Innovations

Foreign Inflows and Financial Institutions Development in Sub-Saharan Africa: A Panel Data Approach

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Abstract: *The study evaluated the impact of foreign inflows on financial institutions development in Sub-Saharan Africa for the coverage period, 1986-2023 and the cross section represents 45 countries of the SSA. The independent variables were diaspora remittance, foreign direct investment, and official development assistance, which were used to measure foreign inflows while the dependent variable, financial institutions development was measured by financial institutions depth. Using dynamic panel least squares (PDLS), particularly the random effect, the study found that diaspora remittance exerted an increasingly significant influence on the depth of the financial institutions of the SSA countries; foreign direct investment adversely and non-significantly affected the depth of financial institutions in the studied SSA countries; while official development assistance exerted positive but non-significant influenced on the depth of financial institutions in the studied SSA countries. Given the mixed influences of the foreign inflows on financial institution depth, SSA should maintain liberalized policies, particularly by minimizing restrictions on remittance inflows, to further develop their financial institutions while strengthening institutional quality is crucial to mitigating these negative influences that may stem from the size of the economy, exchange volatility, weak regulatory frameworks, inadequate supervisory mechanisms, and corruption.*

Keyword: *Foreign inflows, foreign direct investment, diaspora remittance, official development assistance, financial institutions development, financial institutions depth*

1. Introduction

Sub-Saharan Africa (SSA) faces a significant challenge in developing its financial institutions due to limited domestic capital, underdeveloped infrastructure, and a nascent financial services industry; however, the region has witnessed a significant increase in foreign inflows over the past few decades, including foreign direct investment (FDI), foreign portfolio investment (FPI), diaspora remittances and official development assistance (ODA) (IMF, 2023). These inflows played a crucial

role in shaping the region's economic landscape, including the development of its financial institutions (Anidiobu, Paschal, Onyia, & Onwumere, 2020). However, the exact way these inflows affect the overall financial landscape in SSA is complex and multifaceted. The array of extant empirical literatures examining financial institutions in Sub-Saharan Africa (SSA) disagreed on the impact of the foreign inflows. For instance, Ain, et al., (2024); Agabi and Dibal (2024); Mustapha-Jaji, and Adesina-Uthman (2023); Okeke (2023); Adekunle, Tella, Subair and Adegboyega (2022); asserted that foreign inflows is beneficial to the development of financial institutions while Ahmed,et al., (2022); Chude and Chude, (2023); Emiola and Fagbohun, (2021); and Githaiga and Kabiru, (2014) painted insignificant picture on financial institutions development. These contradictions varied across countries and over time, depending on factors such as the composition of inflows, the quality of governance and regulation, macroeconomic conditions, and the overall investment climate.

Furthermore, quantifying financial development presents a challenge due to its vast scope and numerous dimensions; these existing empirical studies mostly rely on readily available, standardized quantitative indicators with long time series data across a wide range of countries (World Bank, 2012). For example, the ratio of financial institutions' assets to GDP, the ratio of liquid liabilities to GDP, and the ratio of deposits to GDP. While these measures provide a starting point, they are limited in capturing the full spectrum of financial development due to the inherent diversity of financial institutions, markets, and products within a country's financial sector (Cihak, 2012; Svirydzenta, 2016). In an effort to bridge this lacuna, the World Bank created a global framework to assess financial development across countries. This framework, called the "4x2 framework," is a simplified but thorough way to measure how well a financial system functions. It focuses on four key aspects of a healthy financial system: depth, access, efficiency, and stability. These four areas are then measured for the two main components of the financial sector: financial institutions (like banks) and financial markets (like stock exchanges).

On the basis of the forgoing, this study investigated the impact foreign inflows on financial institutions development: evidence from selected Sub-Saharan Africa (SSA) countries for the period, 1986-2023. The specific objectives were: i). to investigate the impact of diaspora remittance on financial institutions depth in SSA countries. ii). to examine the impact of foreign direct investment on financial institutions depth in SSA countries. iii). to determine the impact of official development assistance on financial institutions depth in SSA.

The rest of the paper is therefore, structured as follows; part two is for literature reviews, part three is for methodology, part four is for result and discussion of findings while five stood for conclusion and recommendations.

