



Recent Trends in Banking in sub-Saharan Africa

From Financing to Investment

Recent Trends in Banking in sub-Saharan Africa

from Financing to Investment

July 2015



Lead authors

Tim Bending, Economist, European Investment Bank

Angus Downie, Head of Economic Research, Ecobank

Thierry Giordano, Economist, CIRAD

Arthur Minsat, Africa Economist, OECD

Bruno Losch, Research Director, CIRAD

Daniela Marchettini, Economist, International Monetary Fund, Africa Department

Rodolfo Maino, Senior Economist, International Monetary Fund, Africa Department

Mauro Mecagni, Assistant Director, International Monetary Fund, Africa Department

Oskar Nelvin, Economist, European Investment Bank

Habil Olaka, Chief Executive Officer, Bankers Association, Kenya

Jared Osoro, Director, Kenya Bankers Association Centre for Research on Financial Markets and Policy

Henri-Bernard Solignac-Lecomte, Head of Unit, OECD Development Centre

Jean-Philippe Stijns, Senior Economist, European Investment Bank

Stuart Theobald, Chairman, Intellidex

Economics editor

Jean-Philippe Stijns, Senior Economist, European Investment Bank

Debora Revoltella, Director, Economics Department, European Investment Bank

Editorial, linguistic and statistical support

Paul Skinner, Senior Translator-Reviser, Deputy Head of Unit, European Investment Bank

Dr. Polyxeni Kanelliadou, Assistant, European Investment Bank

Magali Vetter, Administrative Assistant, European Investment Bank

Jurate Cepulyte-Dubois, Project Manager, European Investment Bank

Rafal Banaszek, Statistical and Reporting Analyst, European Investment Bank

The articles in this document were discussed at a roundtable event hosted by the EIB's Economics Department in Luxembourg in the context of the Africa Day hosted on 9 July 2015 by the European Investment Bank in cooperation with Luxembourg's Presidency of the European Union.

About the Economics Department of the EIB

The mission of the EIB Economics Department is to provide economic analyses and studies to support the Bank in its operations and in its positioning, strategy and policy. The Department, a team of 35 economists and assistants, is headed by Debora Revoltella, Director of Economics.

Disclaimer

The views expressed in this document are those of the authors and do not necessarily reflect the position of the EIB.

PREFACE

Sub-Saharan Africa (SSA) has been experiencing in recent years high economic growth rates, significant government reforms and a rapidly expanding middle class. Development prospects for SSA remain promising, with real growth in SSA countries forecast by the IMF to be above 4 percent in 2015, a faster pace than for all other developing regions except China.

However, the pace of growth for the region will be below the 4.4 percent annual average growth rate of the past two decades, as a marked slowdown in emerging markets has weakened demand for commodity exports from the region, with immediate negative effects on external and fiscal positions. Furthermore, once population growth is taken into account, the growth of real GDP per capita is forecast by the IMF to be 2.0 percent in 2015. In fact, relatively high population growth rates require GDP growth to accelerate in many SSA countries in order to create a sufficient number of jobs, particularly for young workers.

The quality of economic growth also has to improve and the distribution of wealth needs to become more equitable. Poverty is still widespread: one in two sub-Saharan Africans continues to live on less than USD 1.25 a day. In spite of growth, the region's average GDP per capita barely rises above USD 1 500 a year. SSA countries generally continue to score poorly in terms of infrastructure, adult literacy and life expectancy.

With some notable exceptions, sub-Saharan African financial systems remain underdeveloped. The region's banking sectors are typically concentrated and generally inefficient at financial intermediation. They are constrained by their small size. Competition is still limited, albeit increasing. According to the World Bank's Financial Inclusion Database, only 34 percent of adults in SSA had a bank account in 2014, but this is up from 24 percent in 2011. Consequently, access to finance in sub-Saharan Africa, though expanding, remains among the lowest in the world and one of the key obstacles to the activity and growth of enterprises, especially micro, small and medium-sized enterprises.

Encouragingly, ongoing structural changes, such as the emergence of pan-African banking groups and of mobile banking, are beginning to strengthen competition, to deepen sub-Saharan financial markets and to improve access to finance. The SSA region leads the world in mobile money accounts: while just 2 percent of adults worldwide have a mobile money account, 12 percent in SSA have one. Financial inclusion, while still unsatisfactory, is improving fast.

The Economics Department coordinated this study to inform a Roundtable Discussion on "Recent Trends in Banking in sub-Saharan Africa: from Financing to Investment". We are following up on our January 2013 Roundtable on "Banking in sub-Saharan Africa: Challenges and Opportunities", with the aim of providing an update on the latest developments and trends in the banking sectors of sub-Saharan Africa. We were privileged to organise this year's roundtable in the context of the Africa Day hosted on 9 July 2015 by the European Investment Bank in cooperation with Luxembourg's Presidency of the European Union.

The study aims to support the Bank's initiatives in the region's banking sectors and to discuss some of the key challenges and opportunities that lie ahead. In this second edition of our

study, a survey of pan-African banks was piloted to capture key strategic positioning and market perceptions by the banks best placed in the region to contribute to financial sector deepening, private sector development and regional integration.

This study is a collaborative effort with contributions from international financial institutions and some of the region's leading banks and banking sector analysts. We express our sincere gratitude to all the institutions and individuals that have generously contributed to this study and to all EIB colleagues who have supported the publication of this edition of our study.

A handwritten signature in black ink, appearing to read 'DR', enclosed in a thin black rectangular border.

Debora Revoltella
Director
Economics Department

CONTENTS

Introduction.....	5
JEAN-PHILIPPE STIJNS	
Banking in sub-Saharan Africa: Key features and challenges.....	9
MAURO MECAGNI, DANIELA MARCHETTINI, RODOLFO MAINO	
Banking in Southern Africa	39
STUART THEOBALD	
Banking in East Africa – formal integration following cross-border expansion	55
HABIL OLAKA AND JARED OSORO	
Recent Trends in Banking in Central and West Africa.....	71
ANGUS DOWNIE	
Unlocking the potential of African regions.....	87
THIERRY GIORDANO, BRUNO LOSCH, ARTHUR MINSAT, HENRI-BERNARD SOLIGNAC-LECOMTE	
Pan-African banks: stylised facts and results of a pilot survey	107
JEAN-PHILIPPE STIJNS	
The EIB in sub-Saharan Africa.....	131
OSKAR NELVIN AND TIM BENDING	

Introduction

JEAN-PHILIPPE STIJNS

The overall depth and financial sophistication of the banking sectors in sub-Saharan Africa (SSA) are still low by global standards. The region's banks are generally well-capitalised and profitable but tend to focus most of their lending activity on financing large corporate clients and governments. SMEs and low and middle-class individuals too often remain formally unbanked. However, the overarching conclusion of the seven chapters of this study is that SSA's banking sectors have deepened remarkably in SSA in recent years, and that access to finance is increasing apace. This trend is affecting all SSA countries, with very few exceptions. In particular, SSA is leading the world in terms of the deployment of mobile banking technology. The challenge is that regulation, supervision and resolution capacity have not yet caught up with these developments, which creates some bottlenecks for further expansion and raises concerns about systemic risk.

In the first chapter, Mauro Mecagni, Daniela Marchettini and Rodolfo Maino point out that financial liberalisation, reforms and upgrades in regulatory and supervising capacity have historically set the scene for the transformation of the African banking and financial landscape. They identify the rise of pan-African banks (PABs) as a key feature of this transformation, noting that these banks have become the lead arrangers of syndicated loans for financing infrastructure in SSA. The authors note that some important weaknesses still need to be addressed, however. In particular, while banks in SSA typically hold excess liquidity, there is comparatively low provisioning for non-performing loans. Supervisory colleges should be established to supervise systemically important pan-African banks at a consolidated level.

In Chapter 2, Stuart Theobald reckons that most markets in Southern Africa continue to experience rapid growth overall. However, financial integration within the SADC has been delayed at the multilateral level, and the author notes no clear prospect of the proposed common monetary area. In Chapter 3, Habil Olaka and Jared Osoro point out that cross-border financial integration in East Africa has been led by Kenya and its banks, and is not yet a consequence of the East African Community (EAC) agenda. They do, however, expect that supervision will eventually be harmonised so as to enable East Africa to reap the full benefits of an integrated financial system. In Chapter 4, Angus Downie highlights the fact that the telecommunication and banking sectors of Central and West Africa have yet to fully converge for mobile banking to start contributing significantly to financial inclusion. This is where the author sees growth opportunities over the next decade.

In Chapter 5, Thierry Giordano, Bruno Losch, Arthur Minsat and Henri-Bernard Solignac-Lecomte discuss the economic and social context within which regional integration can be expected to take place and some of the policy options. Encouragingly, the number of economically active people supporting inactive people will rise in Africa in the coming decades, thanks to declining birth rates. This will improve living conditions and boost savings and investment. Yet the authors warn that a rapidly growing workforce will put tremendous pressure on Africa's labour markets. Context-specific approaches will have to be designed to

create the number of jobs that is needed for young workers and to raise productivity in order to match social demands. Against this background, no single sector policy agenda will provide a silver bullet. However, agriculture will remain the main source of employment in Africa and demand for agricultural products will continue to grow.

In Chapter 6, the results of a pilot survey of PABs are presented, together with some stylised facts. PABs, by virtue of operating across country borders, are able to achieve economies of scale. They can leverage group-wide functions and transfer know-how and locally adapted banking products and skills. PABs are best placed to finance intra-regional trade and investment across the countries in which they operate. The rise of PABs can also be seen as the financial corollary of increasing regional integration of trade and investment, as PABs follow their clients in the growing number of cross-country deals and businesses. The footprint of PABs has grown so large that only Eritrea, Ethiopia and Somalia and Sudan do not have a subsidiary or branch of at least one of the PABs included in the pilot survey. PABs plan to continue to expand their cross-border activities over the short and medium term. Ghana, Kenya and Tanzania are reported most often as presenting high growth potential, followed by Nigeria, Rwanda, Uganda and Zambia. Angola, Kenya, Tanzania and Zambia are mentioned most often as target countries for expansion.

In the seventh and final chapter, Oskar Nelvin and Tim Bending offer a brief overview of the European Investment Bank's operations in Africa, with a focus on operations in the banking sector. The EIB invests in financial sector development in SSA with the purpose of supporting the development of the private sector and of promoting access to finance for private companies, micro, small and medium-sized enterprises in particular. The EIB supports financial sector development and access to finance both through intermediated credit lines targeting specific sectors and through direct financial sector projects. Local intermediaries are used to provide funding to clients that are too small to benefit from direct lending from the EIB. Projects can also include the financing of branch network extensions or investments in new technology, and technical assistance within specialised areas such as microfinance. Over the last 10 years, EIB credit lines and funding for regional or domestic banks and other financial institutions in sub-Saharan Africa have amounted to more than EUR 3bn.

In sum, there can be little doubt that financial intermediation has a long way to go in practically all SSA countries. It is therefore no surprise that major actors such as PABs have been scaling up significantly in recent years, and that the general trend is that of continued expansion of cross-border activity. PABs are having great success in collecting an increasing amount of deposits, so much so that they have become systemically important banks in many of the markets in which they operate. The key to improving the resilience and transparency of pan-African banking groups is to improve the exchange of information between regulators and cross-border banks.

PABs themselves stand to gain from increased credibility of their reporting and governance structures. This would enable PABs to raise longer-term resources on more favourable terms and in turn to offer their clients much-needed longer-term credit. We hope that the pilot survey carried out for the 2015 edition of this study will contribute to publicly available knowledge about PABs. Finally, a switch from pan-African networks of subsidiaries to pan-

African networks of branches would lower financial intermediation costs significantly but it requires more effective and more credible supervision on a consolidated basis for it to be permitted by home and host country regulators in SSA. The European Investment Bank is, along with the EU, a sponsor of the IMF's Afritac technical assistance centres.

Banking in sub-Saharan Africa: Key features and challenges

MAURO MECAGNI, DANIELA MARCHETTINI AND RODOLFO MAINO¹

Executive summary

- The acceleration in economic growth in sub-Saharan Africa (SSA) since the 1990s has been accompanied by an expansion of access to financial services, particularly services of commercial banks, which have traditionally been, and remain, the backbone of financial systems in SSA. Banking in SSA has undergone dramatic changes over the past 20 years. Financial liberalisation and related reforms, upgrades in institutional and regulatory capacity, and more recently the expansion of cross-border banking activities, with the rapid development of pan-African banking groups' networks, have significantly changed the African banking and financial landscape.
- Banking systems' soundness has improved over the years, although some weaknesses remain. Most countries have implemented an 8 percent minimum risk-weighted capital adequacy ratio and actual ratios comfortably exceed this minimum in most SSA countries. Progress in reducing the role of state-owned banks and enhanced supervision contributed to a lower incidence of systemic banking crises, and SSA banking systems survived the turmoil of the global financial crisis relatively unscathed. Nonetheless, excess liquidity reflects limited lending opportunities and, despite improvements, asset quality and provisioning remain comparatively low. Dollarisation has also been a persistent characteristic in several natural resource-dependent economies.
- Cross-border claims from international banks that report to the BIS – a first approximation of the extent of the integration of the SSA region into the international banking system – have remained broadly stable in the last decade. The exposure of international bank lenders to SSA is relatively small in absolute terms and compared to other regions, but is significant in terms of recipient countries' GDP. The weight of most traditional European lenders has declined, and bank financing flows in recent years have been directed mainly to resource-rich countries.
- The rapid expansion of pan-African banking groups has created significant cross-border networks. These banks are in some respects overtaking the role of the European and US banks that had traditionally dominated banking activities in SSA but have retrenched in recent years, in part due to changes in the global regulatory environment. Regional banks have stepped in to fill the gap and have become the largest participants in new syndicates and large bilateral loans to finance infrastructure development.

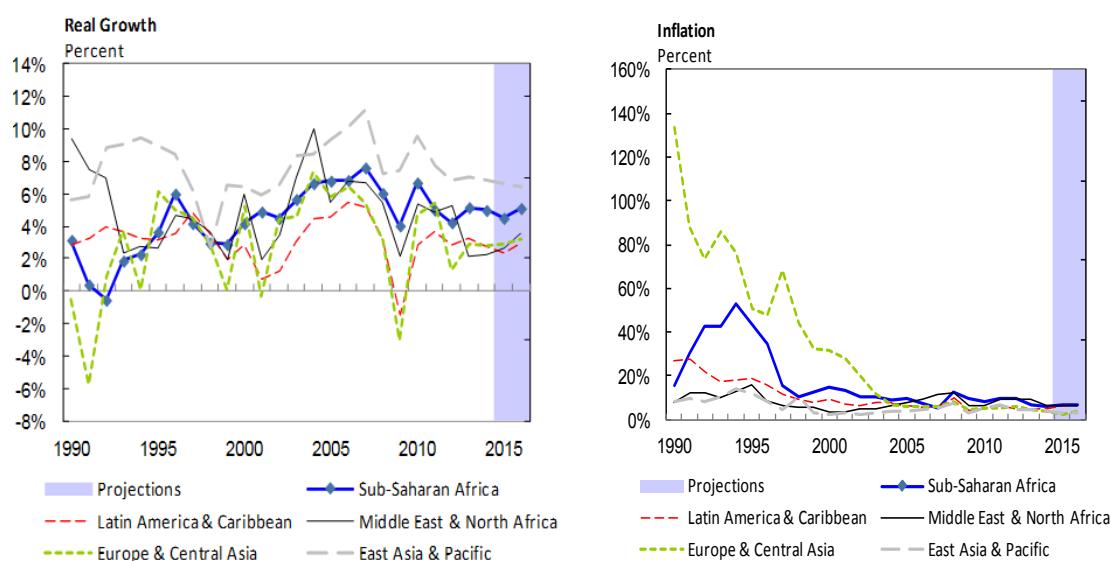
¹ International Monetary Fund, Africa Department

- A number of challenges need to be addressed if pan-African banking groups are to support continued growth with financial stability in SSA. Among the most urgent issues are the lack of formal regulatory oversight of bank holding companies in WAEMU² and their supervision on a consolidated basis. Cooperation on cross-border supervision has started, but efforts to strengthen consolidated supervision need to be intensified and supervisory colleges need to be established for all systemic pan-African groups.

1. Introduction^{3, 4}

Since the 1990s, sub-Saharan Africa (SSA) has been among the world's fastest-growing regions. For the first time since the 1970s, a large number of countries in SSA have been enjoying an extended period of strong economic growth. The recent pace of growth represents a sharp break with the experience of falling living standards and macroeconomic instability in SSA during the 1970s and 1980s — a period when the region fell behind developing countries in other parts of the world. The acceleration in growth has been accompanied, and facilitated, by a sharp reduction in inflation, which in most SSA economies is now typically in the single-digit range, despite persistent vulnerabilities to food and fuel price shocks (Figure 1).

Figure 1: SSA: Growth and inflation, 1990-2016



Sources: World Economic Outlook, IMF; IMF staff calculations.

Among the key factors contributing to this turnaround in economic fortunes were the improved macroeconomic policies in many countries. This includes the strengthening of fiscal positions, the enhanced emphasis given to containing inflation, the liberalisation of

² The West African Economic and Monetary Union (also known by its French acronym UEMOA).

³ This paper has been prepared for the European Investment Bank Africa Day Conference to be held in Luxembourg on 9 July 2015. The findings, interpretations and conclusions in this paper are those of the authors and do not necessarily represent the views of the International Monetary Fund, its Executive Board or its management.

⁴ The authors thank Anne-Marie Gulde-Wolf for valuable comments and suggestions and assume responsibility for any remaining errors. Ejona Fuli provided valuable research assistance and helped with the compilation of the dataset.

exchange controls and unification of exchange rates, and the building of foreign reserves to help contain the impact of adverse external shocks. These shifts in domestic policies were facilitated by international debt relief initiatives, which freed up fiscal space and mitigated external payments pressures in several SSA countries.

The acceleration in economic growth has been accompanied by an expansion of access to financial services, particularly services of commercial banks, which have traditionally been, and remain, the backbone of financial systems in SSA. Indeed, as noted by Beck and Cull (2013), banking in SSA has undergone dramatic changes over the past 20 years. Financial liberalisation and related reforms, upgrades in institutional and regulatory capacity, and more recently the expansion of cross-border banking activities with the rapid development of pan-African banking groups' networks have significantly changed the African banking and financial landscape. Once dominated by state-owned institutions and distorted in their operations by restrictive regulations, banking systems in SSA are now deeper and more stable, the incidence of systemic banking crises having declined dramatically in the last two decades. In fact, banking systems in SSA survived the turmoil of the global financial crisis relatively unscathed, despite indirect pressures through international trade linkages.

