

Chapter IV.

COMMERCIAL BANKS: SOURCES AND USES OF FUNDS

1. INTRODUCTION

There are three commercial banks in Sierra Leone. These are the Standard Bank of West Africa Ltd. (formerly the Bank of British West Africa Ltd., 1894-1957; the Bank of West Africa Ltd., 1957-1971), Barclays Bank D.C. & O. Ltd., and the Sierra Leone Commercial Bank since 1973.

The Standard Bank of West Africa Ltd. was incorporated in Liverpool and its objective was to take over the banking business of Messrs. Elder Dempster Lines and Company. By the end of 1894 the bank had three branches, which were located in Lagos, Accra and Freetown. Since then the bank has established branches throughout West Africa, especially in territories formerly controlled by Britain, and by the end of 1976 operated 14 branches in Sierra Leone. This bank is jointly owned by Lloyds Bank Ltd., Westminster Bank Ltd., National Provincial Bank Ltd., and Standard Bank of South Africa Ltd.¹ At the same time the bank is interlocked

¹ The need for the services of a bank was first felt by merchants who considered it inconvenient to transport large stocks of money from place to place. It was as a result of representations by them to their principals in London that the African Banking Corporation was persuaded to open a branch in Lagos in 1892. When this office was closed a year later, it was a shipowner, Sir Alfred Jones, who

by common directors with Midlands Bank Ltd., Coutts and Company Ltd., and the Yorkshire Penny Bank Ltd.

Barclays Bank D.C. & O. Ltd. originated from the colonial bank which was established by Royal Charter in 1836 to undertake banking business in the West Indies. The first office of the bank in Sierra Leone was opened in 1916. The Colonial Bank merged with the Anglo Egyptian Bank Ltd. and the National Bank of South Africa Ltd., and this affiliate became Barclays Bank D.C. & O., a subsidiary of Barclays Bank Ltd., one of the big "five" in the United Kingdom. In 1925, the year of its incorporation, Barclays Bank D.C. & O., had the same chairman and deputy chairman as Barclays Bank Ltd. (London). Other directors of the bank came from the Bank of Australia, the Eastern Bank, the Bank of New South Wales, and the Seson Banking Company. Unlike the Standard Bank of West Africa Ltd., whose activities are concentrated in Africa, Barclays Bank D.C. & O's activities are more worldwide. Of its 1,600 branches throughout the world in 1976, 13 were in Sierra Leone. Thus, Barclays Bank D.C. & O., and the Standard Bank of West Africa between them operate 27 of the 30 commercial banking offices in Sierra Leone.

Intra Bank (S.L.) Ltd., a Lebanese-owned bank which did business in Sierra Leone between 1964 and 1970, ceased operations

persuaded Elder Dempster and Company to acquire and run the branch that was abandoned by the African Banking Corporation. This new bank not only dealt with the shipowners but also kept the accounts of the colonial government and controlled the flow of British coins into the Lagos colony. In 1893 the government stipulated two conditions for its continued patronage of the bank. These were that the bank should operate independently of the shipping business and should be registered as a joint stock bank. To meet these conditions the British banks listed above founded the Bank of West Africa on 31st May 1894, with Sir Alfred Jones as chairman. It was this bank that opened a branch in Sierra Leone in 1898, its primary purpose being to facilitate trade. This point must be emphasized because it largely explains why the finance of foreign trade has been and continues to be their main business.

in 1970 due to the financial difficulties of the parent bank in Beirut. But after the resumption of business in Beirut of the bank, its branch in Sierra Leone was still unable to satisfy local licencing requirements as a result of which the government decided to take over the bank.

The third bank, the Sierra Leone Commercial Bank began operations on 15th February 1973. This bank is wholly owned by the Sierra Leone government. Although this bank is located at the premises previously owned by Intra Bank it is a completely new bank. The bank's first provincial branch was opened in Koidu Town on 18th June 1973. This was followed a few months later by another branch in Kenema. A third branch was opened in Njala during 1976.

Even with the emergence of the government-owned Sierra Leone Commercial Bank the banking structure of the country is virtually foreign dominated since the total assets of the local bank account for less than 20 per cent of the assets of all commercial banks.

The main consequences of these external connections are: In the first place, the banking operations in Sierra Leone form only a very small part of the bank's total banking business; secondly, the head offices of these banks as well as the directors and shareholders are outside Sierra Leone; thirdly, it is at the head offices that general policies are formulated. The situation is likely to change in the future as a result of two recent legislations in Sierra Leone; these are the Banking Act of 1970, and the Banking (Amendment) Act of 1971.

The significance of the Banking Act of 1970 and the Banking (Amendment) Act of 1971 is to reduce the dependence of the banks from external influences. First, Section 10 (a) of the 1970 Banking Act requires every bank to maintain assets in Sierra Leone equivalent to 85 per cent of their liabilities in the country. The effect is to reduce the flow of resources from Freetown to their head of-

fices. The other sub-sections of Section 10 authorize the Bank of Sierra Leone to determine the forms in which these assets are to be held. Second, Section 6 (b) on minimum paid-up capital states that banks whose head offices are outside the country should, in lieu of paid-up capital, deposit with the Bank of Sierra Leone Le 0.8 million out of their own resources transferred from abroad.

In the case of the Banking (Amendment) Act of 1971, the important provision in terms of making the banks self-contained is Section 8 (c). This section enables a bank whose head office is outside Sierra Leone to transfer its assets and liabilities to a bank incorporated within Sierra Leone. Both Standard Bank of West Africa and Barclays Bank D.C. & O. have made use of this provision and have transferred their assets and liabilities in the country respectively to Standard Bank (Sierra Leone) Ltd., and Barclays Bank (Sierra Leone) Ltd.

But as we shall see later in this chapter, these provisions are not likely to result in any significant inflow of resources as already throughout the 1960's the banks have brought in funds from their head offices, with the result that their assets in the country are greater than the 85 per cent required by the 1970 Banking Act.

In 1950, there were only three bank branches in the country. Ten years later, that is, at the end of 1960, there were twenty banking offices and at the end of 1976 the number had increased to thirty-six. The distribution of these offices by provinces is as follows:

Western Area	16
Eastern Province	9
Southern Province	6
Northern Province	5

The increase in the number of banking offices especially since 1960 partly contributed to the growth in deposits observed during

the period as they were established in towns which previously had only offices of the Post Office Savings Bank. With a population of approximately 3.5 million and a total of 36 banking offices this gives about 100,000 persons to a banking office.

The towns which have banking offices include the main commercial centres. Some important areas are, however, still without banking offices. For example, Kabala in the north is an important cattle centre and has a population of over 5,000. The area around Pujehun is an important piassava and rutile region. Baoma, Yarmandu, Jaima Town, Kailahun, each with a population of 5,000 have no commercial banking facilities. One feature of these areas is that activities are concentrated in the three or four months of the harvest season.

2. SOURCES OF FUNDS

From Table 16 which shows the consolidated balance sheet of commercial banks, it can be seen that the main sources of funds available to the banks are deposits and borrowings from head offices.

Deposits

Commercial banks accept three classes of deposits: savings, time and demand. The minimum deposit acceptable for a savings account at a bank is Le 10 while the minimum for a time deposit is Le 100. Demand deposits, as the name implies, can be drawn upon demand (by means of a cheque) while time deposits require a period of notice ranging from three months to a year. Withdrawals from a savings account can take place at any time as long as the operating balance is over Le 10. But as a result of frequent withdrawals, banks now charge 20 cents for every withdrawal in excess of four during a calendar month.

