete knowledge and insight on how well their monies have been spent. The firms' value added and the return on assets (ROA) often reflect such occurrences. Usually, financial performance is deployed in comparing a firm's performance against completion overtime. Having a robust performance in terms of finance is one of the major benchmarks towards ascertaining the position (good or bad) of banks.

Vincent, (2013) states that commercial Banks have relevant role they play in the allocation of a country's economic resource and channeling of depositors' funds to investors in a unceasingly, this is so if banks are able to produce the necessary income to protect their cost of operation. Furthermore, the role of financial institutions in sustainable intermediation function compels these banks to increase their profitability in order to have high banks performance. Also, aside the role of intermediation, the financial performance of banks has critical implications on ensuring effective socio-economic development in a nation. Stockholders of financial institutions are also described to highly enjoy rewards on their investment in the banks through high financial performance.

Contrary to high financial performance, there could be failure and banking crises if banks performance poorly and the consequence of could be a negative impact of economic growth. Just as it happened in the year 2007 at the USA, baking crises could be accompanied with financial crises which lead to economic meltdown (Marshall 2009). For this reason, the banking sector is heavily regulated, supervised and controlled central banks on the behalf of governments to help produce a healthy and a sound system of banking, thus helping to elude any form of crises and ensuring that depositors and the economy is safeguarded (Mangeli 2012).

In measuring the results of a firm's policies and operations in monetary terms the results are reflected in the firm's return on investment, return on assets, value added and other parameters. Financial ratios can be used by Commercial banks to simplify financial data to monitor and improve business performance. ROA and ROE were used to measure a firms' performance. From the perspective of accounting and finance, ROA is one of the most inclusive determinants of a bank's overall performance. It reflects management's capability to convert the assets of a bank into net earnings. The ROA discloses how a bank's total assets perform, and hence used in ascertaining the effectiveness and efficiency of banks. On the other hand, ROE is used in measuring the performance of firms or organizations from the perspective of shareholders, illustrating the return on investments of shareholders. The ROE approximates net benefits received from shareholders capital investments (Rose & Hudgins, 2006). Financial performance is expressed to be very critical to bank organizations that seek to become profitable and one way that the banks can enhance their performance is through effective lending rate and this paper hence explore the lending rate and how it influences financial performance of banks.

2.3 Theoretical Review

Theoretically the study considers two main theories which relate to interest rates. These theories include interest rate theory and loanable fund theory as discuss below:

2.3.1 Interest Rates Theory

The aspect of the study looks at lenders perspective of describing interest rate. The term lending rate is described as the premium offered to savers for providing surplus funds available to financial intermediaries. The businesses and individuals who solicit funds refer to lending rate as the cost paid on a capital for using a depositor's money for business operations. Two major schools of thought are used to provide theoretical understanding on lending rate that is offered to borrowers.

The first school of thought refers to the classical school of thought and it states that interest rates links those who seek for funds to have an investment and those have excess funds save for the future at equilibrium to connect with each other through a financial intermediary. In this theory investment depicts demand for investable securities and saving denotes the supply. Within these two factions lies the interest rate that is described to mean the price of investable resource at where there is aggregation of those demanding investment and those having surplus funds to save for future purpose. According to the classical theory as interest rate increases, it aids savers to defer their consumption to future by providing more funds for the savings which earns them interest. However, this is presumed to have adverse effect on the borrower since the borrower pays more for the cost of capital (Snowdon & Vane, 2005). It is in light of the payment of higher cost of capital that this study has been designed to investigate how lending interest rates can influence financial performance of a firm.

2.3.2 Loanable Funds Theory

One of the theories that best explain lending rate as well as the interest rate is the loanable fund theory. The loanable fund theory is propounded by Froyen (1996). According to the theorist, interest rates are usually determined at the point where demand for loanable funds and supply for loanable funds are at par with each other. Basically, whenever demand for loanable funds exceeds supply of loanable funds then lending rate charges become high. Alternatively, when supply of securities in an economy exceeds demand for the securities then lending rate will fall. This refers to what the classicalist economist describes as interplay of forces of productivity and thrift.