Yet despite these remarkable achievements, concerns persist that this progress may not have been significant enough to sustain future growth, that several countries still display shallow banking systems with insufficient depth and instruments, that financial inclusion—i.e. the extent of access to financial services and products for the majority of the population—is still limited, and that the challenges of high costs, short bank lending maturities and limited competition remain a drag on the development of a competitive and diversified economic structure in many countries of the region.

Against this background, the purpose of this paper is to take stock of banking sector developments in the region, outline the challenges, and discuss policies that could deal with them. In discussing trends for SSA as a whole, it is important to keep in mind the striking diversity within the region, whose 45 countries vary markedly in terms of population size, income levels, resource endowments, access to international transportation corridors and the extent of sociopolitical stability. These diverse conditions have had significant effects on the pace of growth and development of financial systems, which show considerable variation in depth, size, reach and complexity within the region.

The rest of the paper is organised as follows. Section II discusses the key stylised facts and trends of banking development in SSA, looking at a variety of dimensions such as size, depth, soundness and efficiency. Section III takes stock of the integration of SSA banks into the international banking system. Section IV discusses the rapid expansion of pan-African banking groups and the challenges they pose for cross-border oversight. Section V looks at the role of SSA banks in financing infrastructure development. Finally, Section VI concludes by discussing financial sector policy issues linked to the need to further develop banking and financial markets and forge a stronger financial infrastructure.

2. Stylised facts

Against the macro-financial environment outlined in the previous section, this section takes stock of the current state of banking systems across sub-Saharan Africa through broad measures of financial development, covering depth, size, soundness, efficiency and ownership.

2.A. FINANCIAL DEPTH

The banking sector in sub-Saharan Africa has expanded steadily over the past decade. Helped by reform efforts (Kasekende, 2010), the depth and coverage of financial systems—as measured by all the standard indicators of financial development, such as the ratios of private sector credit to GDP and broad money (M2) to GDP—improved substantially over the period 2000 to 2013, albeit from a low base (Table 1).

Table 1. SSA: Indicators of financial development by income group, 1995-2013

	Average of 1995	Average of 2003	Average of 2013
Domestic credit provided by financial sector (% of GDP)			
AFR LIC	19.9	23.7	27.2
AFR MIC	42.3	48.2	48.6
Other LIC	24.7	28.8	33.8
Other MIC	43.2	43.6	60.7
Money and quasi money (M2) as % of GDP			
AFR LIC	22.9	29.6	34.5
AFR MIC	34.5	40.4	44.9
Other LIC	28.2	33.2	49.8
Other MIC	43.0	50.8	64.6

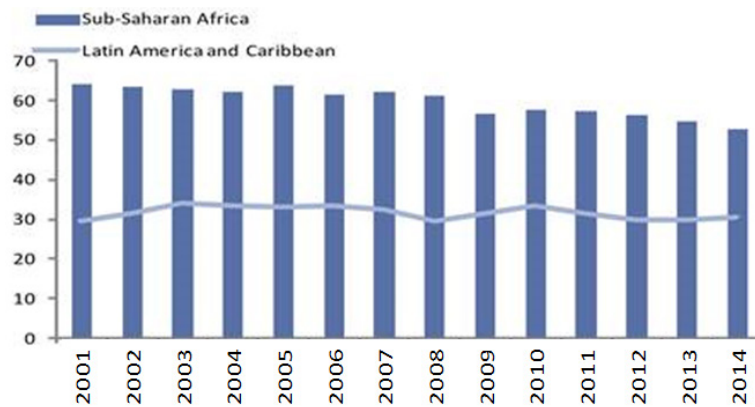
Sources: International Finance Statistics, IMF.

Note: MIC – Middle-income country LIC – Low-income country

Table 1, however, shows that on average SSA countries continue to have shallower financial systems than other developing regions of the world.⁵ This evidence reflects, in particular, the performance of SSA MICs, recording an average M2 to GDP ratio of 45 percent in 2012 against around 65 percent elsewhere. The catch-up of SSA LICs, instead, appears broadly in line with other regions. This is likely to reflect a combination of small absolute size, low economic diversification and infrastructure weaknesses, which represent critical bottlenecks to the development of African financial markets above a certain size. Confirming these observations, the ratio of M1/M2 in SSA has gradually declined over the last decade but remains significantly higher than in Latin America and the Caribbean (Figure 2). Ongoing innovation in SSA payment methods is likely, however, to address some of the difficulties that these countries still face in moving to non-cash means of payment (see sub-section below on Access).

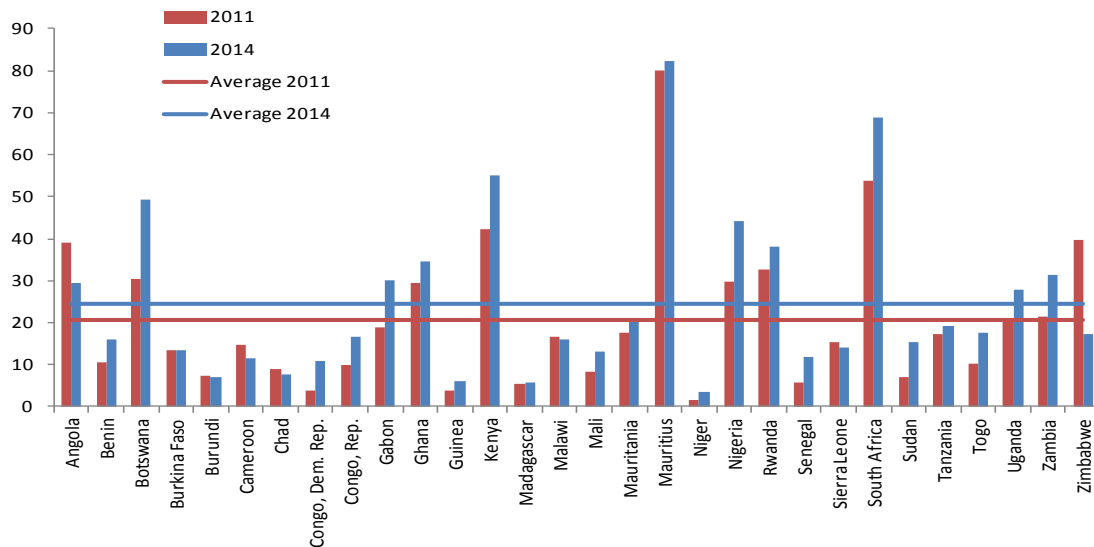
⁵ The sample includes all LICs and MICs with available data over the period 1995-2013. LICs and MICs are based on the 2014 World Bank definition.

Figure 2: SSA and Latin America: Ratios of M1 to M2, 2001-2014



Source: International Financial Statistics, IMF

Figure 3: Account penetration in SSA countries (% of adult population): Comparison 2011-2014



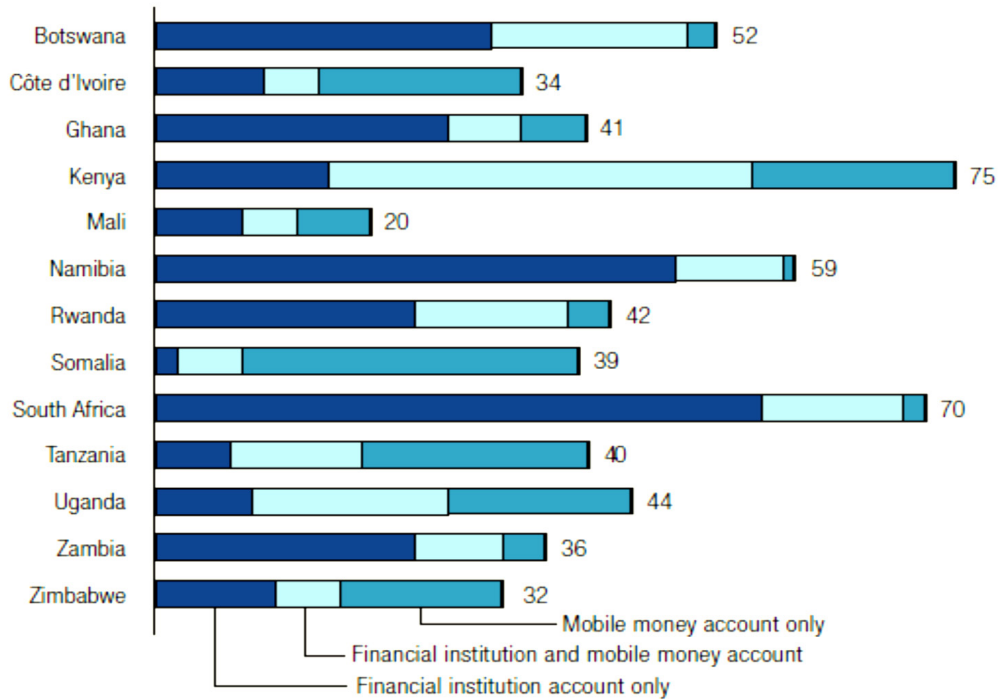
Source: Global Findex database, World Bank.

2.B. ACCESS

Also access has improved in recent years. Account penetration in SSA countries recorded a remarkable increase of almost 20 percent between 2011 and 2014, although from a low base (20.5 percent of the adult population). Account penetration improved in East and Southern Africa in particular (Figure 3). As mentioned before, these favourable developments were facilitated by ongoing financial innovation. In particular, the rapid mobile phone penetration allowed the fast rise of mobile banking in SSA, providing an opportunity to reach consumers in remote areas where efficient transport infrastructure is lacking. In SSA almost a third of account holders — or 12 percent of all adults — reported having a mobile money account (either a mobile money account or an account at a financial institution). Mobile money accounts are especially widespread in East Africa, where 20

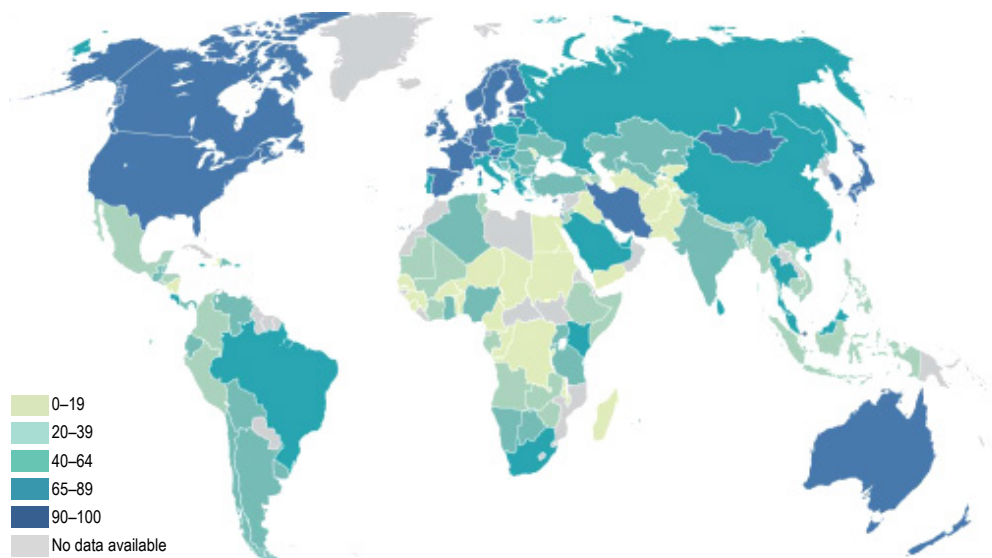
percent of adults reported having a mobile money account and 10 percent a mobile money account only (Figure 4).⁶

Figure 4: Account penetration in countries with mobile money account penetration of 10 percent or more



Source: Global Findex database, World Bank.

Figure 5: Account penetration around the world, 2014



Source: Global Findex database, World Bank

⁶ Kenya has the highest share of adults with a mobile money account, at 58 percent, followed by Somalia, Tanzania and Uganda, with about 35 percent. In Southern Africa penetration of mobile money accounts is also relatively high, at 14 percent, but just 2 percent of adults reported having a mobile money account only.

Despite these improvements, financial access in SSA remains low at an absolute level and lags behind that of other regions (Figure 5).

2.C. SOUNDNESS AND EFFICIENCY

Financial soundness has improved over the years, but some persistent weaknesses remain. In 2012-13, average NPLs for all of SSA LICs stood at close to 7 percent, compared with 9.4 percent in 1996-99 and 9.1 percent in 2000-03 (Table 2). NPLs for SSA MICs remain slightly higher — although figures ranged from as high as 13 percent for Ghana to very small numbers for Namibia (Figure 6). Provision rates (as a percentage of problem loans) declined between the late 1990s and 2000–03 for all SSA countries but rebounded by 2012. Despite these improvements, asset quality and provisioning remain low compared to developing countries in other regions (Table2).

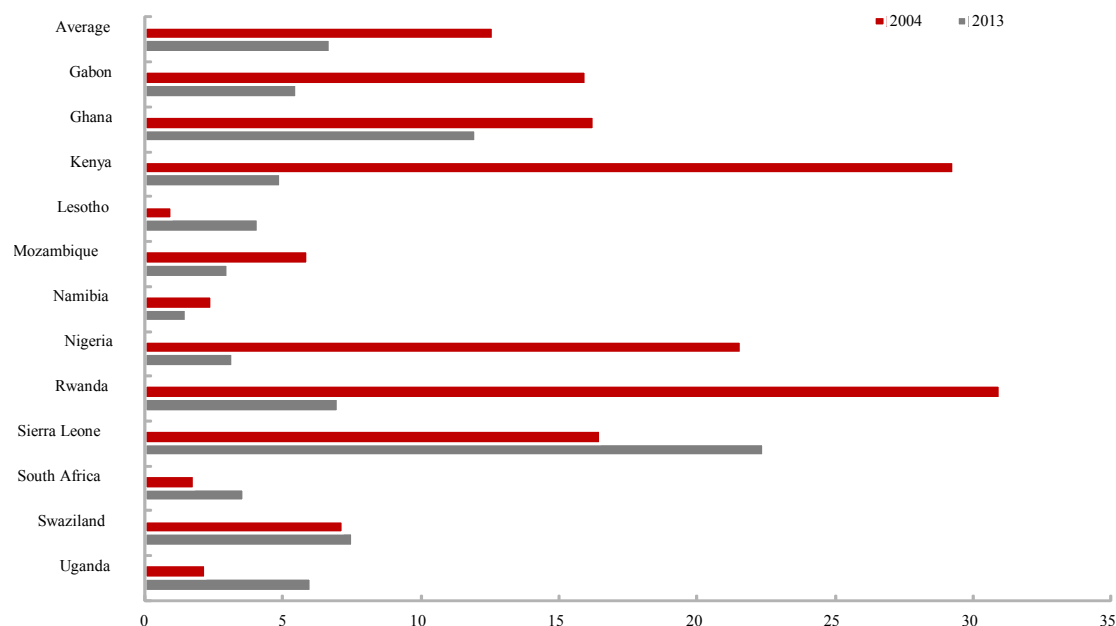
Table 2: SSA: Financial soundness indicators, 1996-2013

	Non-performing loans			Total capital			Liquid assets			Provisioning (percent of problem loans)		
	1996-99	2000-03	2012-13	1996-99	2000-03	2012-13	1996-99	2000-03	2012-13	1996-99	2000-03	2012-13
	<i>(percent of assets)</i>											
MICs in SSA	9.2	8.3	7.8	14.5	18.9	10.6	26.3	28.8	27.5	44.4	43.9	62
LICs in SSA	9.4	9.1	6.9	15.6	21.4	13.8	30.5	28.8	28.9	74.8	41.3	50.3
MICs in other regions	8.5	15.6	1.9	14.1	17.1	9.4	20.0	21.2	26.6	65.5	39.9	106.1
LICs in other regions	9.1	9.4	8	13.8	15.7	13.9	21.2	21.9	25.8	40.4	29.6	66.1

Note: MIC – Middle-income countries, LIC – Low-income countries

Sources: Financial Soundness Indicators, IMF; Gulde et al (2006).

Figure 6: SSA: Non-performing loans in 2004 and 2013
Percent of total loans

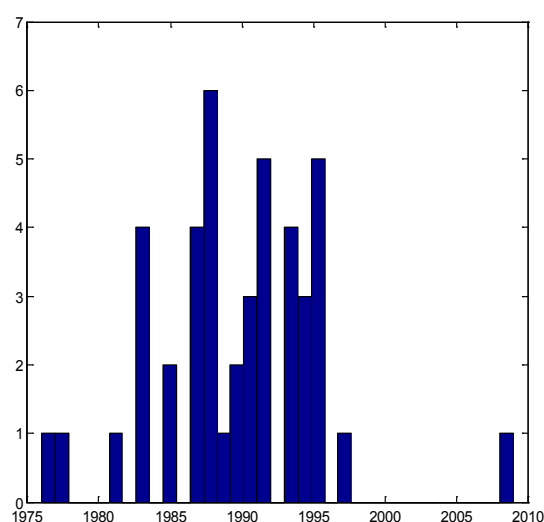


Source: IMF staff calculations based on the African Department survey on financial sector development. Latest data available based on survey conducted in 2013

Most countries have implemented an 8 percent minimum risk-weighted capital adequacy ratio (CAR), and actual ratios in most countries comfortably exceed this minimum. In 2012-13, the banks' capital-to-total assets ratio stood at about 11 percent for MICs and 14 percent for LICs, comparing well with developing countries from other regions. For the same period, the SSA ratio of liquid assets to total assets exceeded 25 percent. Persistent excess liquidity is mainly due to the difficulty in identifying sufficient lending opportunities, and it is a problem shared with other developing countries (Table 2).

Improvements in asset quality, progress in reducing the role of state-owned banks in bank lending and enhanced supervision all contributed to the strengthening of banking systems' financial health. As a result, the incidence of systemic banking crises—a relatively common event in SSA in the 1980s and early 1990s—has declined markedly, with only one major crisis recorded in the last decade (Figure 7).

Figure 7: Sub-Saharan Africa: systemic banking crises, 1975-2011



Sources: Reinhart and Rogoff (2010); Laeven and Valencia (2013).

Profitability indicators, as measured by net interest income and return on assets, declined between 2004 and 2011 but remain very high, pointing to a lack of competition (Table 3). Operational efficiency remains relatively low, as shown by a high ratio of overhead costs to total assets, with banking systems in SSA LICs less efficient than in MICs.