2. Literature Review and Hypothesis Development

The study provides a review of relevant theories that support the relationship between foreign inflows and financial development. They are; the financial deepening theory and conditional impact theory.

2.1.1 Financial Deepening Theory

The Financial Deepening theory, introduced by economist Robert Aliber in the 1970s (Aliber, 1970, 1971), highlights the positive effects of foreign inflows, particularly Foreign Direct Investment (FDI) from foreign banks or financial institutions, on a country's financial system. According to the theory, these inflows inject fresh capital into domestic financial systems, enabling local banks to expand their loan portfolios and extend credit to more borrowers, including businesses and individuals. This increased credit access stimulates economic growth.

Additionally, the influx of capital allows domestic banks to adopt modern technologies, such as advanced IT systems and online banking, enhancing operational efficiency and customer experience. It also supports the development of new financial products, including investment tools, insurance, and wealth management services, promoting a more inclusive and diversified financial system. Through these advancements, foreign inflows drive financial deepening which is the process by which a financial system grows to offer a broader range of instruments and services to a larger segment of the population.

2.1.2 Conditional Impacts Theory

The Conditional Impacts theory, proposed by economist Matthias Eberhard in 2012, examines how foreign inflows, including remittances, influence financial development based on the quality of domestic institutions (Eberhardt, 2012). The theory suggests that while foreign inflows, such as FDI or diaspora remittances, can support financial development, their effectiveness depends on institutional factors in the recipient country: These institutional factors are, firstly, the legal and regulatory framework which is a robust legal system with clear property rights and enforceable contracts fosters trust in the financial sector. Transparent and effective regulations minimize risks like money laundering or fund mismanagement. Secondly, the supervisory mechanisms which stands as the effective oversight by central banks or regulatory bodies ensures compliance with regulations, maintaining financial stability and encouraging participation by individuals and businesses. Thirdly, control of corruption: corruption undermines the benefits of foreign inflows. Weak governance and misappropriation of funds reduce their positive impact on financial development. Therefore, when institutional quality is strong, foreign inflows increase capital availability. This enables domestic banks to expand their loan portfolios, lending to a wider range of borrowers and stimulating economic growth.

2.2.1 Diaspora Remittance and Financial Development

A substantial body of empirical research indicates a positive and significant impact of diaspora remittances on financial system development (Ain et al., 2024; Agabi & Dibal, 2024; Mustapha-Jaji & Adesina-Uthman, 2023; Adekunle et al., 2022; Kanu et al., 2017), whereas other findings exerted non-significant impact on financial development (Sindayihebura & Uprasen, 2023; Ahmed et al., 2022; Githaiga & Kabiru, 2014). The observed inconsistencies in the impact of diaspora remittances on financial development maybe blamed on several factors. Firstly, the prevalence of informal remittance channels, which bypass formal financial systems, could dilute the measurable effects. Secondly, the varying proxies used to define financial system development across different countries likely contribute to the divergent findings. Given the inherent diversity of financial sectors globally, relying on a single indicator within a country provides an incomplete picture of financial development. A more robust approach necessitates the use of composite indices that encompass the depth, access, and efficiency of financial institutions and markets, as emphasized by Cihak et al. (2012) and Svirydzenta (2016). Recognizing these limitations, this study specifically aims to investigate the impact of diaspora remittances on the depth of financial institutions within Sub-Saharan African (SSA) countries.

2.2.2 Foreign Direct Investment and Financial Development

At first glance, the relationship between foreign direct investment (FDI) and the development of a nation's financial system appears tenuous, lacking a readily discernible direct causal link. However, a comprehensive review of empirical literature reveals a more distinctive and often contradictory picture, challenging this initial intuition. The studies examined present a spectrum of findings, both validating and refuting the hypothesis that FDI significantly influences the evolution of financial markets and institutions. Specifically, the impact of FDI on financial institution development is a subject of considerable debate. On one hand, a cohort of researchers, including Sindayihebura and Uprasen (2023), Okeke (2023), Ang (2009), and Ain et al. (2024), have consistently demonstrated a positive correlation. Their work posits that FDI serves as a catalyst for institutional growth, injecting capital, introducing advanced managerial practices, and fostering a more competitive environment. Conversely, the findings of Ahmed et al. (2022) and Agabi and Dibal (2024) diverge significantly, revealing no statistically significant contribution of FDI to the development of financial institutions. This disparity suggests that the relationship is far from straightforward and may be contingent upon a range of contextual factors.