Total deposits rose from Le 9 million in 1960 to Le 70.7 million by the end of 1976, an increase of Le 61.7 million, over half of which occurred during 1972-1976. All three categories of deposits increased, but the growth was particularly rapid in savings and time deposits. While time deposits rose from Le 0.4 million in 1960 to Le 16.6 million by 1976, savings deposits went up by Le 20.3 million between the two dates. Demand deposits on the other hand gained Le 25.2 million during the period under review.

The larger growth in savings and time deposits combined if compared with demand deposits may reflect the lack of convenience in using cheques in the settlement of debts. The inefficiency of cheque services has been cited as one of the general characteristics of the monetary system of underdeveloped countries. Thus Khazzoom observes: "... it is almost universally true, that, except for a limited range, checking deposits cannot be used in underdeveloped countries to pay for transactions before they are converted into currency".² He goes on to argue that "... the choice facing the individual in underdeveloped countries is not between currency and demand deposits, as much as between currency and savings and time deposits".³

Further evidence that demand deposits are not widely used in the settlement of debt in Sierra Leone can be obtained from the turnover rate of demand deposits.

The turnover rate of demand deposits is a measure of the extent of use of demand deposits during the year. If the velocity is high this indicates the growing use of cheques and the ease of acquiring non-monetary assets. A low velocity on the other hand would suggest that securities other than monetary and near money assets are not easily available. Sierra Leone's velocity of demand

² Khazzoom, *op. cit.*, p. 111.

³ *Ibid.*, p. 80.

deposits has not only been low but it has not changed much during the period of our study fluctuating between 3.16 and 4.33. In contrast to a velocity of about 3.0 for the country in 1976, the East African Currency Board Area had a velocity of about 10 in 1963.⁴

A detailed breakdown of the ownership of deposits at commercial banks (aside from the deposits of the government and public corporations) is not available. The breakdowns given in Table 17 are our own estimates. For the period 1960-1965 the breakdown is estimated as follows: Individuals 68.5 per cent; government 10.0 per cent; commercial firms 18 per cent; others 3.5 per cent. These estimates are based on the following assumptions discussed with the commercial banks: (a) Individuals equal all savings deposits plus 50 per cent each of demand and time deposits (average for the period 1960-1965); (b) Government equals the sum of the percentages of government and public corporations at commercial banks; (c) Commercial firms equal 50 per cent of time deposits plus 25 per cent of demand deposits (average for the period 1960-1965); (d) Others are the residual.

For the period 1966-1976 information relating to ownership of deposits was obtained from commercial banks.⁵ From the available information, deposits of individuals averaged 69.3 per cent, those of commercial firms 13 per cent, and financial institutions 1.1 per cent. Figures relating to government and public corporations deposits have been shown separately in the balance sheet

⁴ H.L. Engberg, "Commercial Banking in East Africa", in *Applied Economics of Africa*, Vol. 2: *Macro-Economics*, H. Whetham and Jean I. Currie (eds.), Cambridge, University Press, 1967, p. 55.

⁵ This piece of information however was only in respect of the period 1969-1971. No hints suggest that the data relating to that period have changed significantly since then. Hence they have been assumed as good for the whole period.

since December 1966. These figures have not been averaged but taken as given. The remaining deposits at commercial banks which are treated as residual are grouped together in the category "other deposits".

These ratios were then applied to total deposits as given in Table 16 to obtain Table 17. The most important feature of the latter table is that individuals have accounted for more than two-thirds of the deposits mobilized by commercial banks during the period under review.

Borrowings from head offices

In addition to local deposits, commercial banks being branches of foreign international banks have access to funds from their head offices.

They have made use of this facility to a considerable extent as such borrowings have ranged between Le 0.1 million and Le 7 million during the years 1963-1966 when they averaged 24 per cent of total liabilities. By the end of 1976, however, head office borrowings accounted for less than 1 per cent of total liabilities.

Other liabilities including capital

The 1964 Banking Act defined the minimum paid-up capital of each foreign commercial bank operating in the country as Le 0.4 million. This amount (as we have seen) was raised to Le 0.8 million by the 1970 Act.

As regards reserves, another item in this category of liabilities, the banks are required to transfer 50 per cent of their net profits to reserves until the reserve fund is equivalent to one half of their paid-up capital. Once this level is attained transfers from net profits can be reduced to 25 per cent.

Liabilities on documentary credit and guarantees make up the rest of the banks' liabilities. These arise in connection with the financing of the export/import trade.

Factors explaining the expansion of deposits

The level of deposits at commercial banks depends, on the one hand, on supply factors which emanate from the operations of the banking system while on the other it depends on demand factors which reside in the willingness of the public to hold bank deposits in competition with other types of assets.

The relevant factors on the supply side include the liquidity requirement which the commercial banks are obliged to observe; the acquisition or loss of foreign assets; and the lending policies of the banks, which are greatly influenced by their views on what a good credit risk is or is not. On the demand side, the most important factors are the relative preference of individuals for borrowing from commercial banks, prices and the rate of interest. We now examine these variables in turn omitting the non-quantitative variables.

In the case of the liquidity ratio, all other things being equal, the higher the ratio imposed on the banks, the lower will be the level of deposits. Thus, the level of deposits will be lower if the liquid assets/deposits ratio is 40 per cent than if the ratio is 15 per cent. Liquid assets consist of cash, balances with the central bank and other banks in Sierra Leone, money at call with the central bank, and holdings of Treasury bills and short term government stock. Cash holdings of the banks did not change much during the period under study. This is also true of deposits with the central bank. Most of the changes that have occurred in the behaviour of liquid assets were in money at call and the banks' holdings of government securities.

To the extent that the public prefers to borrow from commercial banks and those who seek commercial banks' loans meet

TABLE 16
AGGREGATED STATEMENT OF ASSETS AND LIABILITIES OF COMMERCIAL BANKS: ASSETS
(thousand Le)

Years	Cash in hand	Balance with		Money at call in Sierra Leone	Treasury bills and other bills discounted and payable		Loans and advances	Other assets including premises	Total assets
		Banks in Sierra Leone	Head office and branches		in Sierra Leone	outside Sierra Leone			
1960	1,168	164	1,164	—	—	—	5,460	3,030	10,986
1961	1,284	44	892	—	—	—	7,022	4,988	14,230
1962	1,334	144	796	—	—	—	9,984	3,492	15,750
1963	1,712	148	8	—	16	—	13,978	4,882	20,744
1964	1,599	653	66	980	1,126	1,603	14,850	5,202	26,079
1965	1,315	921	189	1,660	1,204	42	14,548	5,837	25,716
1966	1,641	285	226	2,830	2,093	10	15,250	5,409	27,744
1967	1,263	825	181	1,490	3,187	27	15,214	5,713	27,900
1968	1,826	1,186	976	1,165	6,473	41	15,698	9,264	36,629
1969	1,839	1,655	417	2,295	5,965	3	16,178	7,906	36,258
1970	1,305	1,144	70	1,715	6,000	—	18,743	8,334	37,311
1971	1,604	756	394	1,325	7,041	338	19,282	11,508	42,248
1972	1,567	865	343	975	8,785	6	21,078	10,785	44,404
1973	1,733	1,101	2,081	2,080	10,751	—	28,076	28,920	74,742
1974	1,429	834	3,549	4,515	17,711	—	35,200	25,619	88,857
1975	1,235	271	2,402	2,540	19,836	—	38,416	23,862	88,562
1976	3,270	266	3,959	4,285	22,140	—	42,711	34,320	110,951