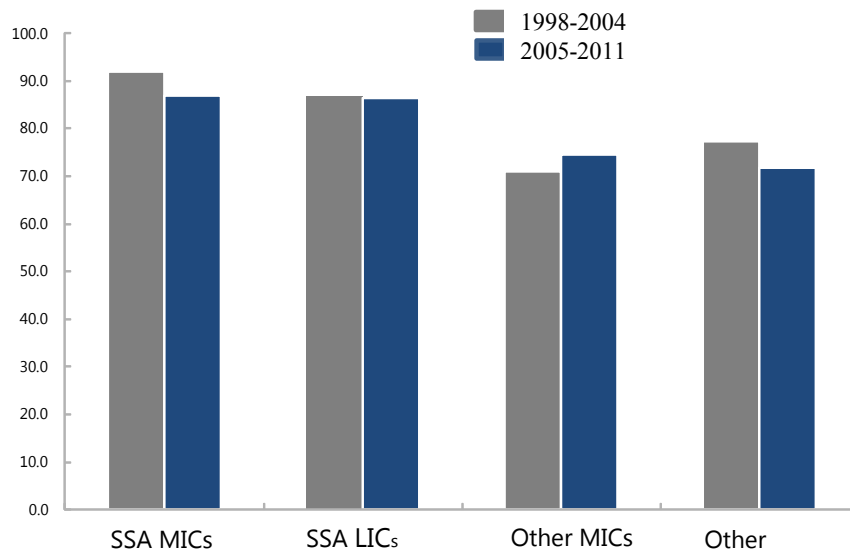
Table 3: SSA: efficiency indicators, 2004-2011*

	Interest margin (% of assets) 1/		Overhead (% of assets) 2/		Return on assets (before tax)	
	2004	2011	2004	2011	2004	2011
Low Income Countries	8.5	7.5	8.4	6.4	3.2	3.1
Middle Income Countries	6.7	5.7	6.2	4.4	2.3	2.6

Notes: * Latest data available is 2011. 1/ Percent of risk-weighted assets. 2/ Percent of total loans. Sources: Global Financial Development Database, World Bank; IMF staff calculations.

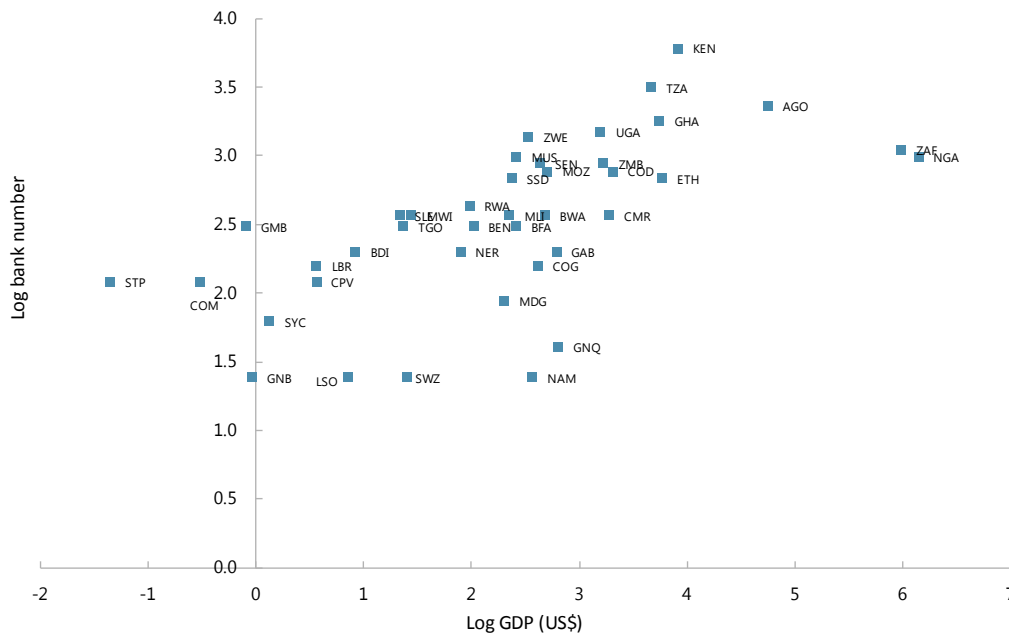
Banking systems in most SSA countries are characterised by high concentration, as measured by the share of banking assets held by the five largest banks. Bank restructuring, privatisations and new entries reduced concentration ratios slightly from the late 1990s to 2005–11, but these remain high when compared to other developing countries (Figures 8 and 9). As stressed by Gulde (2006), the small market size is seen as a major factor contributing to concentration, given the need of financial institutions to achieve economies of scale and scope.

Figure 8: SSA: Share of banking assets held by the five largest banks 1998-2011
Percent of total loans



Source: IMF staff calculations based on the African Department survey on financial sector development. Latest data available based on survey conducted in 2013

Figure 9: SSA: Size of economy and number of banks, 2012



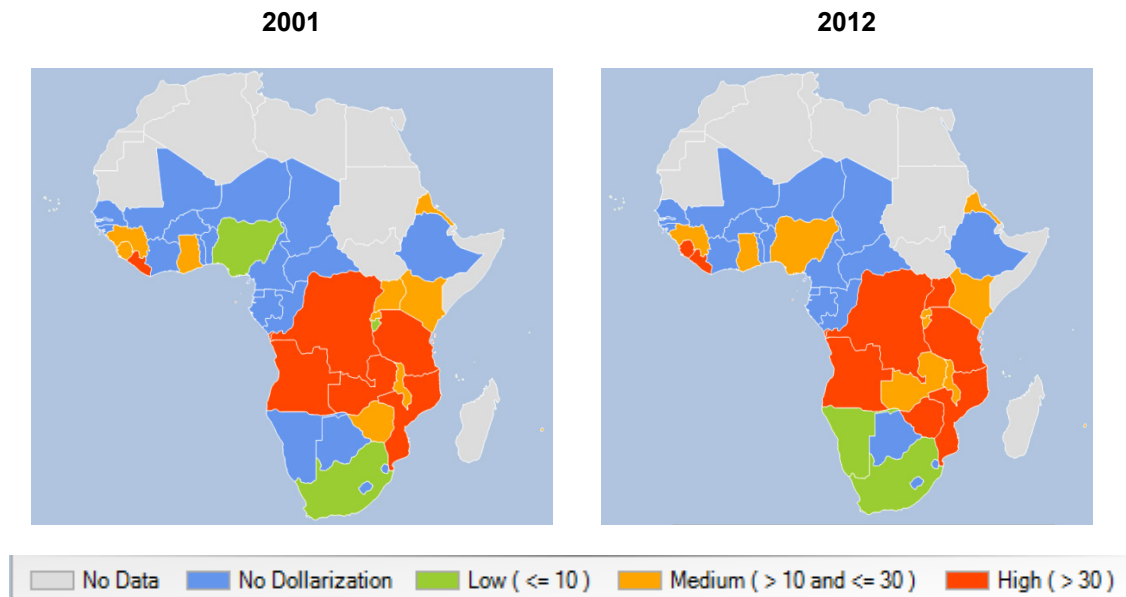
Sources: Financial Sector Profile Database, IMF; World Economic Outlook, IMF. Latest data available

2.D. DOLLARISATION

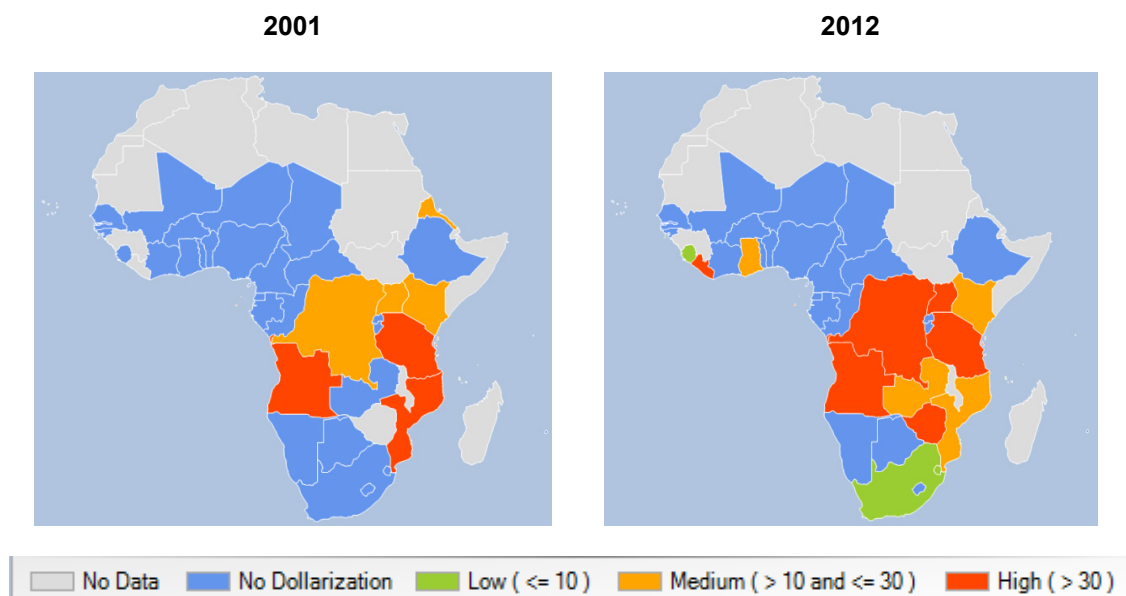
Dollarisation—the use of foreign currencies as a medium of exchange, store of value or unit of account—is a notable feature of financial development under macroeconomically fragile conditions and it has been a persistent characteristic of SSA countries. Of the five most dollarised economies (Angola, Democratic Republic of the Congo, Liberia, São Tomé and Príncipe and Zambia), only Angola recorded a downward trend in the share of both bank deposits and loans denominated in foreign currency in the period considered. The Democratic Republic of the Congo, Liberia and São Tomé and Príncipe, by contrast, recorded an upward trend during the recent decade.

Figure 10: SSA: Dollarisation picture, 2001 and 2012

a. Deposits (Foreign currency deposits as percent of total deposits)



b. Loans (Foreign currency loans as percent of total loans)



Sources: International Financial Statistics Database, IMF; African Department Database, IMF.

Figure 10 maps dollarisation in SSA in 2001 and 2012. All of the most highly dollarised countries in the region (Democratic Republic of the Congo, Liberia, São Tomé and Príncipe, Angola, Mozambique and Zambia) are natural resource-dependent economies. The number of countries with high deposit dollarisation (above 30 percent) remained the same over the period but the composition of this group changed. While Tanzania and Mozambique managed to reduce their respective dollarisation level to below 30 percent, Sierra Leone did the opposite and, as noted, Zimbabwe became fully dollarised. On the other hand, the number of countries with a high level of loan dollarisation increased from four (Angola, Mozambique, São Tomé and Príncipe, and Tanzania) to six (Angola, the Democratic Republic of the Congo, Liberia, São Tomé and Príncipe, Tanzania and Uganda).

2.E. OWNERSHIP

Since 1990, banking systems in SSA have steadily shifted from majority state-owned banking to private-owned banking and towards higher levels of foreign ownership (Table 4). In fact, the restructuring of state-owned banks and financial liberalisation allowed the entry of foreign banking institutions and contributed to higher competition.

Table 4: SSA: Ownership in the banking sector, 1990-2011*

(Banks' assets divided by total system's assets)

	State Ownership			Foreign Ownership		
	1990-99	2000-03	2010-11	1990-99	2000-03	2010-11
MICs	0.2	0.1	0.1	0.4	0.6	0.7
LICs	0.3	0.2	0.1	0.4	0.4	0.6

Sources: Gulde et al. (2006); IMF staff calculations based on the African Department survey on financial sector development. *Latest data available based on survey conducted in 2013.

Increasingly, foreign ownership includes banks headquartered in other African countries (pan-African banks or PABs), which are playing a key role in driving financial innovation and development in Africa. The PABs are contributing to financial integration and inclusion, and spurring innovation and competition.

2.F. NEW OPPORTUNITIES AND RISKS

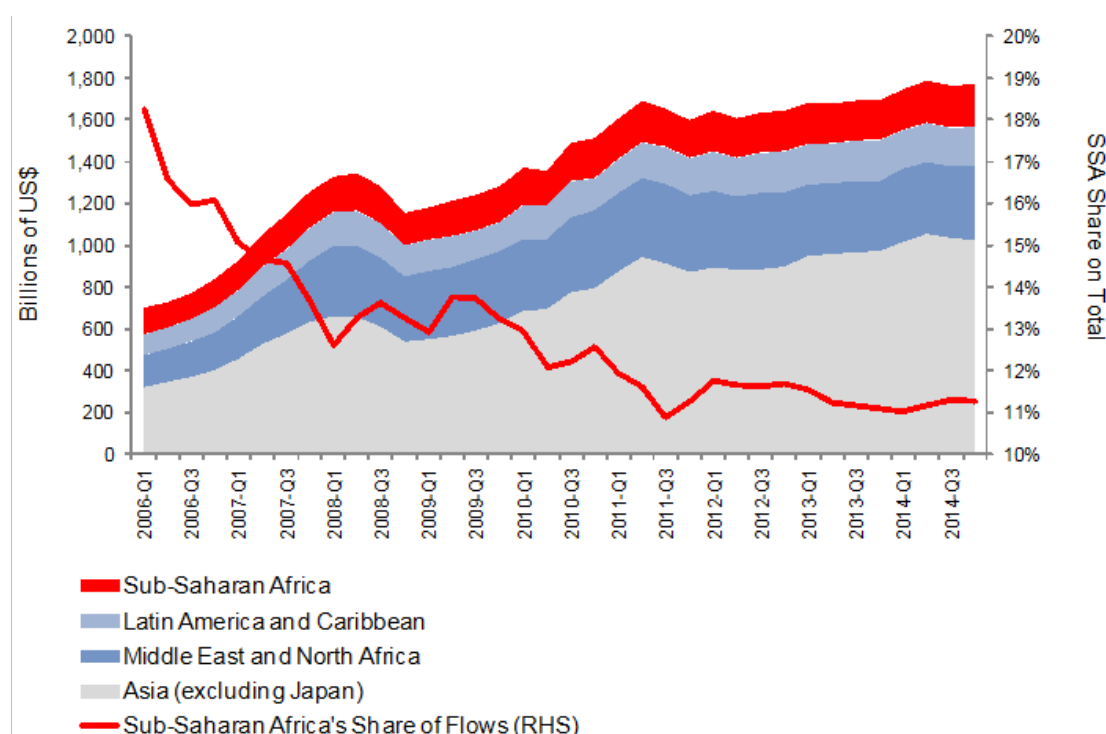
Based on the evidence presented in this section, SSA countries have gone a long way in the process of financial development. Despite the fact that SSA banking systems remain small compared with those of developing countries in other regions, progress has been steady over the past decade and has accelerated in recent years.

A combination of factors has contributed to these recent developments. The analysis in this section has already mentioned the role of financial innovation. Increasing global and regional integration may also provide new opportunities for finance in Africa, as will be illustrated in the next two sections. These developments could bridge SSA's large financing gap and unlock its potential but also bring new risks that need to be carefully monitored.

3. Cross-border credit flows and integration with international banks

International banks have traditionally been an important source of finance in emerging markets and developing economies (EMDEs). Within their overall portfolios, however, the exposure of bank lenders to SSA countries has remained relatively small, in both absolute terms and in comparison to other regions (Figures 11 and 12). In terms of recipient countries' GDP, however, this exposure is significant, and very large in some cases (Figure 18).

Figure 11: Cross-border bank claims on SSA – international comparison (2006-2014)
Consolidated claims of BIS reporting banks



Source: Bank for International Settlements.

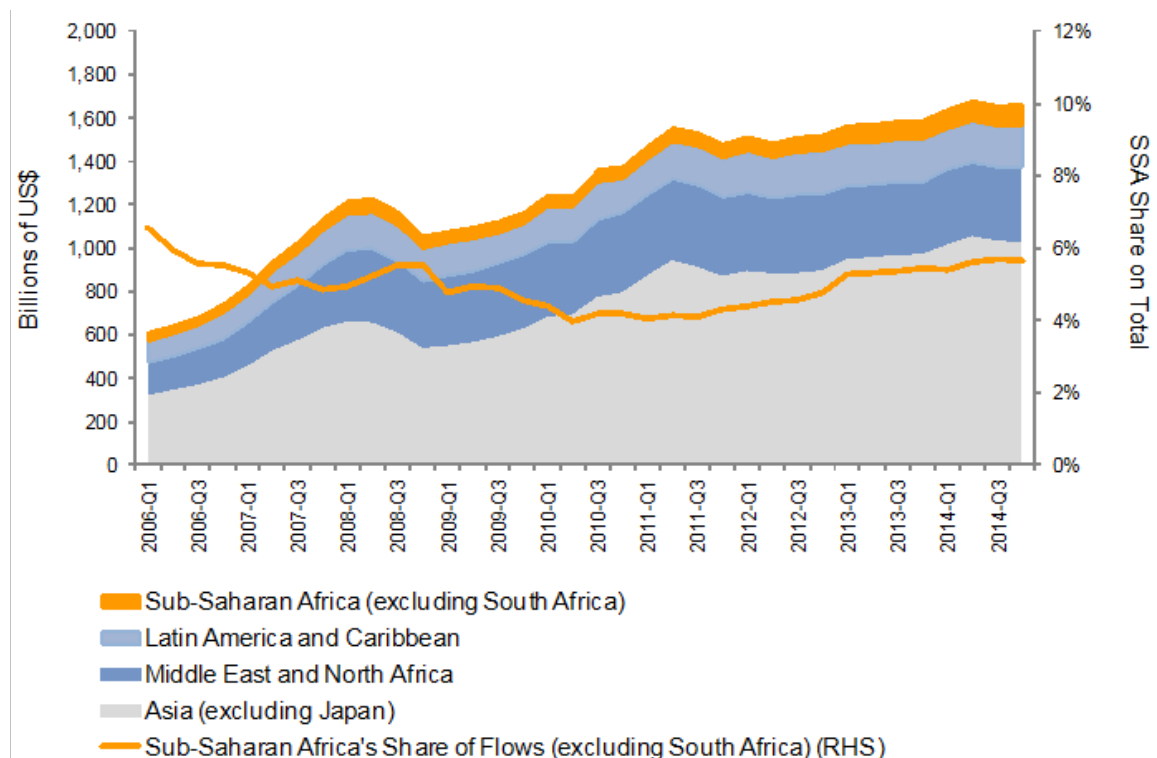
Cross-border claims from international banks that report to the BIS can provide a useful first approximation of the extent of integration of the SSA region into the international banking system. Nonetheless, cross-border exposure by itself does not provide a complete picture of the involvement of international banks in SSA. Some of these institutions, in particular European banks, have had a historical presence in the region and manage subsidiaries, branches and representative offices in many SSA countries. The importance of these subsidiaries is particularly marked in some countries, with affiliates of British, French and Portuguese financial institutions playing a systemic role.