Similarly, the literature presents a mixed narrative concerning the influence of FDI on financial market development. Abubakar and Danladi (2018) and Raza et al.

(2012) provide compelling evidence that FDI plays a substantial role in enhancing market depth, liquidity, and integration with global financial networks. However, Nwiado and Deekor (2013) offer a more cautious perspective, suggesting that the impact of FDI on financial markets may be limited or dependent on specific conditions. These contrasting findings, while rooted in empirical investigations, are likely influenced by a confluence of factors. The size of the economies under study, the volatility of exchange rates, the nature of cross-border trade policies, and, crucially, the quality of a nation's institutions all likely play a mediating role in shaping the relationship between FDI and financial system development. Therefore, a more granular and context-specific approach is necessary to fully comprehend the complex dynamics at play and to formulate effective policy recommendations. Building upon these observations, this study sought to examine the impact of foreign direct investment on financial institution depth in SSA countries.

2.2.3 Official Development Assistance and Financial Development

Official Development Assistance (ODA), which consists of grants or loans extended by governments or multilateral organizations to developing nations, is primarily intended to stimulate economic development and enhance social welfare (World Development Indicator, 2023). While a considerable body of empirical literature has focused on the impact of ODA on economic growth, its influence on the development of financial systems has received comparatively less attention (Emiola & Fagbohun, 2021; Chorn & Siek, 2017; Acheampong, 2019; Anetor, 2020; Chude and Chude, 2023). This relative neglect creates a significant gap in our understanding of how ODA contributes to the vital infrastructure of financial intermediation. Despite the limited research, emerging evidence suggests a complex and potentially significant relationship between ODA and financial system development. Studies such as Ahmed et al. (2022) and Ain et al. (2024) have demonstrated a positive and statistically significant influence, indicating that ODA can play a crucial role in strengthening financial institutions and markets. These findings imply that ODA can facilitate the development of robust financial infrastructure by providing capital, technical assistance, and policy support. However, this positive association is not universally observed. Agabi and Dibal (2024), for instance, found no significant influence of ODA on financial development, suggesting that the impact may be contingent on specific contextual factors or the effectiveness of ODA allocation and implementation. The disparity in findings underscores the need for more rigorous and nuanced research to fully understand the mechanisms through which ODA affects financial system development. Consequently, this study endeavours to explore the impact of official development assistance on the depth of financial institutions in SSA countries.

3. Methodology

Research design refers to the overall strategy used to integrate various components of a study in a coherent and logical manner. This study employs ex-post facto and analytical research designs. As Onwumere (2021) explains, a key feature of ex-post facto research is the researcher's inability to manipulate pre-existing variables. Meanwhile, analytical research design focuses on examining cause-effect relationships between dependent and independent variables, involving a critical evaluation of facts and information related to the variables under study.The adoption of these designs is due to their appropriateness for research of this nature.

Meanwhile the datasets of this study were drawn from the World Development Indicators (WDI) and International Monetary Fund (IMF) databases. The coverage period is 1986 to 2023, and 45 out of 48 SSA countries were selected for this study due to data availability. The independent variables were diaspora remittance, foreign direct investment and official development assistance measuring foreign inflows, while the dependent variable was financial institutions depth. This study employed established theoretical and empirical approaches to specify its models. Theoretical, the study adapts financial deepening theory by Robert Aliber (1970) and conditional impacts theory by Mathias Eberhardt (2012) in building its model. Empirically, following Agabi and Dibal (2024) who studied the impact of foreign inflows on financial institutions development in Nigeria for the period, 1981-2022. The study employed diaspora remittances, foreign direct investment, and official development assistance as measures of foreign inflows, while the financial institution index served as a proxy for financial institutions development, with the inflation rate included as a control variable. Unlike their study, which utilized time series data, this study adapts a panel data approach. The model proposed by Agabi and Dibal (2024) is presented as follows:

FII= f (DR, FDI, ODA, INF)……………………………….…………………………………(1)