TABLE 16 (contd.)
 AGGREGATED STATEMENT OF ASSETS AND LIABILITIES OF COMMERCIAL BANKS: LIABILITIES
 (thousand Le)

Years	Deposits			Balance due to		Bills payable	Other liabilities and capital	Total liabilities
	Total	Demand	Savings	Time	Balance in Sierra Leone	Head office and branches		
1960	9,044	5,784	2,910	350	172	590	1,180	10,986
1961	10,764	6,970	3,442	352	62	1,300	2,104	14,230
1962	12,524	6,860	4,018	1,646	142	1,612	1,472	15,750
1963	12,740	7,256	4,746	738	182	5,810	2,012	20,744
1964	15,255	8,330	6,027	898	22	7,021	3,776	26,079
1965	15,132	7,272	6,609	1,251	141	5,702	4,697	25,716
1966	16,714	7,772	7,118	1,824	90	5,921	4,977	27,744
1967	17,466	8,368	6,697	2,401	11	5,171	5,196	27,900
1968	21,520	9,940	8,598	2,982	13	4,312	10,701	36,629
1969	25,670	11,664	10,269	3,737	31	2,433	8,054	36,258
1970	24,395	10,051	10,824	3,520	135	1,609	11,043	37,311
1971	27,035	11,483	11,623	3,929	108	4,439	10,576	42,248
1972	31,272	13,675	13,304	4,293	—	103	12,670	44,404
1973	40,526	17,539	16,978	6,009	262	2,297	31,324	74,742
1974	51,839	22,152	17,553	12,134	175	4,805	30,559	88,857
1975	53,468	22,148	20,924	10,396	34	2,499	31,120	88,562
1976	70,750	30,916	23,197	16,637	85	370	39,115	110,951

Source: *Quarterly Statistical Review of the Bank of Sierra Leone*, No. 5, June 1966, Table 8 and *Economic Review of the Bank of Sierra Leone*, Nos 3 and 4, July - December 1976, Table 6.

TABLE 17

OWNERSHIP OF DEPOSITS AT COMMERCIAL BANKS
(thousand Le)

Years	Financial institutions	Others	Commercial firms	Individuals	Public corporations	Government	TOTAL
1960	290		1,627	6,195	932		9,044
1961	345		1,937	7,373	1,109		10,764
1962	401		2,254	8,579	1,290		12,524
1963	407		2,293	8,727	1,313		12,740
1964	489		2,745	10,450	1,571		15,255
1965	484		2,724	10,365	1,559		15,132
1966	1,237		2,173	11,583	1,153	568	16,714
1967	192	1,566	2,271	12,104	624	709	17,466
1968	237	2,167	2,798	14,913	809	596	21,520
1969	282	2,264	3,338	17,789	1,257	740	25,670
1970	268	2,491	3,172	16,906	1,172	386	24,395
1971	298	3,608	3,515	18,735	635	244	27,035
1972	344	3,759	4,065	21,672	1,151	281	31,272
1973	446	3,467	5,269	28,085	2,931	328	40,526
1974	571	5,335	6,739	35,924	2,780	490	51,839
1975	589	7,084	6,950	37,053	1,402	390	53,468
1976	779	6,332	9,197	49,032	4,831	579	70,750

Source: Calculated from Table 16.

the required conditions, the volume of deposits will also increase. On the other hand, if the public prefers borrowing from non-bank financial institutions, then the commercial banks are likely to make fewer loans and the volume of deposits will in consequence be smaller. Our conclusion in Chapter VI is that non-bank financial institutions have invested most of their resources in government securities and in financial assets which originate from outside the economy. It can therefore be assumed that the public would prefer to borrow from commercial banks.

In the case of external reserves, a loss of reserves implies that this is the source from which the loan expansion is being financed. For example, there may be profitable investment opportunities but the level of deposits mobilized may be insufficient to take advantages of the opportunities. In such a case, the banks get the required funds by reducing the level of their external assets or they borrow from their head offices. Our analysis has shown that commercial banks have borrowed substantially from their head offices resulting in an overdrawn external position.

The price level is another variable which is likely to affect the level of total deposits. Rapid price rises may increase the need to borrow because they reduce the value of disposable personal income; and for the same reason reduce the amount of deposits that flows to banks. Between 1960 and 1970 the consumer price index rose from 96 in December 1960 to 140.9 by the end of 1970. This represents an annual increase of 4 percentage points. But we pointed out in Chapter II that there had been only marginal increases in wages during the 1960's.

The rate of interest affects the level of total deposits through its effects on willingness to borrow and to the extent that it influences saving decisions. During the 1960's the prime rate, that is, the rate payable by the banks' first class customers, ranged between 5.5 and 8.5 per cent. The rate of interest payable by other customers ranged between 12 and 14 per cent. In contrast, rates

of interest in the unorganized sector exceeded 100 per cent. Because the rate of interest in the organized banking system is lower (other things being equal) people would prefer to borrow from commercial banks. Hence, the prevailing low rate of interest should have a positive effect on the level of deposits.

We now show statistically which of the variables discussed explain the expansion in total deposits during the 1960's. We assume that the relationship between the variables selected and the dependent variable is linear; and take first differences to eliminate any trend that may exist between the variables.⁶ The following are the definitions of the variables shown in the table:

t One quarter.

TD_t Total deposits at commercial banks at time t at constant prices.

LP_t Loans and advances by commercial banks to the private sector at time t at constant prices.

⁶ The variables were tested under the following functional forms: (a) linear and (b) double log. The main difference between log and non-log functions is that in the case of the former, the coefficients are the elasticities of the variables with respect to the dependent variable. In the case of the latter, the coefficients represent the marginal product of the dependent variable with respect to the independent variable. Let us illustrate the difference with the following examples:

$$\begin{aligned} \Delta TD_t &= a_1 + a_2 \Delta LP_t + a_3 \Delta HB_t + a_4 \Delta ER_t = a_5 \Delta ER_t + e_{4t} \dots (1) \\ \Delta \log TD_t &= a_1 + a_2 \Delta \log LP + a_3 \Delta \log HB + a_4 \Delta \log ER + a_5 \Delta \log RR + e_{5t} \dots (2) \end{aligned}$$

The form of equation (1) implies that the change in total deposits at commercial banks has a constant marginal product with respect to each of the explanatory variables. The same equation in log form, that is, equation (2), means that the change in total deposits has a constant elasticity with respect to each of the explanatory variables.

AD Purchases of agricultural produce plus purchases of diamonds at time t at constant prices.

RR_t Required reserves defined as 30 per cent of total deposits at time t at constant prices.

ER_t Reserves over and above 30 per cent of total deposits at time t at constant prices.

HB_t Head office borrowing at constant prices at time t .

Deflator — we have not used the national income deflator as our analysis is based on quarterly figures. The deflator used is arrived at as follows: The consumer price index for Freetown with 1961 = 100 is converted into a series with June 1964 = 1.

Assumptions — conforming to the usual least squares ones. Our best results are given in Table 18.

The level of savings and time deposits could be explained by disposable personal income, yields on these deposits and net alternative yields on other assets. We showed in Chapter II that GNP grew at an annual average rate of 3 per cent in real terms during the years 1963/64 to 1975/76. We would therefore expect some of this increased income to be saved. The explanatory variables on the income side are foreign trade, the level of government expenditure, prices monetization and the rate of interest. We now examine these variables in turn.