That said, in absolute terms, cross-border exposure to SSA countries has remained broadly stable since 2007, at a magnitude of about USD 180 billion.⁷ Relative to other regions, the share of claims on SSA countries is small (just over 11% of total consolidated cross-border claims of BIS reporting banks on non-European EMs) and has declined over the years, mainly

⁷ The analysis in this section excludes cross-border claims to Liberia (international shipping centre).

reflecting the orientation towards Asian countries (Figure 11). The declining share for the SSA region reflects the reduction in the weight of cross-border claims on South Africa, where domestic lenders have expanded considerably at the expense of foreign banks (see also next section) – in part reflecting the incorporation in South Africa in 2013 of Barclays’ cross-border operations in Africa. Cross-border exposure to other SSA countries has instead increased in recent years, and the share of international bank lending flows directed to these countries remained broadly stable over the past decade (Figure 12).

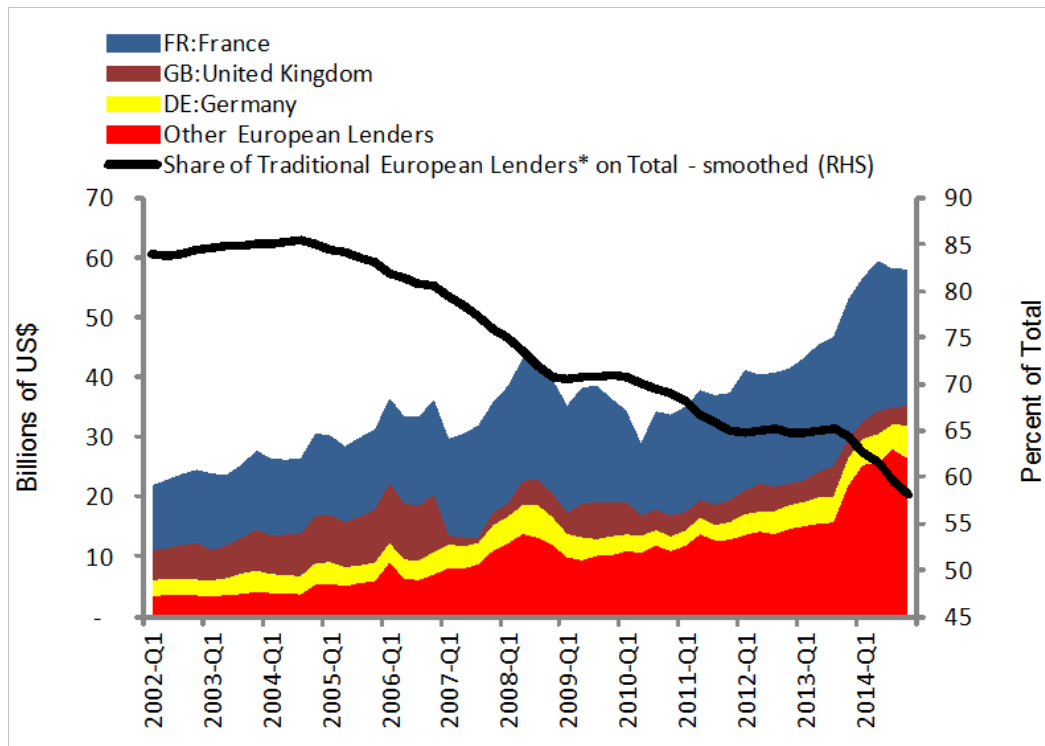
Figure 12: Cross-border bank claims on SSA (excluding South Africa) international comparison (2006-2014)
Consolidated claims of BIS reporting banks



Source: Bank for International Settlements.

International bank exposure to SSA (excluding South Africa) rose considerably in the run-up to the global financial crisis, but declined in the aftermath of that crisis. Cross-border bank flows started to recover in the second half of 2010. Some important changes in the structure of international bank flows are noteworthy. Most importantly, the weight of most traditional lenders (mainly from France, the UK, Germany and also the US) declined in favour of a greater role for banks originating in other countries (Figures 13 and 14). This reflects a number of factors, including the process of deleveraging and balance sheet adjustment undertaken by a number of European banks, as well as the introduction of stricter international standards and regulatory requirements. These have induced bank lenders to change their business strategy towards assets treated more favourably than cross-border activities under the enhanced prudential standards.

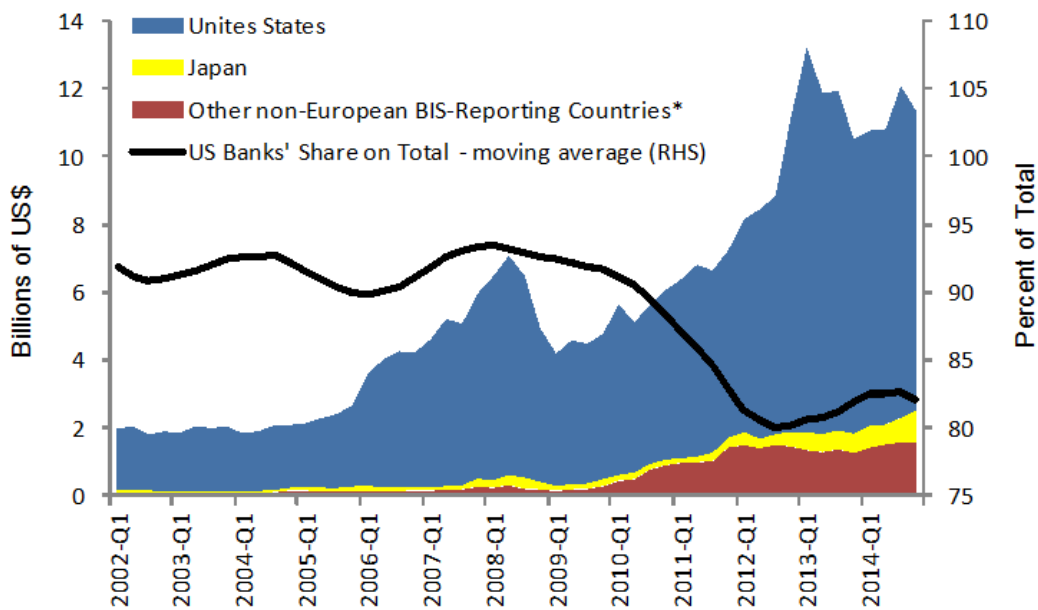
Figure 13: Consolidated foreign claims of European Banks on SSA (excluding South Africa), 2002Q1-2014Q4



Note: *Sum of claims from France, Germany and the United Kingdom.

Source: Bank for International Settlements.

Figure 14: Total consolidated foreign claims of European banks on SSA (excluding South Africa), 2002Q1-2014Q4

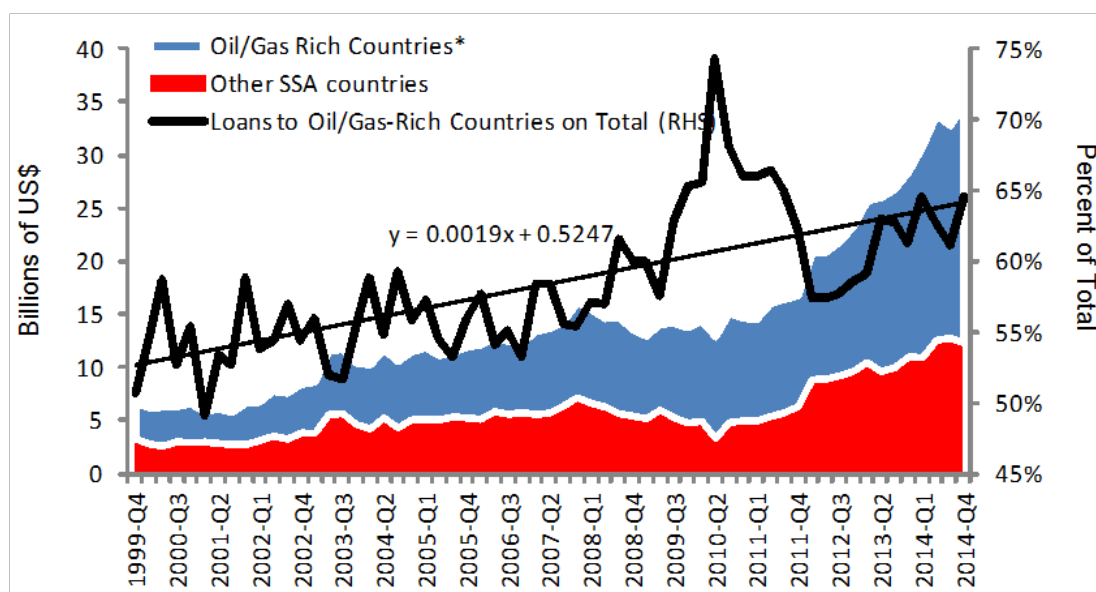


Note: *Sum of claims from Australia, Brazil, Canada, Chinese Taipei and South Korea.

Source: Bank for International Settlements.

The retrenchment of most traditional European bank lenders raises some concerns in regard to development financing, since before the crisis European banks were the principal providers of infrastructure project financing to EMDE countries, mainly in the form of international syndicated loans.^{8, 9} While new European banks have entered the market, most of the new bank financing flows in the most recent years has been directed to resource-rich countries, prima facie suggesting that the extractive industry may have been the primary beneficiary of these new cross-border bank lending flows.

Figure 15: Distribution of claims (2 years and above) by country destination (excluding South Africa), breakdown by oil/gas endowment, 1999Q4-2014Q4



Note: *Sum of claims on: Angola, Cameroon, Chad, Equatorial Guinea, Gabon, Ghana, Mozambique, Nigeria, Republic of Congo, Sudan and Uganda.

Source: Bank for International Settlements.

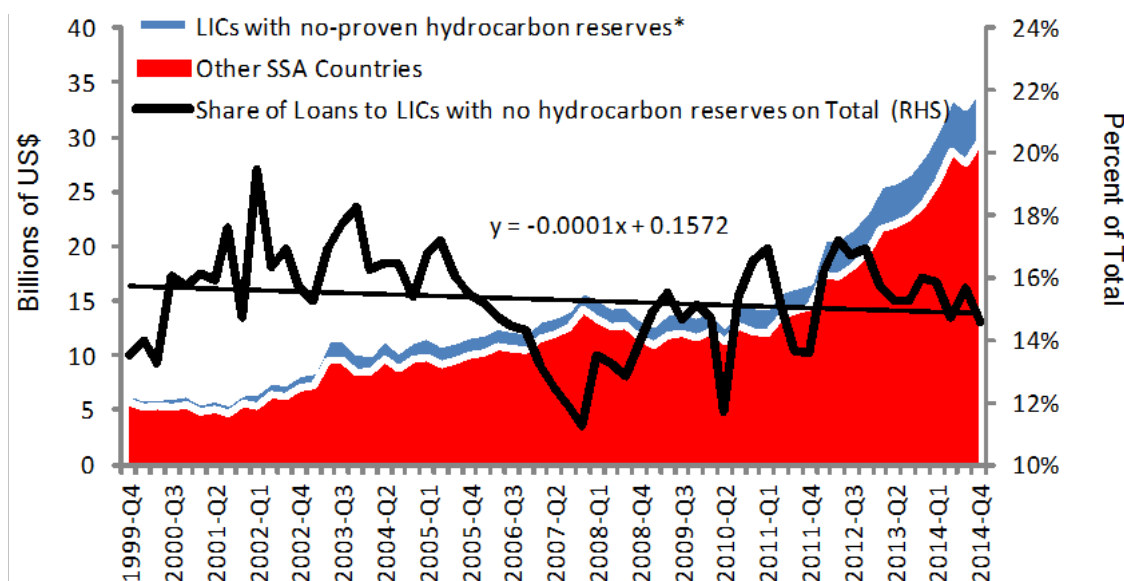
Indeed, the share of longer-term cross-border claims from BIS reporting banks on SSA oil and/or gas-rich countries has been on an increasing trend for more than a decade, despite some volatility (Figure 15). By comparison, the share of cross-border claims on other SSA countries (without proven oil and gas reserves) has fluctuated around a stable, low level (Figure 16).

The analysis of cross-border bank exposure to individual recipient countries confirms the important role of two main country-specific factors—resource endowment and business environment. Taking 2013 as an illustration, the highest exposure of international banks was, outside of South Africa, to resource-rich countries such as Angola, Mozambique, Ghana, Nigeria and Gabon (Figure 17). Among non-resource-rich countries, frontier markets with a favourable business environment and/or a relatively diversified economy (such as Kenya, Mauritius and Senegal, in addition to the already noted Nigeria, Ghana and Mozambique) were able to attract large bank flows.

⁸ Feyen et. al. (2012).

⁹ BIS (2012).

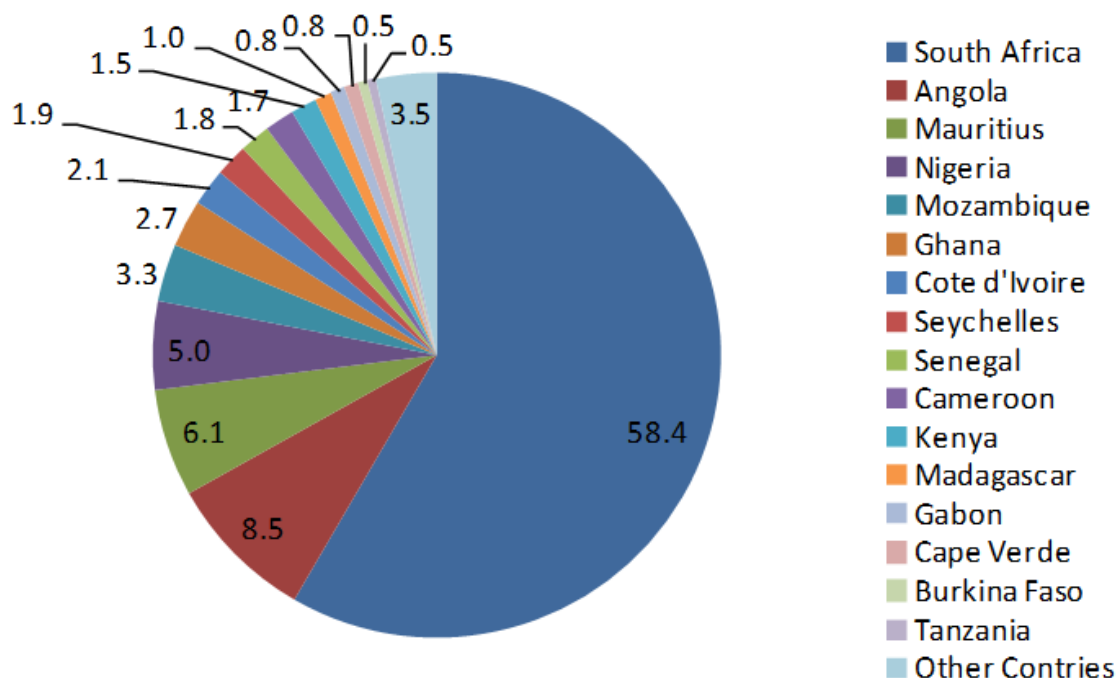
Figure 16: Distribution of claims (2 years and above) by country destination (excluding South Africa), breakdown by income level, 1999Q4-2014Q4



Note: *Sum of claims on: Benin, Burkina Faso, Burundi, Central African Republic, Comoros, Eritrea, Ethiopia, Guinea, Guinea Bissau, Kenya, Malawi, Mali, Niger, Rwanda, Sierra Leone, Togo, Tanzania, The Gambia and Zimbabwe.

Source: Bank for International Settlements.

Figure 17: Major SSA recipients of cross-border claims (% of total, average 2013)

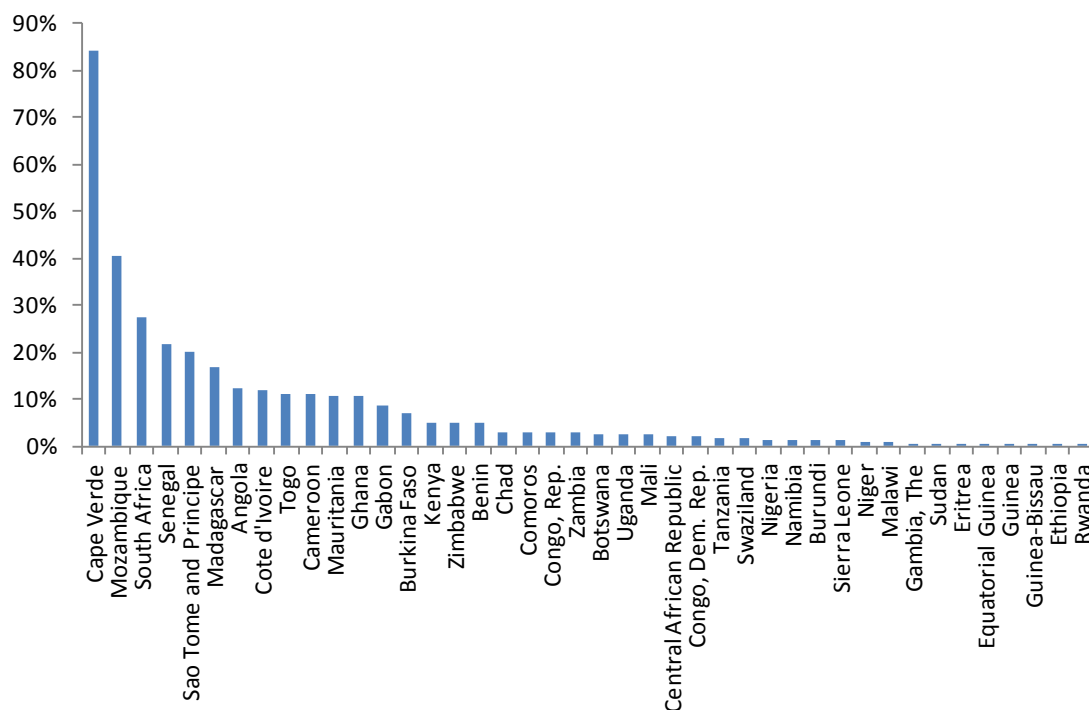


Source: Bank for International Settlements.