With regards to this theory, the availability of amounts or funds loanable essentially determines interest rates. The loanable amounts availability however is relied on some important factors. These factors according to theory include amount saved by people, people's readiness to invest, the net increase in current deposits, fresh capital formation opportunities and improvement in cash balance. Fixler and Zieschang (1998) posit that, the theory of loanable fund is theory that is very dynamic and thus essential for optimizing the operation of banks. The theory also helps to integrate and understand other relevant theories such as the portfolio theory, theory of financial intermediation and production theory. The unified model clarifies the relationship between the risk of asset portfolios and a bank's output of services. Funds borrowed by banks and the rate of return on loans are determined by the portfolio risk. The portfolio risk in turns determines the discount used to arrive at the present value of future profits generated by services of banks. Different amounts of processing information are required for different portfolio risks since the service output is impacted by risk. Additionally, the theory discloses that in simple terms, loanable funds are intermediary inputs which relies in the hands of banks, whiles the value added by banks facilitates serviced through the provision of funds.

The study predicts that lending rates affect financial performance of Oil Marketing Companies. From the view point of the researcher high lending rates cause firms to pay high cost of capital and the cost of capital has an adverse relationship with financial performance. Based on this the research seeks to test the hypothesis stated as follows:

Ho: that lending rate has a positive significant effect on financial performance in OMCs

2.4 Empirical Review

The influence of lending rates on agricultural firms' financial performance in Amsterdam was examined by Garman and Grable (2012). A secondary data collected on time series basis between the periods of 2008-2013 was utilized for analysis. The study purported that lending rates and agricultural firms' financial performance is inversely correlated. The effect of financial performance and lending rate may not present the same results in the oil marketing sector in Ghana and that create a gap which this study seeks to explore in the context of Ghana.

Also Nduwayo (2015) conducts a research on impact loan management on financial performance of universal bank of Kigali. The research use data from 25 employees of credit department of universal bank in Kigali within the periods of 2010 to 2013. The study outcome unveiled a positive relationship between financial performance and the management of loans. This induces that a prudent management of loans portfolio of loans will yield positive influence of finance performance.

Nsambu (2015) examine effect of lending rate changes on Kenya's economic growth and financial deepening. The research used co-integration model to analyse the data obtained. The findings show that lending interest rate changes affect the credit risk, non-performing loans, liquidity and return on assets. Similarly, Kipngetich (2011) examine relationship between lending rate and ROE with commercial banks financial performance in Kenya. Findings of the research show that lending rates have a positive relationship with profitability of the banks in Kenya however that there is insignificant effect on the profitability.

Mang'eli (2012) investigates how the spread of interest rates relates with commercial banks financial performance in Namibia. The findings reveal that an increase in interest rate spread causes the cost of capital to increase for borrowers of funds from banks and are benchmarked against NPL of bank hence the spread of interest rates negatively affect Namibian commercial banks performance in terms of finance.

In a similar study, Onyekachi and Okoye (2013) investigated the performance of deposit money banks in Nigeria, and how their performance is being impacted by interest rates. The data employed in the study covered the period of 2000 to 2010. It was concluded that the performance of deposit money banks in Nigeria positively relies on the country's monetary policy rates and interest rate. Further findings pointed out that in determining lending rates there are banks specific factors which play a key role.

Also, Nduati (2013) investigates the impact of interest spread on financial performance of Kenya commercial banks. The regression analysis technique was used on a 43 years secondary data collected from commercial banks in Kenya. Findings reveal financial performance measured in terms of ROA and lending rate of the banks is inversely related. The study analyse commercial banks without considering the financial performance of Oil marketing companies and how lending rates influence their financial performance. That creates a gap which this study seeks to address.

Sarpong et al. (2013) investigate the causal factors behind the increase spread in interest margins in the Ghanaian economy. Their study relies on time series data and the analysis is based on panel EGLS. The findings reveal that the main determinant of interest rate margin is fees, liquidity and operating cost of the banks. This study seeks to examine how lending rate impact financial performance of Oil Marketing Companies in Ghana

Aboagye et al. (2008) investigate the optimal spread between bank lending rates and interest rates on loans and deposits by commercial banks in Ghana. The finding reveal that rise in bank market power, bank size, staff costs among other factors significantly increase net interest margins and reduces lending rates. The study however fails to examine the effect of the lending rate on financial performance of the other sectors such as the oil marketing sector and that becomes the focus of the study.

Simiyu and Ngile (2015) investigate the effect of macroeconomic variables on financial profitability of listed commercial banks in the Nairobi Securities Exchange (NSE). The finding of the study reveals that lending rate on loans, interest rate, exchange rate and policy rate affects the profitability of banks. The findings may differ in the oil marketing sector hence this study seek to investigate the effect of lending rate on financial performance of Oil marketing companies in Ghana.