Virtually all economic activities are centred around the foreign trade sector.⁷ Consequently, significant changes in the value of exports and imports can affect people's income. Between 1960 and 1976 domestic exports went up by approximately Le 3 million annually. Except for 1962 and 1967 when there were substantial

⁷ See Chapter II.

TABLE 18

REGRESSION RESULTS: TOTAL DEPOSITS
(first difference)

Dependent variable	Constant	Coefficients of explanatory variables					Durbin-Watson statistic	DF
		AD	RR	ER	LP	HB		
TD_t	253.2677 (2.2300)**	0.2322					0.2263	17
TD_t	10.4204		1.3210 (4.4121)**				0.4282	26
TD_t	-36.1316		1.4564 (5.1889)**	0.2296 (1.6081)*	0.2214 (1.8171)*		0.5616	26
TD_t	-45.74077		1.3219 (4.9088)**	0.4070 (2.5939)**	0.3602 (2.7517)**	-0.2078 (-2.1387)**	0.6343	23

Notes:

Figures in parentheses are the t ratios.

* Significant at the 5 per cent significance level.

** Significant at the 1 per cent significance level.

DF are degrees of freedom.

There is no serious problem of multicollinearity because, firstly, the partial correlation coefficients as indicated in the correlation matrix do not show any high correlation between the independent variables; secondly, the coefficients do not change significantly with the introduction of additional variables; thirdly, an examination of the standard errors of the regression coefficients shows that they are not very large (this note applies to all our regression results).

Source: *Economic Review of the Bank of Sierra Leone*, No. 4, March 1972, Table 5.

declines, this growth continued throughout the 1960's. With a continuous rise in the value of exports, one would expect that some of the increased incomes would be saved. But from the point of view of savings and time deposits we consider the activities of the Sierra Leone Produce Marketing Board (SLPMB) and the Government Diamond Office (GDO) of particular importance. This is because purchases of the SLPMB and the GDO accrue to individuals directly as incomes. Export proceeds on the other hand need not accrue directly as income because some may be retained abroad by the mining companies or the Marketing Board.

The level of government expenditure affects incomes and hence the level of savings and time deposits at commercial banks, because a large part of it is for wages and salaries.

Price movements influence the level of savings and time deposits as some people are likely to save less since rising prices reduce the value of disposable income. At the same time, others, saving for a specific purpose, may save more in order to be able to purchase the required articles at current prices.

The monetization of the economy, that is, the reduction of subsistence activities should increase the level of savings and time deposits, as some of the income, being in the form of money, is likely to be diverted to commercial banks. As suggested by Engberg,⁸ we consider total debits an approximate indicator of the extent of monetization. The monetization index thus derived is obtained by dividing total debits by GDP. The resulting index with 1965 = 100 rose throughout the period and was 134 by the end of 1976. There was however a substantial decline in 1966 and 1967 to 90.4 and 94.7

⁸ "As the aggregate volume of payments made through the banks depends on the total number of transactions and purchases of all kinds and on the methods of effecting payments, total debits may be used as an approximate index of the degree to which the money economy has been diffused in a developing country". Engberg, *op. cit.*, p. 59.

respectively due mainly to the general lull in economic activities that followed the financial crisis of those years.

The rate of interest on savings and time deposits might be expected to affect their own level. It could be argued that those people who save for a specific purpose would tend to save less if the rate of interest rises significantly. Others may be induced to save more to take advantage of the higher interest rate. However, during the 1960's there was only one change in the rate of interest payable on savings deposits. This change occurred in November 1967, and was one of the policy measures introduced by the Stabilization Programme of 1967 discussed in Chapter II. This change raised the rate of interest on savings deposits from 3 to 4 per cent. In the case of time deposits, there were two changes in the rates. The first occurred in November 1965, when the rates on 3-6 months, 6-12 months, and over 12 months, which were respectively 2.5, 3 and 3.5 per cent, went up by 0.5 per cent in each case. The second upward movement in the rates took place in November 1967. This time, however, there was a 1 per cent rise in each of the three categories. As the rate of interest did not change very much during the 1960's it would be difficult to come to any definite conclusion about the effect of the rate of interest on the amount of net savings.

Out of the choices available to the individual, he may decide to hold his savings in cash, in the form of Treasury bills and government stock, in an account with a commercial bank, and in the form of claims on non-bank financial institutions. What he actually does with his savings will depend on its amount, the expectations about his future commitments, the yield from each of the available assets, and his own psychological attitude about particular institutions. For example, he may distrust a government financial institution because he believes that his savings may not be safe with it. Alternatively, he may decide not to hold government securities because he believes the government will not redeem the securities when due. The fact of low income, however, restricts the choices open to him.

The minimum investment in Treasury bills and government securities is Le 500. Hence, investment in Treasury bills and government stocks by individuals accounted for only about 2 per cent of outstanding government securities at the end of 1970. Also, people do not have access to non-bank financial institutions because the minimum investments are quite large relative to their income. In addition, we show in Chapter VI that most of the non-bank financial institutions were only recently established and with the exception of one or two of them they do not mobilize deposits from the public. Thus, people would either hold their money in cash or in savings and time deposits at commercial banks.

We now show statistically which of the variables discussed above explain the expansion in savings and time deposits during the period under review.

The following are the definitions of the variables shown in the tables:

QM Savings plus time deposits at commercial banks at time t at constant prices.

AD Purchases of agricultural produce plus purchases of diamonds at time t at constant prices.

G Government total expenditure at time t at constant prices.

$\frac{dP}{dt}$ The rate of change of prices calculated from the Freetown consumer price index. We have used this index because it is the only one available.

Our best results are given in Table 19.

Following Snyder⁹ we assume that demand deposits adjust to currency in circulation; we also assume a one period lag. Our results are shown in Table 20.

⁹ Wayne W. Snyder, "Money in a Developing Economy", *Review of Economics and Statistics*, No. 4, 1968, p. 415.

TABLE 19

REGRESSION RESULTS: SAVINGS AND TIME DEPOSITS
(first difference)

Dependent variable	Coefficients of explanatory variables					Durbin-Watson statistic	DF
	Constant	AD	EG	$\frac{dP}{dt}$	R		
Log Functions							
Log <i>Q</i> _M	0.0143	0.1626 (4.6523)**		—0.8779 (—4.2006)**		0.6075	16
Log <i>Q</i> _M	0.0110	0.1624 (4.5178)**		—0.8507 (—3.7679)**	0.0581 (0.3495)	0.6107	15
Log <i>Q</i> _M	0.0113	0.1630 (4.5015)**	0.0089 (0.2067)	—0.8781 (—4.1321)**		0.6086	15

Notes: Figures in parentheses are the t ratios.

DF are degrees of freedom.

** Significant at the 1 per cent significance level.

Here we make use of the log specification not necessarily because it gives a better fit to the data, but to give some uniformity to the interpretation of the coefficients as the independent variables are measured in different units.

Source: Calculated from quarterly data in the *Economic Review of the Bank of Sierra Leone*, No. 4, March 1972, Tables 5 and 29, and *Quarterly Statistical Review of the Bank of Sierra Leone*, No. 5, June 1966, Table 8. Figures for purchases of agricultural produce are from the Sierra Leone Produce Marketing Board.

TABLE 20

REGRESSION RESULTS: DEMAND DEPOSITS
(first difference)

Dependent variable	Constant	Coefficients of explanatory variables			Durbin-Watson statistic	DF
		Z	Z, (lagged on period)	R ²		
D _d	447.43	0.5393 (9.3758)**		0.7717	0.7890	26
D _d	948.08		0.5185 (7.5430)**	0.6947	1.1273	26

Notes: Figures in parentheses are the *t* ratios.