Relative to the size of their economy, small island economies are the largest outliers (Figure 18), in part reflecting the fact that some have established themselves as offshore financial

centres. On the opposite side of the spectrum, a number of countries with weak institutional frameworks have not been able to leverage foreign private bank funding, even in the presence of significant resource endowments (Democratic Republic of the Congo, Niger, Sudan). This confirms that access to private finance for fragile low-income countries remains a challenge.

Figure 18: Major SSA recipients* of cross-border claims, 2013Q4 (% of GDP)



Note: *Excludes offshore centres: Seychelles (228% of GDP) and Mauritius (103% of GDP).

Source: Bank for International Settlements.

4. The expansion of pan-African banks

4.A. A CHANGING LANDSCAPE

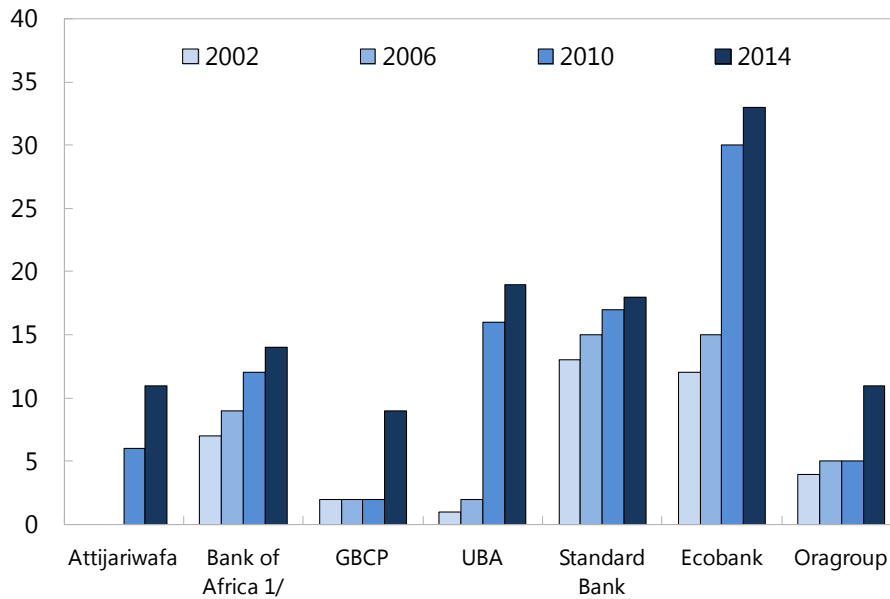
Another major change in the African banking landscape in recent years has been the emergence and rapid expansion of pan-African banking groups (PABs). These banks have created significant cross-border networks and are in some respects taking over the role of the European and US banks that traditionally dominated banking activities in SSA.

This new phenomenon reflects a number of converging push and pull factors. The most important include the improved political and macroeconomic stability in many countries; increasing trade linkages and economic integration, with incentives for banks to follow their customers in their expansion abroad; and the diversification opportunities in markets with large unbanked populations relative to more saturated home markets.

Seven major PABs dominate the landscape in terms of geographic footprint, each with a presence in at least ten African countries (Figures 19 and 20). Three of these groups are headquartered in Morocco, two in Togo and one each in Nigeria and South Africa. Additional banks, primarily from Kenya, Nigeria and South Africa, have more of a regional presence,

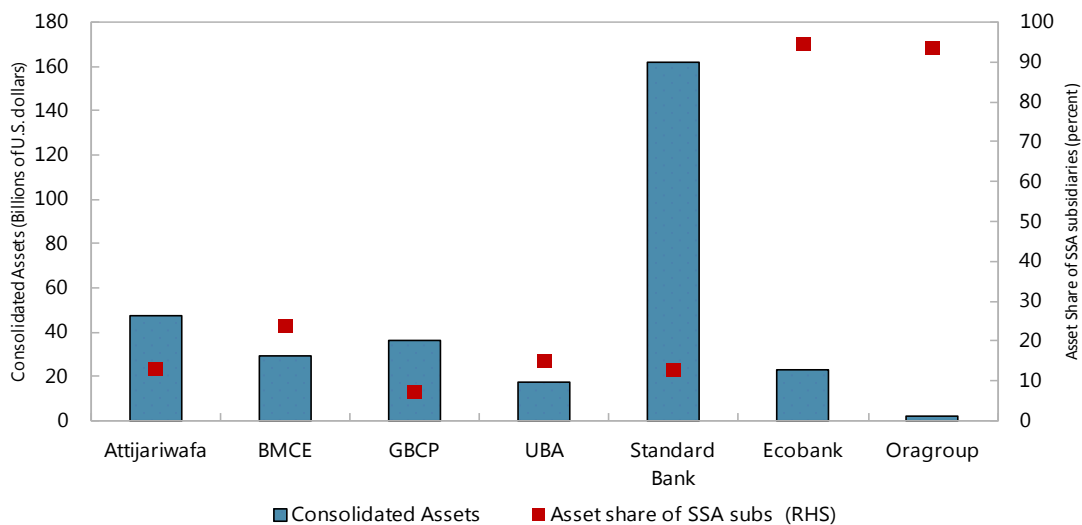
with operations in at least five countries. PABs have expanded mainly through subsidiaries, with quite different strategies and resulting structures, in particular in regard to the weight of cross-border operations and networks relative to total consolidated assets (Figure 21). These groups currently have a systemic presence in around 36 SSA countries, and are now more important in the continent than the long-established European and American banks (Figure 22).

**Figure 19: Major PABs: cross-border expansion, 2002–14
(Number of subsidiaries in SSA)**



Note: 1/ BMCE has been a majority owner of Bank of Africa Group since 2010.
Sources: Bank websites and annual reports.

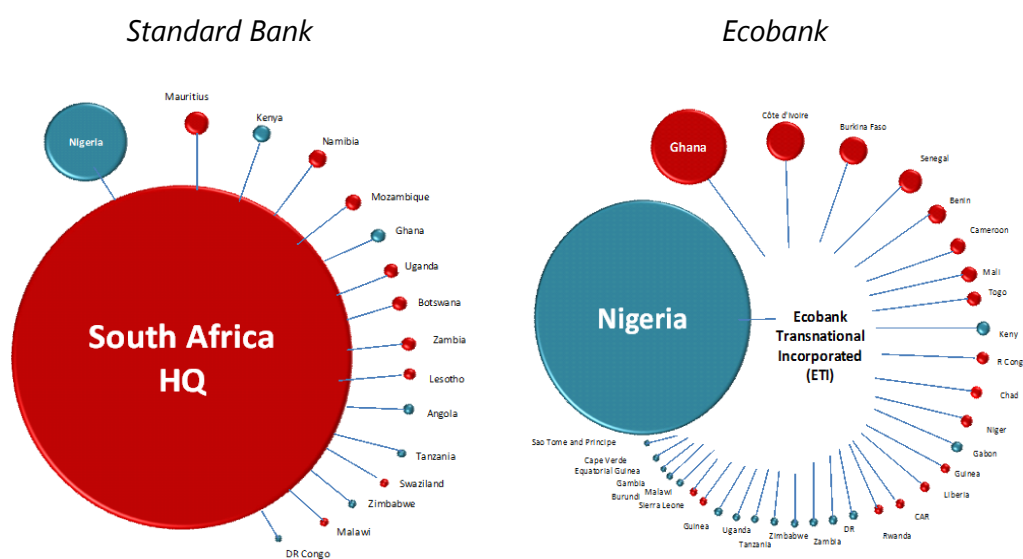
**Figure 20: PABs: Size and share of cross-border subsidiaries, 2013
(USD billion and percent)**



Sources: Annual bank reports; Bankscope; IMF staff calculations.

The expansion of PABs offers a number of opportunities and benefits, as these institutions are playing an important role in driving financial innovation and development. The expansion of these banks is helping to improve competition, supporting financial inclusion and giving rise to greater economies of scale. In addition, these institutions have also become the lead arrangers of syndicated loans for SSA infrastructure financing, filling the gap left during the recent crisis by European banks (see the next section for greater detail). Moreover, reflecting more advanced regulatory practices in Morocco, South Africa and, to a degree, in Kenya and Nigeria, the PABs based there and their home regulators are also inducing host authorities to upgrade supervisory and accounting norms.

Figure 21: Contrasting pan-African bank structure: dominant home versus dominant network



Sources: Annual bank reports; Bankscope; and IMF staff calculations.

Note: The size of the ball indicates the asset share in consolidated assets of that subsidiary. A red ball represents a systemically important presence with a deposits share exceeding 10 percent of banking system deposits.

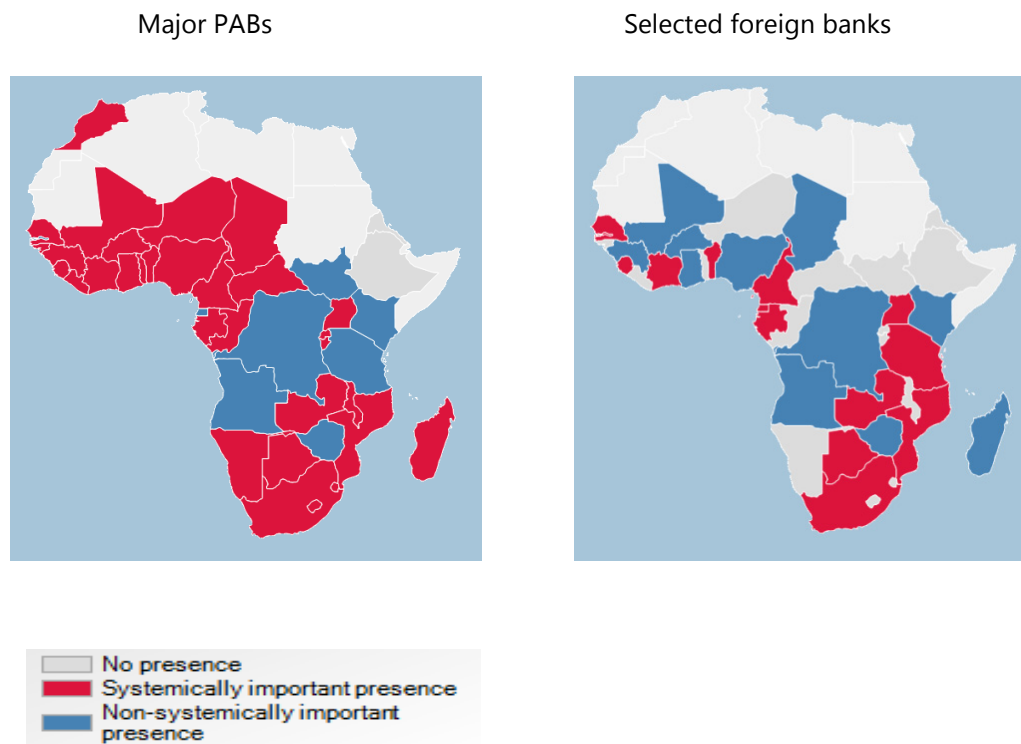
At the same time the rapid expansion of PABs and their systemic importance in a large number of SSA countries pose new oversight challenges, which, if left unaddressed, could raise systemic risks. Greater integration has benefits, but interconnectedness means that countries are more exposed to spillovers from cross-border shocks. The spread of PABs could act as a channel of contagion across African countries if a parent bank or important subsidiaries were to be subject to financial distress.¹⁰ For host authorities where PABs are systemic, risks may also arise when home authorities or parent institutions take unilateral or uncoordinated action with implications for financial stability in the host jurisdiction.¹¹ These

¹⁰ The subsidiary model may reflect the regulators’ wish to minimise contagion risks. But while requiring separately capitalised subsidiaries reduces the extent of possible contagion, it does not eliminate it – subsidiaries may well have exposures to their parents or to other bank or non-bank entities within the same group.

¹¹ The experience of several Central and East European countries with large foreign banks during the global financial crisis is instructive. The greater the asymmetry in economic size between home and host, other things being equal, the greater the likelihood that an overall strategy for a bank will not take account of the host country, and the more likely it is that financial stability will be jeopardised in the host country if problems emerge in the home country.

risks are heightened by the fact that supervisory capacity is limited and under-resourced in most of Africa, particularly in the area of cross-border oversight.

Figure 22: Selected PABs and foreign banks: systemic importance by country, 2013



Note: Systemically important presence includes parents in their home countries and subsidiaries with a deposits share of more than 10 percent of banking system deposits.

Sources: Annual bank reports; Bankscope; and IMF staff calculations.

4.B. REGULATORY OVERSIGHT CHALLENGES

A number of challenges need to be addressed if PABs are to support continued growth with financial stability in Africa. Among the most urgent issues to be addressed are the lack of formal regulatory oversight of bank holding companies in WAEMU and their supervision on a consolidated basis. In fact, at least two large PABs operate in the region as unregulated holding companies. Moreover, the fitness and propriety of owners and shareholders of PABs are not always fully assessed and ownership structures are in some cases opaque.

The availability of financial data is also limited in many countries and the exchange of data among supervisors is constrained by national secrecy laws. In particular, limited information on cross-border exposures within a PAB makes it hard for supervisors to get a firm understanding of potential spillover risks. The lack of a single accounting standard and different levels of implementation of Basel accords across the continent further complicate the assessment of the banks' overall situation (Box 1 and Figure 23).

Box 1: Financial sector supervisory standards in sub-Saharan Africa and Morocco

Summary of Supervisory Standards by Country

	Accounting Standard	Capital Adequacy Standard ^{1/}	Basel Core Principles ^{2/}	Deposit Insurance	Asset Classification ^{3/}
Angola	National	No Basel II yet	<50%	No Dep. Ins.	< 90 days
Botswana	IFRS	Basel II in progress	>80%	No Dep. Ins.	90 days
Burundi	IFRS Plan	Basel II in progress	<50%	No Dep. Ins.	> 90 days
Cape Verde	IFRS	Basel II in progress	50–80%	No Dep. Ins.	< 90 days
CEMAC	IFRS Plan	No Basel II yet	N/A	Implemented	> 90 days
Comoros	National	Basel II in progress	N/A	No Dep. Ins.	N/A
Dem. Rep. of Congo	National	No Basel II yet	N/A	No Dep. Ins.	90 days
Eritrea	N/A	N/A	N/A	No Dep. Ins.	N/A
Ethiopia	IFRS Plan	No Basel II yet	N/A	No Dep. Ins.	90 days
Gambia	IFRS Plan	No Basel II yet	N/A	No Dep. Ins.	90 days
Ghana	IFRS	No Basel II yet	<50%	No Dep. Ins.	90 days
Guinea	National	No Basel II yet	N/A	No Dep. Ins.	N/A
Kenya	IFRS	Parts of Basel II/III	50–80%	Implemented	90 days
Lesotho	IFRS	No Basel II yet	N/A	No Dep. Ins.	90 days
Liberia	IFRS	Basel II in progress	N/A	No Dep. Ins.	90 days
Madagascar	National	No Basel II yet	N/A	No Dep. Ins.	90 days
Malawi	IFRS	Basel II	50–80%	No Dep. Ins.	90 days
Mauritius	IFRS	Basel II	50–80%	No Dep. Ins.	90 days
Morocco	IFRS	Parts of Basel III	>80%	Implemented	90 days
Mozambique	IFRS	Basel II	50–80%	No Dep. Ins.	> 90 days
Namibia	IFRS	Parts of Basel II	N/A	No Dep. Ins.	90 days
Nigeria	IFRS	Basel II in progress	50–80%	Implemented	90 days
Rwanda	IFRS	Basel II in progress	>80%	No Dep. Ins.	90 days
Sao Tome and Principe	IFRS Plan	Basel II in progress	N/A	No Dep. Ins.	N/A
Seychelles	IFRS Plan	No Basel II yet	N/A	No Dep. Ins.	90 days
Sierra Leone	IFRS	No Basel II yet	N/A	No Dep. Ins.	90 days
South Africa	IFRS	Basel III	>80%	No Dep. Ins.	90 days
South Sudan	National	No Basel II yet	N/A	No Dep. Ins.	N/A
Swaziland	IFRS	No Basel II yet	N/A	No Dep. Ins.	90 days
Uganda	IFRS	No Basel II yet	50–80%	Implemented	90 days
Tanzania	IFRS	No Basel II yet	>80%	Implemented	90 days
WAEMU	IFRS Plan	No Basel II yet	50–80%	No Dep. Ins.	> 90 days
Zambia	IFRS	No Basel II yet	>80%	No Dep. Ins.	90 days
Zimbabwe	IFRS	Basel II in progress	N/A	Implemented	91 days

Sources: IFRS.org (Jurisdiction Profiles, April 2014) and PwC report "IFRS adoption by country" (April 2013); FSI Survey on Basel II, 2.5 and III implementation (Financial Stability Institute, July 2014); Standards and Codes Database; Demirgüç-Kunt, Kane, and Laeven (2014); World Bank Survey on Bank Regulation 2012; IMF FSAP and TA reports; information from IMF country teams.

Note: IFRS = International Financial Reporting Standards; CEMAC = Central African Economic and Monetary Community; WAEMU = West African Economic and Monetary Union.

^{1/} The Financial Stability Institute conducts a survey on the current status report on implementation of Basel II, 2.5, III for non-BCBS/non-European Union jurisdictions and publishes unedited responses. The column is based for Basel II on answers to Pillar 1 (standardized approach for credit risk, basic indicator approach, and standardized approach for operational risk), Pillar 2, and Pillar 3.

^{2/} This category shows percentage of compliant or largely compliant BCPs and is based on assessments against the 2006 Basel Core Principles methodology undertaken as part of FSAPs during 2007–12.