From the above model, their study further specified the model in a linear equation as:

$$FII = \sum_{j=0}^{p} \gamma_{it} tFII_{i,t-j} + \sum_{j=0}^{q} \delta'_1 DR_{i,t-j} + \sum_{j=0}^{q} \delta'_2 FDI_{i,t-j} + \sum_{j=0}^{q} \delta'_3 ODA_{i,t-j} + \sum_{j=0}^{q} \delta'_4 INF_{i,t-j} + \varepsilon \dots \dots \dots . (2)$$

However, in alignment with the specified model, slight modifications were made by adopting financial institutions depth as the dependent variable, representing one of the four measures of financial institutions development. The other three measures—financial institutions access financial institutions efficiency and financial institutions stability—were excluded from this study. The independent variables in the model remained unchanged. To enhance the model, two control variables, GDP growth rate and exchange rate, were included.

The model therefore, stated and presented below as follow:

FID = f (DR, FDI, ODA, GDPGR, EXCR)……………………………………………(3)

Building on Pesaran et al. (1999) and adapting the work of Agabi and Dibal (2024), this study empirically modelled foreign inflows, proxied by diaspora remittance as a percentage of GDP (DR), foreign direct investment as a percentage of GDP (FDI), and official development assistance as a percentage of GDP (ODA) with GDP growth rate (GDPgr) and exchange rate as a percentage of GDP (EXR) included as control variables all against financial institutions depth (FID). Accordingly, the econometric specification is presented as follows:

$$FID_{it} = \delta_o + \sum_{j=1}^{p=1} \delta_1 FID_{it-j} + \sum_{j=0}^{q=1} \delta_2 DR_{it-j}$$
$$+ \sum_{j=0}^{q=1} \delta_3 FDI_{it-j} + \sum_{j=0}^{q=1} \delta_4\, ODA_{it-j}$$
$$+ \sum_{j=0}^{q=1} \delta_5\, GDPgr_{i,t-j} + \sum_{j=0}^{q=0} \delta_6 EXR_{it-j} + \mu_{it} \quad \dots (4)$$

δ_o =   constant or the intercept

$\delta_1 - \delta_7$ =   coefficients of the parameters or explanatory variables

μ_{it} =   the residual or error term.

On a prioribasis, our expectation about the relationship between the independent and dependent variables isthat the independent variables (except for one control variable, exchange rate) are expectedto havepositive and significant impact on the dependent variables at 5% level of significant. As shown in table 1 below.

Table 1: Summary of Apriori Expectations

Variables	Apriori expectation
Diaspora Remittance	+
Foreign Direct Investment	+
Official Development Assistance	+
GDP growth rate (Control Variable)	+
Exchange Rate (Control Variable)	-

Source: Authors' Compilation, 2025.

In the techniques of data analyses, the following estimation procedures were carefully followed in this study. The processes begun with the pre-estimation tests which aimed at proving the goodness of fit of the dataset. These include Panel Descriptive Statistics, Panel Correlational Analyses, and Panel Unit Root tests. This was followed by Dynamic Panel Least Squares, specifically, it estimated the Pooled effect, fixed effect, and the random effect. The Hausman Test was also used as a selection criterion from the Model. This was used in determining the most efficient of the technique. Lastly, the study concludes the estimation procedures with Post Estimation Tests and Inferences to check for validity and reliability using cross sectional individualized results and Dynamic Panel Least Squares as robustness checks. Also, the inferences and conclusions made on this study followed the validated estimates.

4. Results and Discussions

To show the basic descriptive characteristics of the panel datasets, table 2 presents the basic descriptive statistics.

Table 2: Summary of Panel Descriptive Statistics

Variable	DR	EXR	FDI	FID	GDPGR	ODA
Mean	4.34	4.6	3.48	0.09	1.39	19.68
Median	1.13	5.7	1.78	0.05	1.56	19.85
Maximum	235.93	9.13	161.82	0.86	4.2	23.16
Minimum	0.000	-5.99	-28.6	0.000	-3.39	13.16
Std. Dev.	16.33	2.45	8.93	0.132	0.85	1.33
Skewness	9.746	-0.98	10.231	3.328	-1.86	-0.54
RSD	3.76	0.53	2.57	1.47	0.61	0.07
Kurtosis	113.42	4.06	149.75	15.029	9.32	3.13
JB STAT	875923.2	347.36	1529434.	13169.41	3232.41	80.84