** Significant at the 1 per cent significance level.

DF are degrees of freedom.

Source: Calculated from quarterly data in the *Economic Review of the Bank of Sierra Leone*, No. 4, March 1972, Table 5, and *Quarterly Statistical Review of the Bank of Sierra Leone*, No. 5, June 1966, Table 8.

We also tested the hypothesis that demand deposits are functions of the cash base. The cash base is defined as the banks' cash holdings plus their deposits with the central bank. That is:

$$D_t = a_1 + a_2 C_t + e_t$$

This equation yields an R^2 of only 0.129 and a Durbin-Watson statistic of 0.54. The log formulation produced similar results.

3. USES OF FUNDS

Commercial banks utilize the resources available to them for their lending operations and their holdings of liquid assets.

Loans and advances

Between 1960 and 1976 loans increased by approximately Le 30 million rising from Le 5.5 million in 1960 to Le 42.7 million by 1976. Most of the increases took place between 1960 and 1963 and between 1972 and 1976 when loans went up by Le 6.5 million and Le 21.6 million respectively.

This rapid expansion in the volume of loans and advances to the private sector suggests that there have been major changes in the lending policies of commercial banks since foreign banks operating in underdeveloped countries have usually been accused of conservative lending policies.¹⁰ In our view no significant change in policy has occurred. What in fact has happened is that there has been a major change in the method of financing the export/import trade.

Up to the late 1950's large commercial firms were very important sources of credit.¹¹ Table 21 shows the extent of such credit by one commercial firm in Nigeria and Ghana. This company also maintained branches in other parts of British West Africa. No detailed figures are available for Sierra Leone but they all the same illustrate the magnitude of credit provided by commercial firms. As can be seen from the table, credit took the form of advances to produce buyers during the crop season. In addition, the company disposed of its merchandise through African traders who

¹⁰ J. Mars, "The Monetary and Banking System and the Loan Market of Nigeria", in *Mining, Commerce and Finance in Nigeria*, M. Perham (ed.), London, Faber & Faber Ltd., 1947, pp. 207-208. H.A. de S. Gunasekera, *From Dependent Currency to Central Banking in Ceylon*, London, G. Bell & Sons Ltd., 1962, pp. 200-205. Newlyn and Rowan, *op. cit.*, Chap. 4. R.A. Sowem, *Towards Financial Independence in a Developing Country*, *op. cit.*, pp. 191-194.

¹¹ United Africa Company, *Statistical and Economic Review*, No. 4, September 1949, pp. 51-56.

TABLE 21

OPERATIONS OF THE UNITED AFRICA COMPANY IN RESPECT OF
PURCHASES OF PRODUCE IN THE 1947/48 BUYING SEASON

Products	Total value of produce purchased on behalf of marketing boards by United Africa Group	Proportion of purchases financed by money advances to middlemen	Average duration of advances	Estimated interval between purchase by company and payment by boards	Average period for which company must use its own funds
	(£ '000)	(%)	(days)	(days)	(days)
<i>COCOA</i>					
Nigeria	1,643	85	21	104	122
Gold Coast	6,334	100	10	23	33
<i>GROUNDNUTS</i>					
Nigeria	3,219	76	14	266	276
<i>PALM OIL</i>					
Nigeria	3,320	15	21	113	116
<i>PALM KERNELS</i>					
Nigeria	3,943	28	28	104	111

Source: United Africa Company, *Statistical and Economic Review*, No. 4, September 1949, p. 52.

were allowed to make payment for these goods after they had been sold. The company estimated the total value of such a credit in August 1948 at £ 1.4 million.¹² The magnitude of these credits led

¹² *Ibid.*, p. 55.

Newlyn and Rowan to make the following observations:

This figure (that is, the sum of net advances to produce buyers and advances to retailers) exceeded the total advances by the two British banks in Nigeria and the Gold Coast. The above figures which are unfortunately not available for later years, show that the United Africa Company is a more important lender than the two British banks together. Moreover, these figures relate to the period when buying activity is small and it is possible that in December advances to produce buyers are as high as £ 2 million.¹³

The magnitude of United Africa Company figures suggests the United Africa Company, which had branches throughout West Africa. But the possibilities are that other expatriate companies, which were also produce buyers and dealers in merchandise, also provided credit to African traders who were their middlemen, in which case the total volume of credit from commercial firms was quite considerable.

The magnitude of United Africa Company figures suggests that funds were raised outside West Africa. We have seen that the total amount involved in financing produce buying was £ 18.5 million (Le 39 million). The company also reported that at the end of 1948 it had to find £ 13 million (Le 26 million) worth of stock of general merchandise in, and in transit to, Nigeria and the Gold Coast, and in London and Manchester. And to meet its daily requirements for cash the company had to hold large sums in West Africa. At the end of August 1948, total cash holdings of the company were £ 6.9 million (Le 13.8 million). Thus, through these trading firms, a large number of small traders had access to credit which they would not otherwise have had.

¹³ Newlyn and Rowan, *op. cit.*, pp. 138-139.

This arrangement changed in the late 1950's. First the trading firms ceased to be agents of the Sierra Leone Produce Marketing Board (by law) and their place was taken over by co-operative and indigeneous traders.¹⁴ Secondly, most expatriate firms moved out of retailing into wholesale trading. Thirdly, the rising wave of African nationalism during the late 1950's probably made foreign firms sceptical about the future, thus employing in their business as little of their own funds as possible and relying rather more on commercial banks' funds. Finally, as in the 1940's and 1950's loans still went predominantly to finance the import/export trade.¹⁵

Table 22 which classifies commercial banks' loans by economic sectors reveals that throughout the 1960's general commerce has been the main recipient of commercial banks' funds. This sector which includes the financing of imports, wholesale and retail trade, has accounted for an average of 65 per cent of total loans during the period under review.

The mining sector which, as we have seen, accounts for 80 per cent of total export receipts does not rely for its finance on commercial banks. The mining companies themselves provide most of their financial requirements. This is the result of the nature of the industry which requires medium and long term investment.

The manufacturing sector received an average of 7 per cent during the 1960's. This sector is in many ways similar to whole-

¹⁴ *Annual Reports* of the Sierra Leone Produce Marketing Board, various issues.

¹⁵ It may be argued that there must have been some change in banks' policy — if only insofar as they were willing to make these substantial loans to foreign firms. The point here is that banks have always been willing to finance these firms. In the earlier years, however, these firms used most of their own funds and hence their need for bank finance was less. The surplus resources which banks could not deploy locally were invested overseas. As commercial firms relied more on bank finance and less on their own funds the situation reversed. The change, if any, is that banks are now bringing in the funds instead of commercial firms.

TABLE 22
ANALYSIS OF LOANS AND ADVANCES: AVERAGE NUMBER OF CUSTOMERS AND TOTAL LOANS
IN EACH CATEGORY

Years	Number of customers in each category						
	Up to Le 50	Le 51 to Le 100	Le 101 to Le 500	Le 501 to Le 1,000	Le 1,001 to Le 5,000	Le 5,001 to Le 10,000	Over Le 10,000
1971	592	254	528	381	403	117	180
1972	699	583	1,244	996	893	803	934
1973	674	358	780	520	575	211	360
1974	809	338	991	473	821	265	382
1975	843	332	1,112	538	986	256	417
1976	888	364	1,200	547	997	270	430
Total loans in each category (thousand Le)							
1971	16	29	221	340	1,397	1,211	16,068
1972	11	16	206	352	2,963	9,052	8,479
1973	13	22	159	382	1,381	1,503	24,215
1974	15	30	307	347	2,203	2,033	30,266
1975	40	39	348	464	2,825	2,322	32,667
1976	—	43	342	427	2,989	2,861	36,042

Source: *Economic Review of the Bank of Sierra Leone*, Nos. 3 and 4, July-December 1976.

sale and retail trades as most manufacturing has consisted largely of putting together what has already been processed outside the economy. Adding manufacturing loans to those for general commerce would increase the share of "general" commerce to about 72 per cent of total loans.