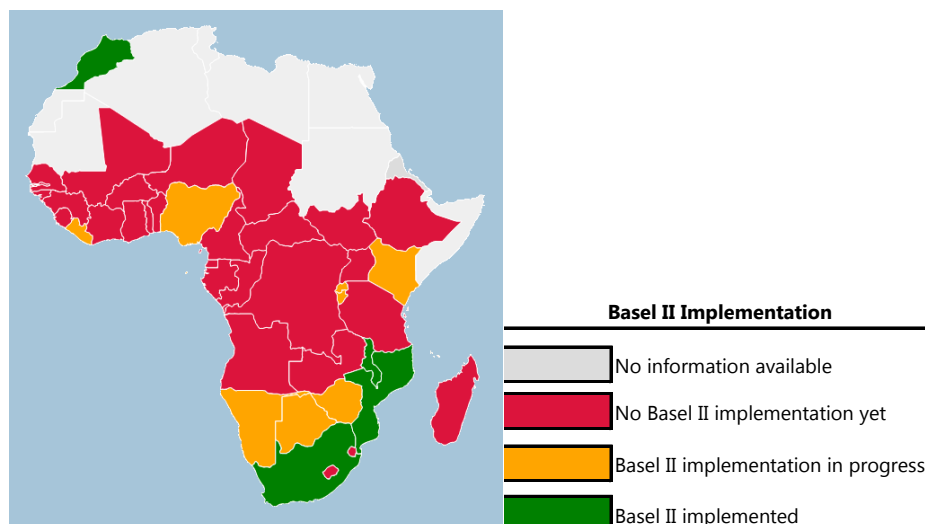
^{3/} This category indicates the threshold of "number of days in arrears" after which loans are classified as nonperforming loans.

Countries in SSA are at different development levels with regard to their financial sector regulation and supervision standards and operate at varying stages of implementation of international standards. Whereas a number of countries have moved to International Financial Reporting Standards, implementation of Basel II standards has been completed only in a handful of countries. An important part of depositor protection, namely depositor insurance, is missing in the majority of countries.

Cooperation on cross-border supervision has started, but efforts to strengthen consolidated oversight need to be intensified. The Central Bank of Nigeria (CBN) requires a Memorandum of Understanding (MOU) with home regulators before allowing a bank to be established in its jurisdiction. Quarterly meetings of the West African Monetary Institute include discussions of PAB issues. In Kenya and the EAC, several joint inspections have taken place and supervisory colleges have been established for a few PABs, with others being planned.

Nonetheless, home authorities should establish supervisory colleges for all systemic PABs. These supervisory colleges are regarded as the best vehicle for supervisors to exchange information, despite some problems that emerged during the recent crisis.

Figure 23: Sub-Saharan Africa and Morocco: Basel II implementation by country



Note: The Financial Stability Institute conducts a survey on the current status of implementation of Basel II, 2.5, III for non-Basel Committee on Banking Supervision/non-European Union jurisdictions and publishes unedited responses. The figure is based on answers to Pillar 1 (standardised approach for credit risk, basic indicator approach and standardised approach for operational risk), Pillar 2 and Pillar 3.

Sources: Financial Stability Institute Survey on Basel II, 2.5, and III implementation (Financial Stability Institute, July 2014); and IMF country team information.

Regional currency unions, such as the West African Monetary Union (WAMU), face particular challenges regarding the interface of responsibilities between regional and national authorities. WAMU operates as a single regional monetary and supervisory authority, but with a licensing and resolution role for national authorities. National responsibility for bank resolution while supervision is conducted at the regional level can seriously complicate the handling of bank problems. Given that WAMU is home to two major PABs and host to many others, developing appropriate arrangements to reconcile regional and national interests is of paramount importance. Despite some success in improving its infrastructure, SSA continues to lag behind other regions, and infrastructure gaps continue to be a major impediment to growth and competitiveness for the region. Against this background, what are the recent trends in the contribution of the banking sector to infrastructure financing?

Over the last fifteen years, privately funded infrastructure investment in SSA has been on the rise, with a variety of modalities ranging from concessions and PPPs, equity investment, syndicated loans and infrastructure bonds. In this context, bank lending has been the major source of private finance for SSA infrastructure projects. This partly reflects the limited development of other sources of private funding, but also a number of features that make bank lending particularly suitable for project finance. Bank lending ensures a more direct relationship between borrower and lender than other debt funding sources, such as the bond market. This may minimize negotiation time and avoid the costs involved in securing a

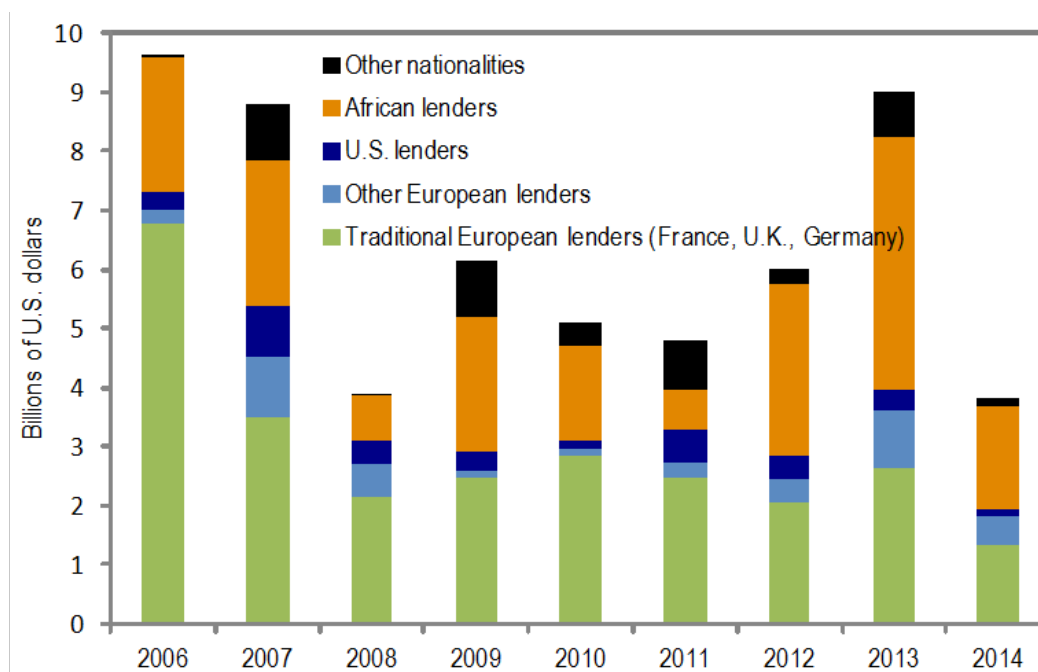
formal credit rating. In addition, banks may be more willing to finance greenfield infrastructure projects because they have a more direct overview of the project and greater ability to manage construction risk.

Bank credit is, however, very sensitive to changes in funding conditions, global risk aversion and prudential regulation, unlike non-private sources of financing. As illustrated in Section III, these (push) factors are important in explaining the decline recorded in cross-border bank credit in the aftermath of the crisis¹². They also account for a changing structure of bank flows from traditional to new bank lenders.

5. Bank financing for SSA infrastructure: from global to regional

The impact of these global factors on bank financing of SSA infrastructure has been substantial. Traditional European bank lenders (from France, the UK, Germany) were in the past the major contributors to SSA infrastructure financing, and in the aftermath of the crisis have scaled back their participation in new syndicates and large bilateral loans. Their contribution reached an all-time low in 2014 (Figure 24). The gap in development financing left by the retrenchment of traditional European banks has not been filled by the new foreign bank lenders that have entered the market (see Section 3). The contribution of these new lenders to SSA infrastructure financing has remained indeed very limited.

Figure 24: New syndicated and large bilateral loans for SSA infrastructure by lender nationality* (2006-2014)



Notes: *Where allocations were not disclosed, these were assumed to be distributed evenly among nationalities participating in the syndicate. The contribution of multilateral institutions and development banks to syndicated loans is excluded.

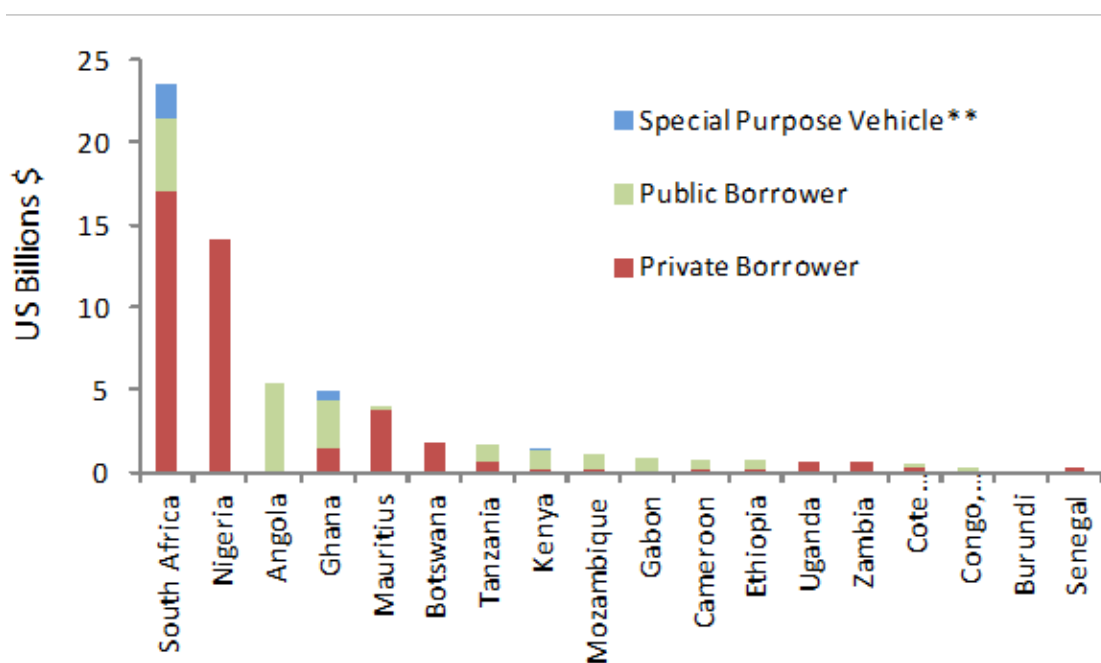
Sources: Dealogic Loan Analytics, IMF staff calculations.

¹² Frazscher (2011).

Local pan-African banks have stepped in to fill the gap and have become the largest participants in new syndicates and large bilateral loans to finance infrastructure. The increased role of African financial institutions in SSA infrastructure financing is also reflected in the growing number and volume of syndicated deals without foreign participation or where African banks are the lead arrangers of the syndicate.

Pan-African and domestic bank lenders, however, are not immune from global conditions. Volatility in international commodity prices, changes in global risk aversion and liquidity conditions can also affect the ability and willingness of SSA banks to provide infrastructure credit. The decline observed in 2014 may indeed reflect the impact of lower international commodity prices and of the depreciation of local currencies against the dollar, which affect both the demand and supply sides of infrastructure credit.

Figure 25: Top recipients of bank lending for infrastructure financing (2006-2014)*



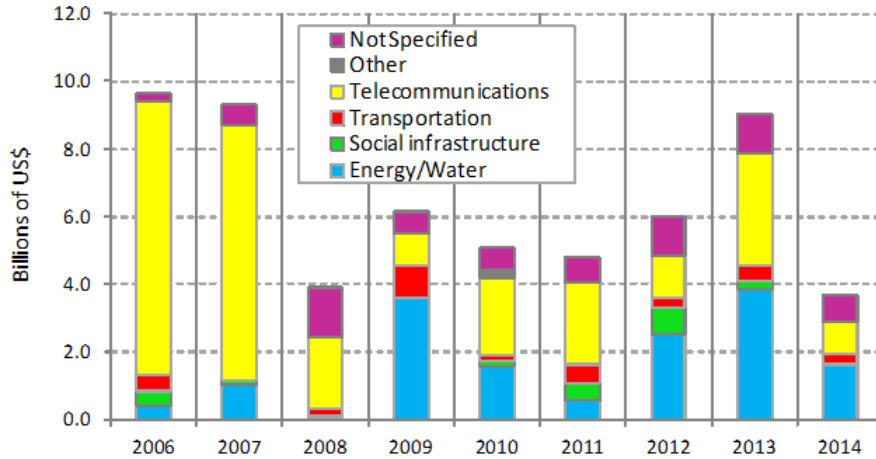
Notes: *The role of the public sector is probably underestimated in this graph, as Dealogic classifies as private borrowers any SOEs, such as Eskom in South Africa. **Ownership not disclosed

Sources: Dealogic Loan Analytics, IMF staff calculations.

While global factors influence the overall dynamics of credit flows through the financial cycle, the wide heterogeneity in lending flows observed across SSA countries points to country-specific (pull) factors in the availability of private financing for infrastructure. The size and diversification of the economy, macroeconomic conditions and natural resource endowment and prospects are among the key drivers. Oil and gas-rich countries are a primary destination of bank credit flows (Figure 25), which helps to explain the drop in bank infrastructure financing in 2014. The decline in oil prices has affected the volume of infrastructure financing deals in major oil-producing countries. In Angola and Nigeria the total value of loans originated in 2014 was, respectively, 47 and 64 percent lower than in 2013. In addition to commodity exporters, however, small middle-income countries with an

attractive business environment (for instance, Botswana and Mauritius) have also been able to attract high bank lending flows for infrastructure financing.

Figure 26: New syndicated and large bilateral loans for SSA infrastructure* – sector breakdown (2006-2014) – USD billion

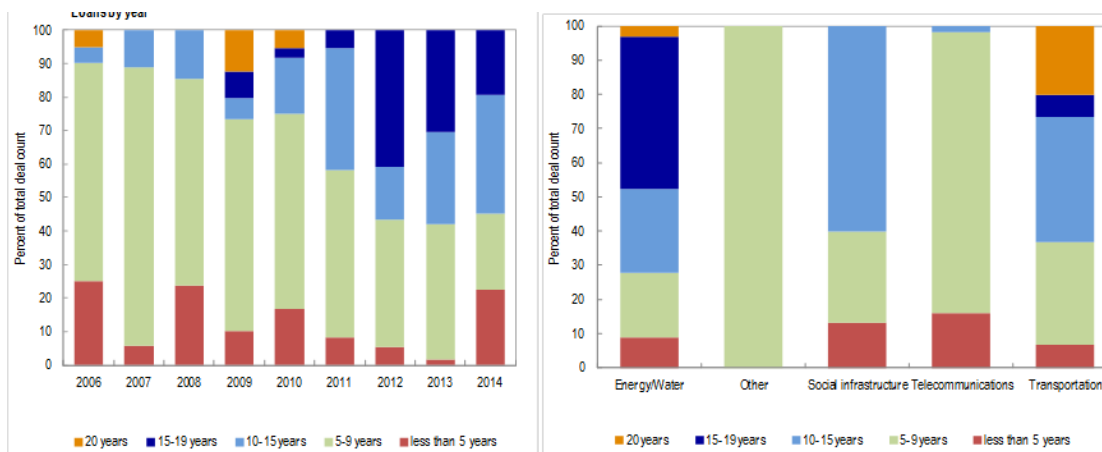


Notes: *"Telecommunications" includes loans for project finance, capital, and M&A purposes and excludes loans for general corporate purposes. "Social infrastructure" includes loans for construction/refurbishing of schools, universities, hospitals, prisons and community housing. "Other" includes loans for agricultural development projects.

Sources: Dealogic Loan Analytics; IMF staff calculations.

The sectoral distribution of syndicated bank loans has shifted in favour of projects in the energy/water sectors, which are critical for growth and development, with a smaller weight for telecommunications projects (Figure 26). This shift was associated with an increase in the tenor of bank loans as these projects usually involve longer implementation and economic life (Figure 27). In addition, unlike projects in the telecommunications sector, energy/water infrastructure projects are usually co-financed by development institutions. The presence of these institutions in the syndicate provides valuable comfort to private bank lenders, allowing them to provide the longer-tenor loans that are essential for these large-scale projects.

Figure 27. Tenor of new syndicated and large bilateral loans over time (left panel) and by sector (right panel) - percentage of total deal count



Sources: Dealogic Loan Analytics; IMF staff calculations.

6. The way forward

The history of SSA countries in the last two decades or so clearly shows that the financial sector plays a key role in fostering economic development. Financial liberalisation, a reduced role for governments in setting the price and allocation of credit and other reforms have contributed to a significant expansion of banking activities and financial products, the use of modern instruments for monetary policy, and improvements in the institutional environment. These reforms helped to set the stage for sub-Saharan Africa to become the second fastest growing region in the world.

The gains in financial development in the past two decades have nonetheless been uneven across the region, with some countries achieving decisive progress in financial deepening and enjoying increased access to international financial markets, while others have lagged behind. And for many SSA countries, financial inclusion remains too narrow, limiting prospects for sustained growth, employment and poverty reduction.

Against this background, careful consideration of the reforms needed to boost banking and financial development in the coming years is warranted, especially with regard to access to credit by firms and the population at large. In addition, a key lesson from the 2008-09 global financial crisis is that excessive complacency among market participants or regulators regarding risk and deficiencies in banking and the financial system could compromise financial stability. While many SSA countries avoided these problems during the crisis because they were not exposed to the complex instruments that were at the centre of the financial turmoil, they would do well to apply these lessons as their banking systems continue to expand in depth and sophistication, and become increasingly interconnected across national and regional borders.

In light of the above, reform efforts should target priorities and bottlenecks to support financial development and strengthen financial systems. While financial sector reforms should be tailored to country-specific challenges, the following priority areas need to be addressed:

Foster financial inclusion. Technological advances in mobile banking have opened up new possibilities to boost financial access, promote financial depth and remove financing obstacles to entrepreneurial activity while enabling lower intermediation costs. The regulatory framework should be enhanced to allow telecoms operators to collaborate with financial institutions, taking stock of the experience in the SSA countries that have succeeded in fostering these financial innovations in payment systems, savings and credit flows;

Remove structural impediments to credit and improve the market structure. In most countries, limited credit typically arises because of poor creditor rights or lack of information on borrowers' creditworthiness. In many SSA countries, the problem calls for focused reforms to legal and judicial systems (including to enhance recovery of collateral) and, in some cases, for establishing or improving the functioning of credit registries. In addition, considering alternatives to collateralisation (e.g. group guarantees) could be important going

forward. Complementary efforts such as building appropriate accounting and financial sector skills are also critical in many SSA countries;

Enhance governance and regulations. Enhancements in governance are critical in many SSA countries, and reforms in this area must be supported by a clear and even-handed application of the legal and regulatory frameworks for the financial sector. This, in particular, requires commercial courts and specialised judges. In addition, differences in commercial law, accounting and auditing standards and related practices should be reviewed and, if necessary, amended with a view to achieving harmonisation, especially in countries where cross-border banking has grown sharply;

Improve the environment for non-bank financial institutions. Legal and regulatory frameworks that cover the important role of non-bank financial institutions such as insurance companies, credit unions and other hybrid financial service providers, including leasing companies, are important in some countries to enable further financial development. Microfinance institutions also play an increasingly important role in providing credit to low-income households and micro and small enterprises;

Strengthen bank supervision. In a number of SSA countries, there is scope for further improvements in supervisory practices, approaches and techniques, including on and off-site work to identify emerging risks at the firm level and system-wide. Although the region has successfully removed interest rate controls and costly monetary instruments,¹³ there is still room for increased operational independence, adequate resources for supervisors and an end to supervisory forbearance that will allow better pricing of risk and facilitate interbank relations. Banks need to hold high-quality capital, keep adequate liquidity and implement robust internal risk management procedures and strong corporate governance;

Enhance cross-border cooperation and consolidated supervision. Given the rapid expansion of pan-African banking groups, enhancing cross-border cooperation and implementing consolidated supervision for all groups is critical. It is of mutual interest for PABs' homes and hosts that oversight capacity is strengthened as quickly as possible. In this regard, strategic collaboration between the home regulators and central banks of the major PABs could drive the cooperation and harmonisation agenda, for instance by including host country supervisors in the training they conduct for their own supervisors (e.g. Kenya, Nigeria); using joint inspections and meetings of colleges to share their knowledge with their host country colleagues; and taking the lead in promoting staff exchanges and other peer learning initiatives with supervisors from jurisdictions that have been facing similar challenges.