Source: Authors' Computation (2025)

The measures of the central tendency and dispersion are shown above with the test of normality also shown. The variables are all shown to be outside the normality threshold. All the kurtoses are in excess of 3 while the skewness is all either above zero or less than zero. The key average of interest is the relative standard deviation (RSD) which shows the combined effect of measures of central tendency and measures of dispersion. The financial development indicator tends to be above unity, suggesting its high dispersion. Normality indicators are found to be consistent with the behaviour of financial time series which are usually not mesokurtic but platykurtic and leptokurtic. The degree of linear association of the panel series is

evaluated using the panel bivariate non-directional correlational matrix. The result is reported in table 3 below:

Table 3: Panel Correlational Matrix

	DR	EXR	FDI	FID	GDPGR	ODA
DR	1.000000					
EXR	-0.069881	1.000000				
	-2.862743					
	0.0043					
FDI	0.027969	-0.011687	1.000000			
	1.143413	-0.477637				
	0.2530	0.6330				
FID	0.117084	-0.171613	-0.030215	1.000000		
	4.817857	-7.118666	-1.235334			
	0.0000	0.0000	0.2169			
GDPGR	0.007003	0.039750	0.290180	-0.018183	1.000000	
	0.286182	1.625709	12.39155	-0.743169		
	0.7748	0.1042	0.0000	0.4575		
ODA	-0.070865	0.077724	0.008480	-0.045340	0.083691	1.000000
	-2.903260	3.185869	0.346569	-1.854764	3.432114	
	0.0037	0.0015	0.7290	0.0638	0.0006	

Source: Authors' Computation (2025)

The linear association of all the variables are shown with their correlation coefficients, t-statistics and associated probability value. The results rule out suspicion of multicollinearity as the coefficients of correlation are below the 0.9 or 90% threshold. This supports the fact that the estimates can be unbiased and independently distributed.

Next, the unit root tests as presented in table 3 below.

Table 4: Summary of Panel Unit Root Tests

VARIABLE	IPS			LLC			ADF FISHER		
	Test Stat	Pvalue	Inference	Test Stat	Pvalue	Inference	Test Stat	Pvalue	Inference
DR	-22.574	0.000	I(0)	-27.319	0.000	I(0)	581.388	0.000	I(0)
EXR	-20.061	0.000	I(0)	-18.302	0.000	I(0)	553.275	0.000	I(0)

FDI	-20.742	0.000	I(0)	-29.268	0.000	I(0)	698.694	0.000	I(0)
FID	-17.986	0.000	I(0)	-16.702	0.000	I(0)	459.135	0.000	I(0)
GDPGR	-20.264	0.000	I(0)	-19.402	0.000	I(0)	554.564	0.000	I(0)
ODA	-19.626	0.000	I(0)	-14.546	0.000	I(0)	508.279	0.000	I(0)

Source: Authors' Computation (2025)

The test follows the Im, Pesaran and Shin; Levin, Lee and Chu and the ADF Fisher. The unit root test results show that all the variables are integrated of order zero (0). With the stationarity property of the variables, basic/static panel models are applicable. This is the justification for the use of pooled, fixed effect and random effect model. The choice of the most appropriate of the model is determined by the Hausman test which is reported at the lower wrung of the associated model results in table 4 below.

The Dynamic Panel Least Square estimations made up of the pooled, fixed effect and random effect results below form the basis for the test of the model.

Table 5: Summary of Dynamic Panel Least Square

Model Output									
	Pooled			Fixed Effect			Random Effect		
	Coefficient	Std. Error	P. value	Coefficient	Std. Error	P. value	Coefficient	Std. Error	P. value
C	0.11	0.05	0.02	0.11	0.05	0.03	0.11	0.05	0.02
DR	0.00	0.00	0.01	0.00	0.00	0.02	0.01	0.00	0.02
FDIs	-0.00	0.00	0.14	-0.00	0.00	0.15	-0.01	0.00	0.14
LODA	0.00	0.00	0.09	0.01	0.00	0.07	0.01	0.00	0.09
LGDPR	-0.01	0.00	0.00	-0.01	0.00	0.00	-0.01	0.00	0.00
LEXR	-0.02	0.00	0.00	-0.02	0.00	0.00	-0.02	0.00	0.00
Diagnostic test									
R^2	0.142405			0.162171			0.142405		
Adj R^2	0.139412			0.133239			0.139412		
Hausman Test									
4.539839 (0.4746)									