The agricultural sector received a mere 5 per cent of total loans on average. The average of 10 per cent for the period 1967 to December 1969 is rather misleading. This sudden upsurge in the percentage of loans to the agricultural sector in 1967 and which continued until early 1970 was due to the special loan to the Sierra Leone Produce Marketing Board which was discussed in Chapter II.

An examination of the main recipients of commercial banks' loans further supports our assertion that there has been no fundamental change in the lending policies of the banks and what has happened is that foreign commercial firms now rely more on bank finance instead of bringing in most of their own resources (Table 22). Using 1966 as an example, there was an average of 1,767 customers per quarter and loans averaged Le 15.9 million. Of this amount, 194 customers received Le 3.4 million. That is, 11 per cent of total customers received 85 per cent of the available loans. This group was made up as follows: Those receiving loans of over Le 20,000 numbered 106, and 88 received loans ranging between Le 10,000 and Le 20,000. From our knowledge of business in Sierra Leone it is most unlikely that more than a few Sierra Leoneans are in either of these groups. At the other end of the scale, about 65 per cent of total customers received loans ranging from Le 1 to Le 1,000. The total amount received by this group of customers was Le 0.29 million or 2 per cent of total loans. As Table 23 shows this has been the pattern of distribution throughout the period of our study.

Under an agreement with the government, commercial banks made funds available to the Registrar of Co-operative Societies for financing agriculture. The total amount provided by commercial

TABLE 23

SECTORAL DISTRIBUTION OF LOANS AND ADVANCES: PERCENTAGE OF TOTAL LOANS

Borrowers	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
Government	1.6	1.0	5.5	—	—	—	—	—	—	—	4.2	—	1.1
Local authorities	0.2	0.1	—	—	—	—	—	—	—	—	—	0.4	0.8
Financial institutions	2.3	—	—	—	0.1	0.1	0.7	4.9	4.9	4.2	3.8	3.4	2.6
Public utilities	—	0.1	—	—	—	—	—	—	0.1	1.3	2.7	2.7	7.1
Agriculture	2.0	7.1	0.8	11.9	11.3	6.8	0.7	0.9	0.8	1.3	1.0	1.8	1.6
Mining	—	2.2	3.8	0.9	1.1	2.6	1.8	2.7	3.1	4.1	2.1	3.0	4.1
Manufacturing	5.0	6.4	8.4	7.9	6.9	7.2	9.3	5.2	6.5	5.2	7.0	4.5	4.2
Building and construction	6.7	14.5	14.8	8.3	9.3	8.7	3.3	3.6	1.5	4.1	4.1	4.9	5.6
General commerce	72.4	61.8	44.5	63.2	66.4	69.5	74.7	75.1	72.5	69.1	67.0	55.7	53.8
Miscellaneous	9.8	6.8	22.2	7.8	4.9	5.1	9.5	7.6	10.6	10.7	8.1	23.6	19.1
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: *Economic Review of the Bank of Sierra Leone*, Nos. 3 and 4, July-December 1976.

banks under this agreement amounted to Le 0.8 million (exclusive of interest) of which Le 0.5 million were still outstanding at the end of December 1970. The extent to which loans under the Registrar of Co-operatives Loans Scheme have been successful in improving agricultural productivity is examined in Chapter VI. What is clear is that even with the special contributions to the Registrar of Co-operatives the flow of credit to the agricultural sector has remained very small.

Building and construction received about 9.5 per cent of all loans in the 1960's. Loans to this sector have been relatively high in 1965 and 1966. With independence and the appearance of new industries there has been an increase in demand for offices, factory buildings and more sophisticated dwelling houses, mainly for the large influx of expatriate personnel. This higher demand for new structures continued throughout the 1960's. We should point out that the building and construction sector also contains large foreign construction firms.

Most requests for loans and advances in the miscellaneous category are from salaried employees for the purchase of cars, property and consumer durables in general.

With the establishment of the Bank of Sierra Leone, short term financial requirements of the government and government corporations are now met by ways and means advances from the Bank of Sierra Leone and by the issue of Treasury bills. Hence loans to the government have been negligible. The banks however provided substantial assistance to the government during the financial crisis of 1966 at which time the government had used up all the facilities available to it from the Bank of Sierra Leone.

Liquid assets

If commercial banks can quickly dispose of their securities without capital loss, if all customers honour their obligations on

time, and if loans can be called in quickly, then there need be no problems about illiquidity. However, commercial banks are concerned about liquidity because of the existence of uncertainties.

In general, commercial banks encounter uncertainties from the following sources: the number of customers who might default; the percentage of customers who may not request renewal of loans; possible fluctuations in their deposit liabilities; changes in the market value of their securities; and adverse clearings.¹⁶

To be able to meet unexpected demands on their resources banks should be able to convert quickly part of their assets into cash without incurring a capital loss. This in turn depends on the length of life of the securities they hold. When the life of the assets is three months, the loss risk in rediscounting such assets is relatively small. On the other hand, the capital loss on an asset with maturity exceeding three months will be higher especially if it is rediscounted at a higher rate than that at which it was acquired.

The first line of liquidity protection required to meet an unexpected demand is to hold cash and/or balances with other banks, including balances with the central bank. Cash and deposit balances are completely free of risk of capital loss. However, cash and deposit balances do not earn interest, so that the holding of these assets reduces their earning potential. Hence, to maximize their earnings banks seek to minimize their holdings of cash reserves. The desire to maximize their income results in the banks holding as-

¹⁶ Basil J. Moore, *An Introduction to the Theory of Finance: Asset-holder Behaviour Under Uncertainty*, New York, The Free Press, 1968, pp. 156-168. Stephen M. Goldfeld, *Commercial Bank Behaviour and Economic Activity*, Amsterdam, North Holland Publishing Co., 1966, pp. 12-54. Edward J. Kane and Burton Malkiel, "Portfolio Allocation, Deposit Variability, and the Availability Doctrine", *Quarterly Journal of Economics*, February 1965, pp. 113-134. Richard C. Porter, "A Model of Bank Portfolio Selection", in James Tobin and Donald Hester, *Financial Markets and Economic Activity*, New York, John Wiley & Sons, Inc., 1967, pp. 69-71.

sets other than cash. In Sierra Leone these other assets which are relatively liquid and yet earn interest include money at call with the Bank of Sierra Leone, Treasury bills, short term government stock, inland bills of exchange and promissory notes. Of these assets, money at call and Treasury bills possess maximum shiftability as the former is managed by the central bank while Treasury bills can be rediscounted at any time at the central bank.