Carroll and McCann (2015), examine lending rates and the development of SME in Europe. The study uses the residual interest rates model and collected secondary data across banks in Europe. The findings show that when the net worth of a bank is low, the leading rate becomes high whiles when the net worth of the bank is high the lending rate becomes low. The gap is how the lending rate affects the financial performance of a company.

Aboagye et al (2008) investigate factors affecting bank performance and its effect on interest rate spread in commercial banks in Ghana. The study employs secondary data from financial reports of listed banks. The findings reveal that economic conditions and banking sector specific variables, macroeconomic indicators among others are the reasons of having high interest rate spread.

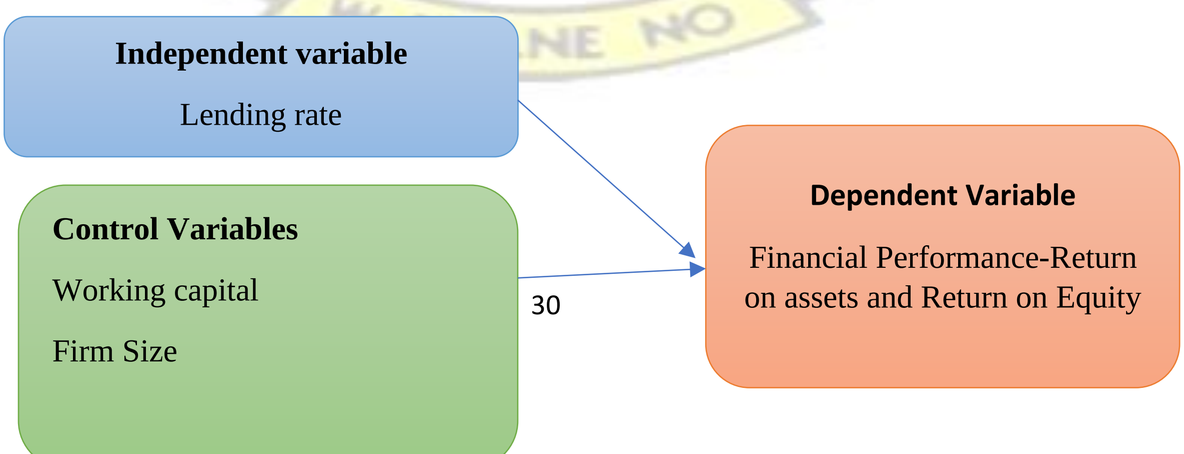
Furthermore, Khat and Bathia (2013) study the relationship between interest rates and other macro-economic variables, including savings and investment. The study use groups from Sixty-four developing countries. The research applies Mann - Whitny test in analyzing the study. The finding reveals that lending rate has no significant impact on the three groups of firms considered.

A study was also conducted by Okech (2013) in Kenya on the relationship between financial performance of commercial banks and lending rates. The survey base design was employed by the study. The efficiency of operating cost and management was considered by the study with regards to lending rates. Analysis of data collected on the study concludes a positive but weak relationship between commercial banks performance and lending rates. The study focus only on banks and their benefit from the lending rate without looking at how lending rate affects performance of oil marketing companies. This becomes a gap that this study seeks to address.

2.5 Conceptual Framework

The study identifies lending rate as the independent variable whiles financial performance is considered to be the dependent variable measured by return on assets (ROA) and return on equity (ROE). These control variables include working capital firm age and capital adequacy ratio. The research establishes that lending rates have some influence on sales turnover of Oil Marketing Companies and also may affect working capital, return on assets and return on equity. However, in this study working capital, return on equity is employ as control variables that are of no high interest to the researcher. Lending rates are fixed by financial institutions and there is no consideration given to how the rate may affect firms and their performance financially and that stands the reason for making lending rates as the independent variable. The conceptual framework envisage that financial performance will change whenever there is an alteration in the lending rates of financial institutions from which firms lend funds for their operations. The study employs some control variables that may determine the financial performance of a firm using the return on assets.

Figure 2.1 Conceptual Framework



Source: Researchers own Development

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This aspect of the study provides an introduction on the research methodology which the researcher plans to use in investigating the effect of lending rate on financial performance of Oil Marketing Companies in Ghana. The chapter discusses the research design, research data, method of data collection, model for the analysis and the data analysis.

3.1 Research Design

The study uses quantitative research design to explain the existing link between lending rate and financial performance of indigenous Oil Marketing Companies in Ghana.