The agenda is formidable and many of the priority areas suggested here require efforts to strengthen capacity. Pursuing the reform agenda expeditiously will require extensive technical assistance. The IMF has been providing assistance in its areas of responsibility and is liaising with other multilaterals and national providers to prioritise a comprehensive programme to enhance capacity to supervise banking activities, and in particular the PABs' cross-border operations. Such a programme is urgent, in view of the many institutional

¹³Such as the constant use of high reserve requirements.

development challenges posed by the PABs. It could have a substantial payoff for the financial stability of individual African nations, regional groups and Africa as a whole.

References

Beck, T. and R. Cull, 2013, "Banking in Africa," Center for the Study of African Economies, WPS/2013-16, August

BIS, 2012, "European Bank Funding and Deleveraging", BIS Quarterly Review, March.

Demirguc-Kunt A., L. Klapper, D. Singer, P. Van Oudheusden, 2015, "The Global Findex Database 2014 Measuring Financial Inclusion around the World", World Bank Policy Research Working Paper 7255

Enoch C., P. Mathieu and M. Mecagni, 2015, "Pan-African Banking: Opportunities and Challenges for Cross-Border Oversight", African Departmental Paper No. 15/3, (Washington: International Monetary Fund).

Feyen E. and I. Gonzales Del Mazo, 2012, "European Deleveraging and Global Credit Conditions", WB Note.

Frazer M., 2011, "Capital Flows, Push versus Pull Factors and the Global Financial Crisis", ECB Working Paper, Series 1364.

Gulde, Anne-Marie, Catherine Pattillo, Jakob Christensen, Kevin Carey and Smita Wagh, 2006, "Financial Sectors: Issues, Challenges and Reform Strategies," Technical Chapter in Regional Economic Outlook: Sub-Saharan Africa (Washington: International Monetary Fund, May).

Gulde A.M., E. Gelbard, and R. Maino, 2015, "Financial Development in Sub-Saharan Africa: Challenges for Sustained Growth," IMF Working Paper 15/... forthcoming.

International Monetary Fund, 2012, "The Impact of Global Financial Stress on Sub-Saharan African Banking Financial Systems", Regional Economic Outlook: Sub-Saharan Africa - Sustaining Growth amid Global Uncertainty (Washington, April).

International Monetary Fund, 2015, "Navigating Headwinds", Regional Economic Outlook: Sub-Saharan Africa- Navigating Headwinds (Washington, April).

Kasekende, L., 2010, "Developing a Sound Banking System in Sub-Saharan African Countries," in African Finance in the 21st Century, ed. Quintyn and Verdier (Washington, International Monetary Fund).

Laeven, L. and F. Valencia, 2013, "Systemic Banking Crises Database," IMF Economic Review, Vol. 61, No. 2.

Mecagni M. et al., 2014, "Addressing the Infrastructure Deficit in Sub-Saharan Africa", Technical Chapter in Regional Economic Outlook: Sub-Saharan Africa - Staying the Course (Washington, October).

Mecagni M., R. Maino et al., 2015 "Dollarization in Sub-Saharan Africa : Experiences and Lessons", African Departmental Paper No. 15/4 (Washington: International Monetary Fund).

Mlachila, M., S. Gil Park and M. Yabara, 2013, "Banking in Sub-Saharan Africa. The Macroeconomic Context", African Departmental Paper No. 13/3. (Washington: International Monetary Fund).

Reinhart C. M. and K. Rogoff, 2010, "From Financial Crash to Debt Crisis," NBER Working Paper, No. 15795.

Banking in Southern Africa

STUART THEOBALD^{1,2}

Executive summary

- The banking industry in the Southern African Development Community (SADC) region has experienced substantial growth over the last decade, particularly in less developed markets.
- Two countries, South Africa and Angola, have faced banks in distress over the last year, which has added to pressure on governments and regulators to firm up the legal mechanisms for managing crisis-hit banks.
- There is a wide range of differing prospects for banking markets in the region, reflecting widely varying states of general economic development, political outlook and policy stances. Most markets will continue to experience rapid growth, with the possible exceptions of South Africa, Zambia and Zimbabwe, though for different reasons. Sharply weaker oil prices have dampened prospects, particularly for Angola, but also for Mozambique and Tanzania, though other sectors will continue to stimulate growth in those countries.
- Increased financial integration within SADC at a multilateral level has been delayed and there is no clear prospect of the proposed common monetary area and central bank. However, private sector banks continue to build cross-border capabilities in the region, driven by the prospect of large-scale project finance as well as rapidly developing consumer markets.

1. Introduction

The Southern African Development Community comprises 15 states³, with widely varying levels of economic development and financial sector sophistication. The region is dominated by South Africa's banking system, which accounts for 78% of the region's banking assets, considerably more than the next-largest, Angola's, which accounts for 8%⁴. South Africa's banks also tend to play a large role across the region, with subsidiaries in many other SADC countries.

The region consists of vastly different levels of income, from Seychelles' average GDP per capita of \$25 607, 36 times the average GDP per capita of the DRC, at \$704⁵. Financial inclusion also varies widely. In Mauritius, 85% of the adult population has a bank account,

¹ Chairman, Intellidex.

² The views expressed in this document are those of the author.

³ SADC's members are Angola, Botswana, Democratic Republic of the Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

⁴ Intellidex calculations, Bankscope (Bureau van Dijk).

⁵ IMF World Economic Outlook, 2014 estimates.

while in Madagascar the figure is just 9%, all below the OECD average of 94%⁶. This variation means that banking strategies are not easily replicable in different countries, limiting the degree of integration that can be expected as the region's banks expand into each other's markets. That is despite concerted efforts at the SADC level to increase regional integration, particularly in cross-border trade. Monetary union is a long-held ambition of SADC, with plans for a single currency by 2018 still on the table, a deadline that all acknowledge will be missed. That vision foresees the establishment of a single central bank for the region as a precursor.

Table 1: Banking industry selected indicators

	Domestic credit to private sector (% of GDP)	Total assets (US\$ m)	Growth over prior 10 years
Angola	23.5	106 683 283.20	2 466.25%
Botswana	32.0	19 148 173.66	137.09%
DRC	5.2	4 420 637.58	805.38%
Lesotho	20.2	495 910.54	218.34%
Madagascar	11.9	3 810 779.74	163.32%
Malawi	18.5	3 208 154.46	565.42%
Mauritius	108.1	56 110 687.12	424.76%
Mozambique	28.9	15 416 437.27	2 186.40%
Namibia	47.0	18 298 253.34	1 157.18%
Seychelles	21.9	1 842 406.43	4 273.61%
South Africa	149.5	1 029 837 517.71	143.37%
Swaziland	25.3	2 527 742.45	352.40%
Tanzania	13.1	22 073 818.31	724.19%
Zambia	16.5	13 547 298.39	229.49%
Zimbabwe	n/a	-	--

Sources: World Bank World Development Indicators, Bankscope (Bureau van Dijk), Intellidex calculations

The banking sector has grown dramatically in the region over the past two decades alongside increasing political stability and improved regulation. Those latter developments have in part been thanks to technical support from the International Monetary Fund, directed at efforts to improve financial sector supervision capabilities. Many countries have also benefited from central political support for deepening financial sector capacity, including local capital market development and improving the legal system to facilitate banking activities.

Over the last 10 years the region's banks have grown their asset base by 183% (excluding Zimbabwe, whose hyperinflation and dollarisation over the last decade make it incomparable). That average has been pulled up, particularly by Angola, Mozambique and Seychelles – which have each grown their banking sector more than 20-fold over the decade (40-fold in the case of Seychelles, off a very low base) – and Namibia, DRC, Tanzania, Malawi and Mauritius. Slower growth was seen in the more established markets, particularly Botswana and South Africa. The slow growth in South Africa, which has by far the greatest

⁶ World Bank, Findex study, 2014.

market share in the region, has been a significant drag on overall growth of banking assets in the region, ultimately reflecting relatively weak GDP growth and the greater level of saturation in the South African market. The countries displaying the largest banking sector growth have done so within a context of strong overall GDP growth, but that has been leveraged with specific policies to foster financial market deepening and better structural support for their banking industries.

The outlook for economic growth is very positive, with the exception of South Africa. The banking sector is likely to outpace that growth by a wide margin as institutional reforms take hold and allow banks to make inroads into their own retail markets. Institutional reform will also see better regional interaction, including more acquisitions by banks across borders. South Africa's banks, in particular, are hungry to buy into faster growth markets to their north.

Table 2: SADC key economic indicators

	GDP (US\$bn)	Real GDP growth (%)	Population (million)	GDP per capita, PPP (US\$)
Angola	128.6	4.22	24.4	7 203
Botswana	15.8	4.94	2.1	16 036
DRC	34.7	9.09	79.3	704
Lesotho	2.2	2.17	1.9	2 764
Madagascar	10.6	2.97	23.6	1 437
Malawi	4.3	5.70	17.6	780
Mauritius	13.2	3.24	1.3	18 553
Mozambique	18.6	7.37	26.5	1 174
Namibia	13.4	5.30	2.2	10 765
Seychelles	1.4	2.94	0.1	25 607
South Africa	350.0	1.53	54.0	13 046
Swaziland	3.7	1.71	1.1	7 797
Tanzania	47.9	7.24	47.7	2 667
Zambia	26.8	5.42	15.0	4 064
Zimbabwe	13.7	3.17	13.3	2 046

Note: 2014 estimates.

Source: IMF World Economic Outlook.

A final important issue is the evolution of SADC's banking regulation alongside that of the rest of the world. South Africa is a member of the G20 and is intimately involved in regulatory reforms being led by that body. South Africa's central bank also tends to play an important role in the region through the Committee of Central Bank Governors in SADC and as the home supervisor of many of the large banks in SADC markets. The region has also had to deal with its own institutions in distress, including African Bank in South Africa and Banco Espírito Santo Angola, which faced major challenges following the collapse of its Portuguese parent. These have served to spur regulatory reform to support bank supervisors' efforts to ensure financial stability in the face of banks in distress.

In the remainder of this paper I consider some important themes in the region before discussing each of the main markets. Clear themes are those of financial inclusion, capital

market development and institutional reform. All told, there is little doubt that SADC's banks have a positive outlook, particularly outside South Africa, with a growth rate among the highest in the world.

2. Banking market development

Table 3: Financial Inclusion in SADC

	Adults with an account at a formal financial institution (%)	Adults who have borrowed money in the last year from a formal financial institution (%)	Adults with a credit card (%)	Adults who have used a mobile money account in last 12 months (%)	Adults with an outstanding mortgage (%)	Adults who have sent domestic remittances in the past year (%)
Angola	29.32	2.82	4.41	0.00	2.16	14.58
Botswana	51.96	13.03	9.86	20.75	9.63	36.13
DRC	17.48	2.40	1.97	9.21	2.74	15.32
Lesotho	18.50	3.04	2.45	0.00	0.00	n/a
Madagascar	8.55	2.00	0.12	4.36	1.82	21.50
Malawi	18.09	6.03	1.53	3.84	6.03	22.65
Mauritius	82.21	17.06	17.29	0.86	15.22	4.26
South Africa	70.32	12.09	13.46	14.43	9.17	41.47
Swaziland	28.57	11.51	13.28	0.00	0.00	n/a
Tanzania	39.78	6.50	0.72	32.36	4.52	35.93
Zambia	35.64	4.82	1.88	12.11	4.64	28.95
Zimbabwe	32.39	4.04	1.83	21.60	1.53	31.17

Notes: 1.The Findex 2014 study had no data on Mozambique or Seychelles. 2.Figures are most recent values, usually 2014. 3. n/a = not available.

Source: World Bank Findex survey.

Greater financial sector inclusion has helped growth although this is not often clear in top-line asset figures, where increased government bond issuance or corporate borrowing often swamps retail asset accumulation. New technology also has a dramatic effect on inclusion, particularly the use of cellular phones. In Tanzania, Botswana and Zimbabwe, more than 20% of adults report having used a mobile account for a transaction in the last 12 months⁷, a figure that lags certain other African markets but is significantly higher than in any developed banking markets. This fact gives credence to the view that banking markets in SADC (and elsewhere in Africa) could leapfrog certain technologies. For instance, in Tanzania, less than 1% of the market has a credit card but 32% has used a mobile money account. Tanzania may in fact never have a “card phase” in the development of its retail banking market, with adults instead becoming locked into a behavioural pattern of using phones as a payment mechanism. That stands in stark contrast to developed markets, where despite the clear advantages of mobile-based payment systems, legacy banking cultures mean the card is going to be with them for a long time, just as in some markets the decidedly redundant cheque book still plays a role. These features of the technological

⁷ World Bank, Findex study, 2014.

development of retail banking markets in Africa make it difficult to predict just where the market may go next. Certainly, mobile is expected to be a central technology for transactions, account management and remittances, and may even become an important tool for consumer lending and small business banking.

While mobile has massively lowered the cost of remitting payments within countries in SADC, the development of lending markets has been less dramatic. Overall, domestic credit to the private sector only breaches 100% of GDP in Mauritius and South Africa, with the rest of SADC at below 50% of GDP.

There are a few reasons for this low level of lending to domestic borrowers. In a number of markets, yields on government paper are sufficiently attractive for banks to park much of their balance sheets in government bonds, with little need to seek higher-yielding assets. Retail banking is basically a deposit-gathering activity, with depositors earning little in the way of returns. Banking markets tend to be concentrated among just a few players, with negligible efforts by banks to compete for deposits or to lend to the retail sector. The bigger threat to the incumbent banks is competition from non-banks, including mobile companies and non-bank unsecured lenders.

The penetration of formal lending in the retail sector is modest, with fewer than 10% of adults in most markets holding any sort of bank loan. That compares with an OECD average of 18%. Housing finance is particularly scarce, with only Mauritius boasting reasonable market penetration of 15%. Angola, DRC, Madagascar, Tanzania, Zimbabwe and Zambia all have less than 5%. In many respects, this is a consequence of legal environments that do not adequately provide security of tenure or allow for efficient recovery of security in the event of default. Clear steps, however, have been taken, for example, to provide people living on communally owned land with title deeds, set up central land registries (some of which were destroyed in civil strife over the years) and promulgate laws to support speedy resolution of defaults. Some of this is being driven by SADC centrally, with support from multilateral institutions like the IMF and the United Nations Development Programme.

Consumer finance has seen rapid growth in the region over the last decade. South Africa has been through a boom and bust cycle in unsecured lending, but Botswana, Zambia, Tanzania and Malawi are still on a clear growth trajectory. Consumer finance is a two-edged sword, at one level helping to drive consumption-led growth but at another increasing the financial vulnerability of consumers to economic shocks. Consumer lending depends substantially on well-functioning consumer credit bureaus that are able to record behaviour. Only South Africa, Botswana, Namibia and Swaziland have sizeable coverage of their local populations' credit history⁸. The SADC Credit Reporting Alliance is a project to try to accelerate this development, with the long-term aim of increasing access to finance for small businesses and households. It is also aiming to improve cross-border information sharing, which will facilitate greater integration and supervision.

Despite limited credit information history, some non-bank lenders have still built sizeable businesses relying on their own information and other analytics such as cellular phone use for credit scoring. These alternative business models have the potential to shake up the

⁸ World Bank World Development Indicators, 2014.

banks, particularly when it comes to the liability side of the balance sheet. For example, Botswana-based Bayport operates across the region and has built a large unsecured lending business. It is now applying for banking licences in its markets. With those in hand it will be able to dramatically cut its cost of funds by replacing its shareholder and bond funding with cheaper consumer deposits. Banks will have the options of either increasing the cost of their deposits or increasing the yields on their assets, or both. Business as usual will leave many uncompetitive.

Banks are also working to drive development of syndicated lending across the region. The SADC Banking Association, which conducts projects among member banks from the region, has led a 10 year-long programme to improve capacity for public-private partnerships, in which banks can play a prominent funding role. Given the region's infrastructure needs there is clear scope for banks to be active lenders in large project finance, although it is critical that balance sheets in the region grow to be able to accommodate large single exposures.

Local banks are playing an increasing role in syndicated transactions, often alongside South African, US and European banks and a growing number of Chinese and Indian banks. 2012 saw a record number of syndicated deals in the sub-Saharan region⁹, heralding a recovery after the financial crisis. These deals have focused on corporate loans, project finance and reserves-based lending to oil and gas, telecommunications and mining industries, with Zambia and Angola seeing rapid growth in such deals. Resource-based projects will continue to be a major source of asset growth for banks, with markets like Tanzania and Mozambique set for a number of mega-projects. Often local banks will form conduits for international bank funding as they access global credit lines. There are also clear opportunities in domestic infrastructure finance, with international and local banks working alongside multilateral development finance institutions like the African Development Bank and the Development Bank of Southern Africa. As the capital bases of domestic banks grow, they will become an increasing feature of such club deals.

3. Deepening capital markets

The 2007/2008 financial crisis put the brakes on the development of Africa's capital markets. Nascent stock exchanges in Mozambique and Malawi have stalled, with only a few counters listed. A proposed stock exchange in Angola has yet to be launched, seven years after its planned launch date.

The Committee of SADC Stock Exchanges was created in 1997, shortly before the emerging markets crisis of 1998, and has served to share best practice and expertise across the region. The SADC Protocol on Finance and Investment was set up in 2006 to drive integration of capital markets across the region. All of these are making slow progress in helping to build capital market institutions and activities.

⁹ Green, 2013.