But as the commercial banks are expected to maintain a liquidity ratio equivalent to 30 per cent of their total deposits, it can be argued that most of the banks' holdings of Treasury bills are not available to meet unexpected demands in respect of adverse clearings or for satisfying new loan requirements. Only the excess above the required liquidity stipulation is available for this purpose. However, money at call, by its nature, is suitable for emergencies. These funds are held on a day-to-day basis, and hence although the rate of interest is only 2.5 per cent while that on Treasury bills is 5.5 per cent they are convenient interest-earning assets which enable banks to meet sudden demands without having to rediscount their holdings of Treasury bills or having to borrow from their head office.

Table 24 shows the banks' holdings of liquid assets for the period 1964 to 1976.

At the end of December 1964, commercial banks held Treasury bills to the value of Le 0.4 million. Their holdings remained at this level throughout 1965. In 1966, they increased to Le 1.7 million. By 1968 their investment in Treasury bills totalled Le 5.2 million; growing slightly in 1969.¹⁷ Between 1971 and 1976 the banks more than doubled their holdings of Treasury bills.

¹⁷ In 1969, commercial banks purchased government stock to the value of Le 0.9 million. These were included in liquid assets because they were suitable for rediscounting at the central bank and by the end of 1969 had less than nine months to maturity.

TABLE 24

COMPOSITION OF LIQUID ASSETS OF COMMERCIAL BANKS
(million Le)

Years	Cash	Bank balances	Money at call	Treasury bills (and other government securities)	TOTAL
1964	1.6 (43)	0.7 (19)	1.0 (27)	0.4 (11)	3.7 (100)
1965	1.3 (29)	1.1 (24)	1.7 (38)	0.4 (9)	4.5 (100)
1966	1.6 (24)	0.6 (9)	2.8 (42)	1.7 (25)	6.7 (100)
1967	1.3 (20)	1.0 (15)	1.5 (22)	2.9 (43)	6.7 (100)
1968	1.8 (17)	2.2 (21)	1.2 (12)	5.2 (50)	10.4 (100)
1969	1.8 (16)	2.1 (18)	2.3 (20)	5.3 (46)	11.5 (100)
1970	1.3 (12)	1.2 (12)	1.7 (16)	6.2 (60)	10.4 (100)
1971	1.6 (15)	1.2 (11)	1.3 (12)	6.7 (62)	10.8 (100)
1972	1.6 (13)	1.2 (10)	1.0 (8)	8.4 (69)	12.2 (100)
1973	1.7 (8)	3.2 (16)	2.1 (11)	12.9 (65)	19.9 (100)
1974	1.4 (5)	4.4 (16)	4.5 (16)	17.7 (63)	28.0 (100)
1975	1.2 (5)	2.7 (10)	2.5 (9)	19.8 (76)	26.2 (100)
1976	3.3 (10)	4.2 (12)	4.3 (13)	22.1 (65)	33.9 (100)

Note: Figures in parentheses are percentages of total liquid assets.

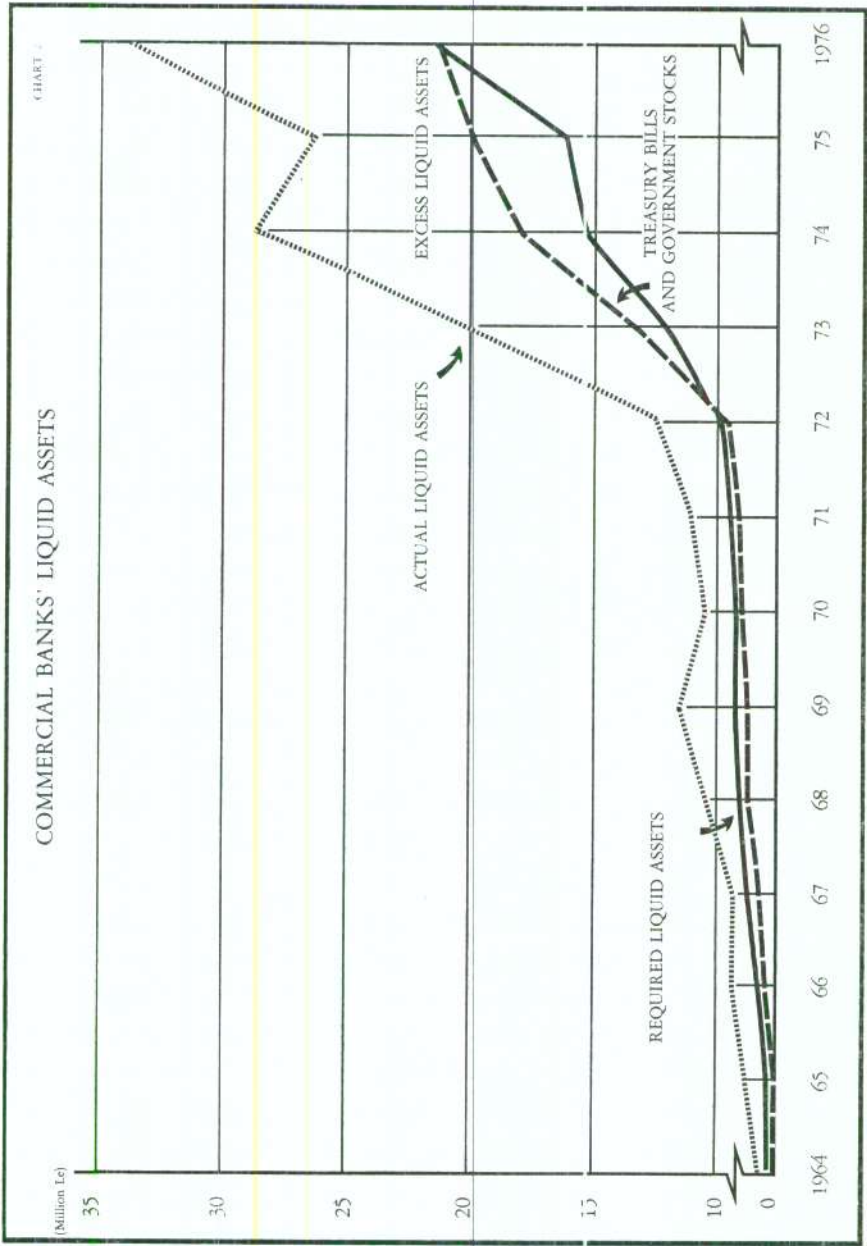
Source: See Table 16.

The commercial banks' increased holdings of Treasury bills resulted from the official raising of the liquidity ratio requirement from 15 per cent in October 1966, to 30 per cent by March 1967. The liquidity ratio requirements compel commercial banks to maintain the equivalent of 30 per cent of their deposit liabilities in liquid assets within Sierra Leone. Since Treasury bills are by far the most profitable of these assets, commercial banks purchased increasing amounts of Treasury bills to comply with the liquidity stipulation.

This is not the entire explanation however, since with the exceptions of 1964 and 1965 banks have held more than 30 per cent of their deposit liabilities in liquid form. Chart 2 shows liquid assets of commercial banks during the years 1964-1976. It indicates that during this period the banks held a large amount of excess liquidity. What was significant about the new liquidity regulation was the condition that the liquid assets had to be payable within Sierra Leone. But even without this stipulation commercial banks would probably have invested in Treasury bills because of the attractiveness of this form of investment. To illustrate, the rate of return on Treasury bills ranged between 5 and 6 per cent during the years 1967 to 1976. On the other hand, the rate of return on commercial banks' loans ranged between 8.5 per cent (the prime rate) and 12 per cent to other customers. However, the return on Treasury bills investment is tax-free and with practically no risks involved. The higher rate of return on other investments by the commercial banks is subject to tax at the usual rate of 45 per cent and, in addition, there is some element of risk. Thus, when the higher rates of return are discounted for risk and tax obligation they are not much higher than the lower rate of return on Treasury bills. It is therefore probable that the attractiveness of this form of investment was also a contributory factor explaining the growth in Treasury bills investment by commercial banks.