3.2 Data and Data Collection

The study uses secondary data as a source of data to quantitatively test the relationship existing between the variables. The study collects lending rate data from the central bank of Ghana and also financial statements of the Oil Marketing companies. The study gathers panel data from the period of 2008 to 2018 on lending rates and financial performance of the OMCs.

3.3 Model Specification

It will entail data to be obtained from the different oil marketing companies at time periods. Based on the objectives and the data, hence panel regression model would be best for fitting the relationship between financial performance of OMC and lending rates. Fundamentally, there are fixed and random panel data models. However, the study uses Hausman test to determine appropriate model. The models adopted for the study are:

$$ROA_{it} = \alpha + \beta_1 LIN_t + \beta_2 WOC_{it} + \beta_3 FSZ_{it} + +\mu_{it} \qquad (1)$$

$$ROE_{it} = \alpha + \beta_1 LIN_t + \beta_2 WOC_{it} + \beta_3 FSZ_{it} + +v_{it} \qquad (2)$$

Where α is the constant, β_1 β_2 β_3 and β_4 are coefficients for lending interest rate, working capital, firm size and Net profit margin. μ_{it} and v_{it} are the error terms in the two equations respectively.

The financial performance of the companies will be measured in terms of ROA_{it} (return on assets of company i at time t and ROE_{it} (return on equity company i at time t).

LIN_t represent the lending interest rates at time t, used as the independent variable. Other variables in the model described below would be utilised as control variables

WOC_{it} = working capital of company i at time t

$FSZ_{it} =$ firm size or the size of company i at time t

3.4 Data Analysis

The data analysis starts by gathering the data from the various secondary sources and the data to be collected will be streamlined to reduce any form of errors that pertains to the data. Outliers both at the lower end and the upper end are eliminated to ensure that the data are smooth for the analysis. The entire data are keyed into a STATA computer package to generate the various test results in order to successfully carry out the analysis. The study uses the tables to presents its results after estimating the above models.

CHAPTER FOUR

RESULTS AND DISCUSSIONS

4.0 Introduction

This chapter presents and analyses data. The analysis begins with the examination of the properties of the data, followed by the regression analysis. The chapter ends with the discussion of results.

4.1 Presentation of Data and Data Analysis

The results of the descriptive statistics have been displayed in Table 4.1. The specific measures considered include mean, standard deviation and skewness.

Table 4.5 Descriptive Statistics

Variables	Obs.	Min	max	Mean	sd.	Skewness
ROE	54	0.108	0.427	0.216	0.078	0.661
ROA	54	0.011	0.413	0.042	0.059	5.080
Lending rate	54	0.239	0.289	0.266	0.014	-0.113
Working capital	54	0.012	1.348	0.604	0.227	0.235
Firm size	54	1.098	2.397	1.760	0.251	0.092

Source: Stata Output, 2020

The results from Table 4.1 as depicted above reveal the mean ROE of the companies is 0.216. It means that on average the oil marketing companies make 21.6% as returns on owners' investments. It is also evident that the oil marketing companies averagely make 4.2% as returns on their assets (ROA). Lending interest rate in Ghana within the period is estimated at 0.266(26.6%) on the average. Working capital also displays a mean of 0.604 (60.4%). It reveals that these companies have a good chunk of cash for their business operations. It also shows that their current assets are highly above their current liabilities. Moreover, firm size is estimated at an average 1.76, revealing that the companies on the average are largely sizeable in terms of assets accrued to them.

Table 4.6 Correlation between variables

	ROE	ROA	Lending rate	Working capital	Firm size
ROE	1.00				
ROA	0.223	1.00			
Lending rate	-0.659*	-0.421*	1.00		
Working capital	-0.014	0.273*	-0.013	1.00	
Firm size	-0.254	-0.096	0.001	-0.116	1.00

*Note; n = 54, *Correlation is significant at $p < 0.05$*

Source: Stata Output, 2020

The correlation matrix above ascertains the correlation or level of association existing between the variables used in the study. It is pointed out that there is some significant association between some of these variables. ROE has a significant negative (-0.659) correlation with lending rate. It suggests that there is a negative association between the two variables. Again, lending rate is negatively correlated with ROA. Furthermore, working capital has a significant positive correlation with ROA. All other correlations between variables are not significant.

The conclusion is that there is negative relationship existing between the dependent variables which are return on equity (ROE) and Return on Asset (ROA) and lending rate of banks. It implies that as lending rate increases, the ROE and ROA of oil marketing companies in Ghana decreases. However effective working capital management reveals a positive correlation with return on assets of Oil Marketing companies.