Source: Authors' Extraction from the full Results

In investigating the impact of foreign inflows on financial institutions development in selected Sub-Saharan African countries for the period, 1986-2023. The low R-squared value indicates a low degree of multicollinearity between the foreign inflows series and financial institutions development variable, suggesting they are independently and identically distributed. While the impact of the individual regressors will be discussed, the moderating variables which are exchange rate and economic growth rate were found to adversely affect the depth of the financial institutions in SSA countries. It is evident that most SSA countries contend with exchange rate and growth problems which not only have been harmful to several areas of the economy but also to the economy in general.

The Hausman test results show that the random effect is more efficient and consistent. This is evidenced by the non-significant p-value of the result implying the null hypothesis in favour of efficient and consistent random effect cannot be rejected. Aside from the choice of the estimates of the random effect estimates, a degree of consistency is found amongst the results of the pooled, fixed effect and random effect estimates.

The impact of the individual foreign inflows variables on the financial institutions' depth are discussed as follows:

In the investigation of the impact of diaspora remittance on financial institutions depth of selected Sub-Saharan Africa. Diaspora remittances significantly boost financial depth in Sub-Saharan Africa (SSA), with a 1% increase in remittances leading to a 1% increase in financial depth. This supports the financial deepening theory, as more capital allows institutions to expand lending. This finding aligns with similar research on developing economies, such as Ain et al.'s (2024) work on Pakistan.

Conversely, in investigating the impact of foreign direct investment on financial institutions depth of selected Sub-Saharan Africa. Foreign direct investment had no significant impact on financial depth in Sub-Saharan Africa (SSA) during the study period. A 1% change in FDI resulted in a statistically insignificant 1% decrease in financial depth. This aligns with similar findings in Nigeria and Bangladesh (Agabi & Dibal, 2024; Ahmed et al., 2022), both developing economies like those in SSA.

In the examination of the impact of official development assistance on financial institutions depth of selected Sub-Saharan Africa, Official development assistance (ODA) had no significant impact on financial depth in Sub-Saharan Africa (SSA) during the study period. A 1% increase in ODA resulted in a statistically insignificant 1% increase in financial depth. This also aligns with similar findings in Nigeria and Bangladesh (Agabi & Dibal, 2024; Ahmed et al., 2022), where ODA showed no significant influence on financial development.

5. Conclusion and Implications

This study investigates the impact of foreign inflows on the development of financial institutions in sub-Saharan Africa. The research is driven by the conflicting findings in existing studies and the World Bank's policy review on financial system development measures. Focusing on 45 sub-Saharan African countries over a 37-year period (1986-2023), the study examines significant episodic changes within this timeframe. To examine the transmission impact of foreign inflows on financial institution development within SSA during the study period, appropriate econometric techniques were employed. Foreign inflows were represented by three proxies: diaspora remittances, foreign direct investment, and official development assistance. Financial institution development was measured using financial institution depth. The study yielded key empirical findings, derived from the applied econometric tests.

The study's initial findings revealed a positive and significant relationship between diaspora remittances and financial institution depth. Given the positive influence of diaspora remittances on financial institution depth, Sub-Saharan African countries should maintain liberalized policies, particularly by minimizing restrictions on remittance inflows, to further develop their financial institutions, however ensuring that informal channel of remittance into SSA countries are impassable this will deepen the financial institution in the studied SSA countries. Conversely, foreign direct investment exhibited an adverse and statistically insignificant effect on the same variable. The adverse and insignificant impact of foreign direct investment on financial institution depth in the SSA may stem from weak regulatory frameworks, inadequate supervisory mechanisms, and corruption. Therefore, strengthening institutional quality is crucial in mitigating these negative influences. Finally, official development assistance demonstrated a positive impact on financial institution depth, this effect was also found to be statistically insignificant. Given the insignificant impact, SSA monetary authorities and anti-corruption agencies of the SSA countries should scrutinize the use of foreign aid to prevent corruption and potential diversion of the funds.

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