The Banking Act permits commercial banks to include in their official liquid assets inland bills of exchange and promissory notes that are eligible for rediscounting at the Bank of Sierra Leone. The central bank has informed commercial banks that such bills held for liquidity purposes should not exceed 2 per cent of their total deposits. In fact, however, no suitable inland bills existed which could be rediscounted at the Bank of Sierra Leone.

Liquid assets accounted for 24 per cent of total deposits at the end of 1964. Since then, they rose continuously and were 44



Source: Table 24.

per cent by 1968; at the end of 1976 they represented 49 per cent of total deposits.

Other assets including premises

The main items in this category are the banks' buildings and equipment. The growth in "other assets" is due partly to the increase in the number of branches of commercial banks. We have seen that the number of banking offices increased from 3 in the 1950's to 36 by the end of 1976. The noticeable rise in other assets since 1967 is largely explained by the revaluation of banks' assets which mainly affected the Freetown premises.

The other items in other assets are contra items, that is, assets on documentary credit and guarantees.

4. COMMERCIAL BANKS AND THE AVAILABILITY OF DEVELOPMENT CAPITAL

During the period 1960-1976 commercial banks accounted for an average of 45 per cent of the assets of all financial institutions (see Table 16). The assets of these banks rose from Le 11 million in 1960 to Le 110.9 million by the end of 1976. These figures suggest that commercial banks have been active in mobilizing domestic financial resources. The banks have been able to achieve this result because of their better branch coverage compared with the 1950's, their increased advertising on the radio, in cinemas, and through publicity posters, and because they have benefited from higher incomes due partly to the growth of GDP during the period and to the Africanization of the civil service.

These increased resources available to banks have, however, not resulted in any significant change in their lending policies. Although their total loans went up by about Le 85 million between 1964 and 1976, they continue to flow largely to general commerce which is devoted mainly to financing the export/import trade. How-

ever, since 1964 loans to the private sector have been declining in relation to total deposits. In 1964 loans were 97.5 per cent of total deposits but the ratio has declined continuously and was 61 per cent at the end of 1976. At the same time finance to the government in the form of holdings of government stocks and Treasury bills has risen considerably, increasing from Le 0.4 million in 1964 to Le 22.1 million by the end of 1976. So that the increased investments in government securities have been at the expense of loans to the private sector. Although it could be argued that the change in the liquidity requirement which took place in 1967 is an explanatory factor, it has been shown that the banks have always held excess liquid assets and that part of the explanation must be that it is more profitable to invest in government securities than to expand loans.

The banks' continued preference for the foreign trade sector may have been influenced by their desire for liquidity, but we do not think that this factor has been the dominating influence. As Williamson has observed, "... the broad conclusion that may be drawn is that commercial banks can rely on a proportion of their funds as being of a stable nature and therefore capable, without endangering the liquidity of the banks, of being lent for somewhat longer periods than the customary short term commercial advance".¹⁸

Two factors appear to play a leading role in explaining the loan distribution pattern of banks. The first is credit-worthiness which appears to be of over-riding importance. As long as banks are satisfied about the credit-worthiness of the client the loan is provided. On the other hand if the demand for loans by potential

¹⁸ G. I. Williamson, *The Role and Practice of Commercial Banks and Other Institutions in Financing Development*, Fiftieth Anniversary Commemoration Lectures, Cairo, National Bank of Egypt, 1965, p. 10.

For similar views, see R. Maimberg, "About the Theory and Practice of the Participation of Deposit Banks in the Financing of Capital Projects (with reference to conditions governing England and India)", *Indian Economic Journal*, Nos. 4/5, April/June 1969, pp. 496-506.

credit-worthy borrowers is greater than local resources, banks borrow from their head offices.¹⁹ The second is the fact that the collaterals demanded by banks are not derived from the available range of local securities; instead they reflect the conditions prevailing in the United Kingdom where the head offices of the banks are situated.

Not only is the foreign trade sector able to satisfy these two conditions but also banks were originally established to finance the export/import trade. This is thus an area with which banks are familiar. Besides, the sector has been dominated by large foreign firms, most of which have their parent companies in the same country of origin as the banks. Consequently the risk of loss in financing such firms is likely to be less than in financing an unfamiliar institution. Also, the foreign trade sector is able to provide the type of securities that are acceptable to banks as firms in this sector have been accustomed to these securities in their countries of origin. And besides, a firm in this sector is able to obtain a loan on the strength of its parent company. Further, moving into the agricultural sector, for example, would involve having to deal with a large number of small farmers, whereas at present they deal with a few large firms. Investing in agriculture is not only likely to increase administrative costs, but also the possibility of default is greater. Because the foreign trade sector is well-known and less risky there has not been any pressing need to move outside this sector into unfamiliar fields where the degree of loss would be greater. Furthermore, investment in government securities is highly profitable. What we are in fact suggesting is that there have been no compelling

¹⁹ In the introductory chapter we pointed out that an important feature of the colonial banking practice was that the head offices of British banks looked at their operations globally. On this point also Greaves reported as follows: "Managers everywhere were of the opinion that all local credit requirements which are properly the business of commercial banks were fully met, and they declared that they were both able and willing to increase the value of loans if suitable opportunities for doing so were offered them". Greaves, *op. cit.*, p. 47.

reasons for commercial banks to look for investment outlets outside their traditional areas.

There is sufficient evidence, however, to suggest that commercial banks may be ready to change their policies. We have noted earlier that the banks have provided overdraft facilities for the Registrar of Co-operative Societies Loan Scheme.²⁰ In addition, commercial banks are shareholders in the National Development Bank discussed in Chapter VI. Also, commercial banks nominated representatives to the working party appointed by the Governor of the Bank of Sierra Leone to examine the problems of entrepreneurial development in Sierra Leone. Finally, we pointed out in Chapter II that one of the commercial banks made a substantial loan to the Sierra Leone Produce Marketing Board during the 1966/67 financial crisis. These developments indicate that commercial banks are adaptable. But it is apparent that the initiative must come from the central bank. Appropriate incentives would have to be offered to the banks and, in particular, the problem of securities for loans and poor repayment records would have to be given serious attention.

5. CONCLUSIONS

Under the colonial monetary system, commercial banks made loans and advances primarily to the large firms in the foreign trade sector because it was for the financing of the export/import trade that these banks were established.

Our analysis of the sources and uses of funds shows that there has been a very large growth in total deposits made possible by better branch coverage, advertisement and the rise in incomes. The

²⁰ The poor repayment records of loans under this scheme would justify the commercial banks' lack of enthusiasm in extending a large number of small loans. This is further discussed in Chapter VI.

expansion in loans and advances together with extensive borrowing from head offices would, a priori, suggest that there has been a fundamental change in the lending philosophy of commercial banks. Our analysis shows on the contrary that there has been no significant change with the result that their resources continue to flow to the foreign trade sector. The agriculture and small-scale industries sector whose development we have argued would raise the rate of growth of the economy still continue to look for their credit needs outside the organized banking system.

The major change has been that whereas under the colonial monetary system any surplus funds from commercial banks sought investment outlets in the London money and capital markets, they now rely entirely on their own resources. Secondly, through their purchases of government securities, banks now place substantial financial resources at the disposal of the government and such investments have been at the expense of loans to the private sector.