4.2 Effect of Lending Rate and other Factors on Return on Equity (ROE)

The study in this section examines the influence of lending rate and other factors study on the performance of the companies with regards to returns on equity.

Table 4.3 Hausman Test (ROE)

	Fixed (b)	**Random (B)**	**Diff (B-b)**	**S. E.**
Lending rate	-3.5312	-3.5311	-0.0001	0.0427
Working capital	-0.0090	-0.0090	0.0001	0.0034
Firm size	0.0185	-0.0011	0.0196	0.0191
Chi2 (χ^2)	1.08			
Prob.	0.782			

Source: Stata Output, 2020

The test above seeks to identify if the differences in the estimate of the correlation coefficients of the fixed and random effect panel models are systematic. The test basically ascertains whether the unique errors are correlated with the regressors. The p-value (0.782)

> 0.05 of the test is insignificant at 5%. Therefore, the random effect model becomes the preferable model to use.

Table 7.4 Random-effect GLS regression (ROE)

	Coef.	Std. Err.	z	P>|z|	95% Confi. Interval	
Lending rate	-3.531	0.345	-10.23	0.000	-4.207	0.950
Working capital	-0.009	0.023	-0.38	0.702	-0.055	0.037
Firm size	-0.001	0.042	-0.03	0.979	-0.083	0.081
Constant	1.164	.121	9.59	0.000		1.402
No. of Obs.		54	R-square	0.437		
No. of groups		6	R	0.661		
Wald χ^2		104.64				
Prob.		0.000				

Source: Stata Output, 2020

The results also reveal that 43.7% of the changes in ROE have been accounted for by the variations in the independent variables. The results show that there is a negative relationship between ROE and lending rate. The regression coefficient is -3.531. This is significant 1% significance level. This is observed at 1% significance level. It means the prediction of a negative relationship is confirmed. It implies that lending rates significantly influence oil marketing company's performance in terms of return on equity.

Regarding the other factors included in the study, working capital and firm size have a negative but insignificant effect on return on equity of oil marketing companies. These are shown by respective p-values greater than 0.05.

4.3 Effect of Lending Rate and other Factors on Return on Assets (ROA)

In this section the study analyses the effect of lending rate on the financial performance of oil companies when financial performance is measured by the return on assets. The appropriate regression estimation technique is selected by performing the Hausman test. The results are reported in Table 4.5. The results show that the random effects model is the appropriate panel estimation technique.

Table 4.8 Hausman Test (ROA)

	Fixed (b)	**Random (B)**	**Diff (B-b)**	**S. E.**
Lending rate	-1.6809	-1.6827	0.0017	0.0568
Working capital	0.0861	0.0783	0.0077	0.0079
Firm size	-0.0394	-0.0204	-0.0189	0.0484
Chi2 (χ^2)	1.00			
Prob.	0.802			

Source: Stata Output, 2020

The results of the effect of lending rate on the financial performance of oil companies when financial performance is measured by the return on assets are reported in Table 4.6

Table 4.6 Random-effect GLS regression (ROA)

	Coef.	Std. Err.	z	P>|z|	95% Confi. Interval	
Lending rate	-1.682	0.463	-3.63	0.000	-2.591	-0.775
Working capital	0.078	0.031	2.51	0.012	0.017	0.139
Firm size	-0.020	0.038	-0.53	0.594	-0.096	0.055
Constant	0.479	0.143	3.34	0.001		0.760
No. of Obs.		54	R-square	0.252		
No. of groups		6	R	0.502		
Wald χ^2		20.25				
Prob.		0.000				

Source: Stata Output, 2020

The coefficient of determination (0.252) shows that only 25.2% of the variation in ROA is explained by the variation in the lending rates and the control variables. The relationship between ROA and the lending rates is negative and statistically significant. This is observed at 1% significance level. It implies that, holding other factors constant, an increase in the lending rates in Ghana is associated with a drop in the financial performance of oil marketing companies. This may be explained in terms of high operational costs occasioned by higher interest payments on funds borrowed by the companies for their operations.

Regarding the two control variables, the results show that whereas working capital exhibits a positive and statistically significant effect on financial performance firm size shows a negative and statistically insignificant effect. An improvement in the working capital position of oil marketing companies is accompanied by an improvement in the financial performance of the companies. Having sufficient working capital usually makes a firm able to take advantage of opportunities as well as pay their short-term obligations as and when they fall due.

4.4 Discussion of the Findings

The study examines the impact of lending rates on the financial performance of oil marketing companies in Ghana. Findings reveal slightly high lending rates in Ghana over the period of 2008 to 2019, averagely 0.266 (26%). This indicates that the cost of capital for debt financing by investors and businesses in Ghana has been about 26%. This may be advantageous to commercial banks in the financial industry since it will boost their financial performance due to the possibility of a rise in the returns on their loan portfolio. This lending rate will however not favour borrowers such as Oil Marketing Companies which require huge sums of capital for their operation and investment, since they have to pay more for the cost of capital. The high level of lending rates within the period can be attributed to Froyen (1996) theory of loanable funds. High lending rates in Ghana can therefore be as a result of demand for loanable funds exceeding the supply, in context this the theory of loanable funds is been applied by the central bank of Ghana to control the demand for loans.

The study discloses a significant statistical negative effect on the financial performance (in terms of both ROE and ROA) of Oil Marketing Companies in Ghana. This confirms the findings of Garman and Grable (2012) and Corrol and McCann (2015), who have proposed an inverse relationship between lending rates and performance of financial institutions. Contrary to these findings, Mwangi (2017) and Irungu (2013) reveal that lending rate has a positive effect on the performance of commercial banks since it increases the cost of loan charged on borrowers. On the other hand, Kipngetich (2011) finds no significant effect of lending rates on financial performance. This study aligns with the studies that have reported a negative relationship between lending rate and the financial performance of firms. Since almost all previous have not paid attention to oil marketing companies the current study represents a very important piece that enriches the extant literature.

CHAPTER FIVE

SUMMARY OF FINDINGS CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

The fifth chapter of the study focuses on the summary, conclusion and recommendation on the study. Accordingly, the chapter is divided into three sections. Section provides summary of findings. Section two focuses on the conclusion of the study whilst section three provides the recommendations of the study.

5.1 Summary

The core aim of this study is to examine the impact of lending rates on the financial performance of Oil Marketing Companies in Ghana. The findings reveal that lending rates significantly affects Oil Marketing Companies. The findings of the analysis reveal a negative relationship between ROE and lending rate. The study also pointed out that 43.7% of changes in ROE pertains to variations in lending rate. The research again reveals a negative regression coefficient of -3.531which is significant at 1% corroborating the negative relationship between ROE and lending rate. In addition, the study reveals further that negative significant relationship between ROA and lending rates with regression coefficient of 1.6809 and shows that 25.2% of variation in ROA is explained by lending rate. The study implies that increase in lending rates in Ghana is associated with a decline in financial performance of Oil marketing companies. The summary of the study shows that lending rate has negative relationship with return on equity (ROE) and return on asset (ROA). This implies that financial performance of oil marketing companies is poor owing to high lending rate prevailing in the Ghanaian economy.

5.2 Conclusion

The purpose of the research is to examine the effect that lending rates have financial performance of Oil Marketing Companies in Ghana. The study is carried out using two specific objectives which are to examine the effect of lending rate on financial performance of indigenous Oil Marketing companies in Ghana and to examine other factors that influence the financial performance of indigenous Oil Marketing companies in Ghana. The researcher approaches the thesis using quantitative design and depends on secondary data for its analysis. The results show that lending rates are negatively related to the financial performance of oil marketing companies. Based on this, the study concludes that an ineffective monetary policy that results in hikes in interest rates may be injurious to the financial performance of oil marketing companies.

5.3 Recommendations

The findings of the study reveal that lending rates have adverse effect on return on equity and return on assets which are measures financial performance of the oil marketing employed for the study. This implies that a sound and effective monetary policy that succeeds in bringing interest rates down carries some hope for the oil marketing companies.

It is also recommended that government should set up an Oil Marketing Capital fund to support all the oil marketing companies that are struggling with financial performance owing to high lending rate. To ensure the success of such a fund, the government should set up a committee which will scrutinize the performance of the firms for financial assistance.

The study reveals that working capital management has a positive effect on financial performance. It is, therefore, recommended that management and board of directors of Oil Marketing Companies should pay attention to the working capital management. They should develop a strategic governance framework for working capital management to ensure that challenges confronting managing daily activities of them firms are addressed.

To the extent that the study has not covered all oil marketing companies in Ghana, it will be interesting if the issues addressed in it are addressed with bigger data involving all or a greater number of Oil Marketing companies in Ghana.

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