Table 4: Stock exchanges in SADC

	Value traded (\$m)	Listed companies	Data for (year)
Botswana Stock Exchange	135.6	39	2012
Dar es Salaam Stock Exchange (Tanzania)	278.7	17	2012
Johannesburg Stock Exchange (South Africa)	408 629.0	400	2012
Lusaka Stock Exchange (Zambia)	68.3	20	2012
Malawi Stock Exchange	26.7	14	2014
Mozambique Stock Exchange	60.5	3	2012
Namibian Stock Exchange	777.5	38	2014
Seychelles Securities Exchange	2.6	4	2014
Stock Exchange of Mauritius	586.0	90	2014
Zimbabwe Stock Exchange	448.2	79	2012

Note: Other SADC markets have no functioning stock exchange.

Source: African Securities Exchanges Association.

Capital markets are critical to a healthy banking market. Bond issuance and trading allows for the creation of a yield curve to serve as a pricing benchmark for all lending. Stock exchanges allow banks to raise high-quality capital but also to improve financial intelligence on key domestic companies by obtaining price discovery for their shares and detailed financial information. Bond markets provide additional funding sources and allow banks to securitise and shift certain assets off their balance sheets on to those of other domestic institutions, giving them liquidity.

Botswana and South Africa have both worked hard to deepen bond markets by issuing instruments at the longer end of the yield curve and by creating more sophisticated benchmark instruments such as inflation-linked bonds. Often this issuance has been surplus to government funding needs and conducted simply to develop capital markets. Stock exchanges are less dependent on government issuance, although some have been established with government debt as the first listed securities. Some exchanges like Lusaka and Malawi were brought into existence through the privatisation and listing of state-owned companies, a mechanism that was common in the 1990s but has been used less often since.

The proposed Angolan exchange, which was first slated to open in 2008, is now set to open with the listing of subsidiaries of Angola's oil giant Sonangol in 2017. Two large banks (Banco Angolano de Investimentos SA and Banco de Poupança e Crédito SA) and mobile phone companies are also expected to list. As Angola has the second-largest economy in the region, the opening of an exchange there could be a significant spur to development of the financial sector.

Exchanges depend on the mobilisation of domestic savings and demand from local companies for equity capital. Often reform of pension and insurance regulations is a key part of mobilising domestic savings and it needs to accompany stock exchange reform. Banks are both friend and foe in the development effort, able to spur stock exchange growth by listing

themselves, but then acting to intermediate on companies' capital needs rather than leaving them to issue securities.

SADC's existing stock exchanges have been pushing ahead with their development despite the headwinds of the financial crisis. Many have been tightening up custody rules and settlement, written and amended securities legislation, and are improving the institutional structure of exchanges, including demutualisation. They have also been widening access to new instruments such as exchange-traded funds, credit securities and commodities. Trading technology has also been improved in most markets to allow retail online trading and live data feeds. These are all small steps in the right direction that can only support financial market development.

4. Regulatory reform

Central banks in the region have dramatically improved their supervisory capabilities over the years. Development has often been supported by technical assistance from the IMF but also by increased cooperation between SADC member countries. This has not only supported regulatory reform, but also development of banking infrastructure such as regional electronic settlement systems. Domestic money markets and interbank lending markets are also growing across the region, facilitated by institutional architecture set up by central banks and governments.

Most central banks now operate with legislated independence from their governments. Licensed banks include privately owned domestic institutions, foreign-owned banks and branches and state-owned banks. In markets where state-owned banks are still a presence in commercial banking, they usually have private sector competitors and operate on a more or less level playing field with similar risk management rules and sources of funding.

The wide variation in banking markets, however, leads to very different capabilities among regulators. South Africa, as a member of the G20, has been among the first countries in the world to implement the Basel 3 capital accord. With over \$1 trillion in assets, its banking market is deep and sophisticated. Other markets are at a much earlier stage of building oversight capacity. But despite this variation, common themes emerge in regulatory trends.

South Africa is busy with amendments to legislation to improve its capabilities to manage banks in distress. It is also likely to implement reforms in its shadow banking system, particularly around money market accounts. It is also introducing a "twin peaks" regulatory model, with the central bank responsible for systemic oversight and a conduct authority to oversee market behaviour.

In other markets, reforms are focused on improving bank capitalisation and risk management by stipulating liquidity ratios, single exposure limits, and occasionally controls on the term structure of balance sheets. In certain markets, regulators have been reluctant to impose onerous Basel regulations on their sectors, particularly risk-weighted capital rules, in order not to constrain their lending into local economies. This differentiation in regulatory burden will see local and foreign banks coming to play slightly different roles in each economy in terms of which market segments they focus on. In the longer run, however, regulatory standards will converge across the region and the rest of the world.

In what follows I discuss some of the issues particular to each of the main markets in the region.

5. Comments on selected markets

5.A. ANGOLA

Angolan financial institutional capacity has improved dramatically over the last decade, with the asset base of the industry having grown 20-fold. The sector remains highly concentrated, with the top five banks holding 72% of assets, although this concentration has been slowly declining as smaller private sector banks have gained market share. The industry is geographically concentrated in Luanda and has significant exposure to the oil sector, with 21 banks and foreign-owned branches licensed. The industry appears comparatively profitable and efficient, with an average return on equity of 15.4% and cost-to-income ratio of 67%. Performance varies though, with the third-largest, Banco de Fomento, boasting RoE of 33.6% and a cost-to-income ratio of 35.2%, while the fourth-largest, Banco de Poupança e Crédito, is at 8.0% and 69.5% respectively.

The industry has had a somewhat tumultuous time following the collapse of the Portuguese parent of 56%-held Banco Espírito Santo Angola, the largest bank by assets in the country. A bad bank/good bank resolution plan for Lisbon-based Banco Espírito Santo (BES) was announced by the Portuguese central bank in August 2014. The Angolan subsidiary was an important part of the resolution as it held a €3.0bn line of credit from the Portuguese parent that was initially considered to be one of the good assets of the holding company.

BES Angola was recapitalised in 2013 and had rapidly grown its loan portfolio. There have been suggestions that this portfolio has seen loan quality deteriorate although it holds provisions for bad loans of less than 3% of its book, the lowest of the five largest banks. It has the smallest deposit base of the big banks but the largest loan book, with a loan to deposit ratio of over 200%, by far the most leveraged bank in the market thanks to the line of credit from its parent. Conflicting reports say the Angolan government had guaranteed up to \$5.7bn of the \$7.9bn loan book at the time of the 2013 recapitalisation. This guarantee was very material, representing 4.4% of Angolan GDP.

The collapse of the Portuguese parent had interesting consequences for BES Angola, although the exact details of the process followed remain obscure. The Angolan government took the curatorship of the parent as a reason to withdraw the guarantee, leaving BES Angola insolvent as a result. This triggered a recapitalisation plan for the Angolan bank that saw state-owned oil company Sonangol and another local company, Lektron, become major shareholders, diluting the Portuguese parent's interest to 9.9%. As of late last year this was being challenged by the Portuguese parent, raising the prospect of a diplomatic standoff.

Whatever the resolution of the situation, Angola's policy framework is sure to face an overhaul to improve the central bank's ability to manage distressed banks.

In the rest of the industry, the collapse of the oil price has raised fears over the quality of various oil industry exposures. Sustained weakness in the oil price will exacerbate this and may lead to a spike in provisions and damage to profitability in the industry.

The regulators have been pushing ahead with the development of financial market infrastructure, including a money market, which now sees active trade in treasury bills of up to 364 days in maturity to mop up liquidity¹⁰. At some point the long-planned Angolan stock market will open for business, perhaps by the current deadline of 2017. A focus on improving company accounting and reporting is now taking place. Bank disclosure rules are also being tightened, with stricter rules on auditing, risk management and the use of stress-testing.

5.B. BOTSWANA

The Botswanan banking market is mature and well-regulated. The industry has 10 licensed banks operating, dominated by subsidiaries of South Africa's First National Bank and Standard Bank, and UK banks Barclays and Standard Chartered. Those four banks command 82% of assets in the industry¹¹.

The maturity of the industry means asset growth has lagged that of the rest of the region. Botswana is among the top three countries for bank account and mortgage penetration and offers relatively sophisticated consumer banking products. The banking industry is highly profitable, with the larger banks all boasting RoEs of around 30%. High RoEs are facilitated by relatively thin capital ratios, with those of most of the larger banks being under 10%. Because banks are backed by large foreign parents, lower capital ratios are the norm. Most banks are quite efficient, with cost-to-income ratios of between 40% and 65%.

The central bank supervises the sector and has clear and well-adhered-to policies on liquidity ratios, capital adequacy, provisions, concentration risk limits and foreign exchange exposures. It has been attempting to encourage banks to support growth in the real economy. The government has done well over the last 12 years to build a yield curve by issuing bonds of varying maturities despite running budget surpluses in most years. The average asset-to-loan ratio is about 65%, with banks parking idle cash in government paper.

The Botswanan government has various programmes in place to drive diversification of the economy away from its concentration on minerals, particularly diamonds. This includes an offshore financial services centre, modelled on Ireland's, which has been slowly attracting some regional-based financial institutions. Gaborone's close proximity to Johannesburg (356 km by road) provides a large potential market on its doorstep. However, weak diamond prices in the wake of the financial crisis led to a sharp economic slowdown, although the economy has bounced back from this fairly quickly.

Botswana's strong regulatory environment and well-conceived industrialisation policy is sure to drive continued growth and diversification of the economy. The highly profitable banking sector will accordingly show steady growth.

5.C DEMOCRATIC REPUBLIC OF THE CONGO

The DRC's banking market is small, with 14 banks operating and total assets of \$4.3bn. Profitability and efficiency are patchy. Bank balance sheets have limited loan exposure, with loans on larger banks' balance sheets all under 50% of total assets. The balance of assets is

¹⁰ Committee of Central Bank Governors in SADC (2014).

¹¹ Bankscope, Bureau van Dijk.

mostly government-issued securities of up to 84-days maturity, though the central bank is working to establish the infrastructure for an open market operation. It is also considering various initiatives to encourage more private sector credit, which is currently the lowest in the SADC region at just 5.2% of GDP.

The relatively undeveloped banking industry stands in contrast to the DRC's massive natural resources base. Giant projects to develop and exploit this mineral wealth are entirely managed by suitcase bankers from the global and South African majors. The domestic banking industry remains some way off having the capacity to play a part in these large deals; however, the potential in the long run is clear.

5.D MAURITIUS

The island nation has a relatively large and sophisticated financial sector, growth of which has been supported by tax incentives for financial intermediaries to base themselves in the country. There are now 17 licensed banks on the island with \$36bn in assets, mostly foreign-owned.

Banks do extensive lending with private sector credit extension at 108% of GDP, and the two largest banks have over 60% of their assets in loans. The domestic market has the highest retail penetration level in SADC, with 82% of Mauritian adults having a bank account and 17% a credit card. The home loan market is well developed, with 15% of adults having an outstanding mortgage, significantly ahead of second-ranked South Africa's 9%. Corporate debt, however, is at relatively low levels and concentrated in a few firms, a situation the central bank is trying to address through credit exposure limits in line with Basel guidelines.

The challenge for Mauritius's financial sector is how to grow in a small market. The answer has been to build its capabilities as an offshore financial centre in fund administration, custodial services, trusteeship, financial engineering and international portfolio management. Mauritius is often used as a home for holding companies of banks operating in the rest of the SADC region, given its good access to those markets and an advantageous tax regime. This has led to significant exposure of the financial sector to the rest of SADC and to India, a source of some risk.

Mauritius has a sophisticated interbank money market with use of extensive government securities. The central bank has been building a macroprudential supervision framework in line with the Basel 3 capital accord and is considering a risk-weighted assets framework. It is also establishing a formal deposit insurance scheme and operates a financial intelligence centre to combat money laundering. It has imposed loan-to-value restrictions on lending into its property market, various liquidity risk guidelines and credit impairment rules. Second perhaps to South Africa, Mauritius sports a regulatory environment that has been most in line with global post-financial crisis best practice.

5.E MOZAMBIQUE

Mozambique has seen rapid growth and development of its banking market over the last decade. It now has 13 licensed banks, most with South African, Portuguese or UK parenthood. The industry is highly concentrated among the three largest banks, which command 75% of assets, and is solidly profitable, with RoEs of around 20% and impairment

reserves of 2% to 5% of loan books. Loan-to-deposit ratios are all at about 70% and the industry is well capitalised, with ratios of over 10%, although the regulatory minimum is 8%.

Strong GDP growth figures have supported growth in the industry although penetration levels are still low. A high poverty rate in the country has to be addressed as part of overall development efforts that will support retail banking sector growth. The country has recently proven massive natural gas reserves, adding to good coal reserves that are being developed, though recent energy price weakness has dampened the potential for these. The local presence of major foreign banks ensures that big project finance opportunities are efficiently taken advantage of by international majors.

The central bank oversees an active interbank money market and open market operation. Bank supervision imposes strict impairment recognition rules and has rules for large credit exposures. It does not actively set liquidity ratios and has limited oversight of balance sheet maturity mismatches.

5.F. NAMIBIA

Namibia has a small but vibrant banking sector focused on four commercially operating banks. Three are subsidiaries of South African banks (First National Bank, Standard Bank and Nedbank) and then there is locally listed Bank Windhoek. The banks are solidly profitable with RoEs of 15%-30% and fairly well diversified loan portfolios, making up between 70% and 85% of assets. Impairment reserves are the lowest in the region at under 1%.

Despite asset and deposit growth of tenfold in the past decade, there is good scope for further penetration in the domestic market, with current credit to the private sector at 47% of GDP. Retail lending is well supported by the best credit bureau coverage rate in the region (64% of adults).

Namibia inherited a bank supervision framework from South Africa on independence in 1991 and has since developed it to meet local needs while introducing Basel compliance measures, including liquidity rules, large exposure restrictions and impairment rules. The commercial banks deal extensively with the South African interbank market via their parents, with the Namibian dollar pegged to the rand.

5.G. SOUTH AFRICA

South Africa's banking industry dominates the region and is 10 times the size of second-placed Angola. Its growth rate, however, has been among the lowest, reflecting the relative maturity and penetration levels of the banking industry. Risk appetite was also sharply restrained by the financial crisis, which triggered a sharp deterioration in housing prices and losses on home loan books in 2009 and 2010. The one major growth area for the banking industry – unsecured personal loans – took off in 2007 with the introduction of new legislation to facilitate it, but overheated towards the end of 2012, when default rates spiked on the back of weak economic growth and retrenchments.

South Africa's industry is well regulated by the central bank, which won plaudits for navigating it through the financial crisis. The local market experienced little direct contagion although there was a range of counterparty exposures, including to Lehman Brothers, which had to be managed aggressively.

The government has attempted to widen financial access using devices like the Financial Sector Charter, which sets goals for branch distribution and targeted funding for designated groups.

Until late 2012, unsecured lending had been a successful area in widening access when banks stepped back from this area of the market. African Bank, the dominant operator in the segment, collapsed in August last year after massive impairments. The central bank, worried about systemic fallout, immediately launched a rescue plan for the bank. Unusual in the South African market, African Bank was funded almost entirely by wholesale sources, including foreign and domestic bond markets and the money market. The collapse threatened significant damage to South Africa's standing in international bond markets but the impact on the domestic money market probably forced the central bank's hand more than other concerns. Some money market funds "broke the buck" – an extraordinary situation where the funds traded at less than the notional value of their deposits, reflecting market views that the funds' exposure to African Bank instruments would cause losses. African Bank's instruments accounted for only 1.3% of assets held by money market funds but the prospect of a haircut down the road encouraged fund holders to be first out of the door.

This was the first test of South Africa's shadow banking system and it failed. South Africa's efficient regulators, however, are already working on regulatory amendments to address the weaknesses, alongside extensive reforms to keep the country in line with international bank oversight norms being promulgated by the G20 and the Bank for International Settlements.

African Bank's resolution is still a work in progress. The plan to "bail in" subordinated creditors has been challenged by the creditors, who argue that their instruments are Basel 2 rather than Basel 3-compliant. The government is attempting to pass a retrospective amendment to the Banks Act to allow the planned resolution to take place, which will divide the bank into a 'good bank' and a run-off book of bad assets. Success with this plan is by no means certain.

The rest of the banking industry has seen credit performance steadily improve since the 2009 spike, with impairments down to a cyclical low of just over 1% of assets in the most recent year. Profitability has recovered, with RoEs among the largest four banks back above 20%. This reflects improving asset quality and risk pricing, but growth is going to remain subdued within a broader economy that is struggling. Energy supply problems have created a major constraint on economic activity along with weak commodity prices. The country is heavily dependent on foreign portfolio flows to finance its current account deficit, so it is vulnerable to international trends that may drive capital back into developed markets. While the banking industry is currently in a stable position, the prospects are weak.

5.H. TANZANIA

Tanzania has a large but fragmented market, with 31 licensed banks operating. This is dominated by the three largest, FBME Bank, CRDB Bank and National Microfinance Bank, which hold 50% of the industry's assets. They are mostly privately held, though the government holds 30% of NMB. Outside of the top three, most banks are owned by international majors, including Barclays, Standard Chartered, Standard Bank and Citibank.

The local banks have RoEs of 20%-30%, with the foreign-owned banks lagging in the teens. Apart from FBME, which has provisions of 15% of its book, impairment provisions are around 3% in the rest of the industry. Overall, non-performing loans in the industry are around 8%.

Despite this diversification the banking market is relatively undeveloped. Private sector credit extension stands at just 13% of GDP, against a regional average of 37%. Banks tend to hold less than 50% of their balance sheets in loans and the rest in government paper. While the asset base of the industry has grown 700% over the last decade, deposit growth has been far faster at about 3 200%. Further credit development requires improvements to the legal environment to support recovery of security and land tenure rights, which are both weak in Tanzania. The central bank is an active driver of development of the sector, with current projects including setting up a credit bureau, improving settlement infrastructure and a wider financial inclusion project. The central bank also leads an active risk-based supervision framework.

Credit cards and transactional accounts have low penetration but the highlight of Tanzania's industry is the high penetration of mobile money, with 32% of adults having conducted a phone-based transaction in the last year¹². This is supported by high mobile phone penetration and liberal regulation of mobile transactions although new rules to govern mobile payments are being promulgated.

Like its southern neighbour Mozambique, Tanzania has also benefited from extensive offshore gas reserve finds, and has also found on- and offshore oil. While low energy prices have taken the shine off potential development, there is extensive scope for growth in resources that will diversify the economy. The strong presence of international banks means large project finance deals will be on the cards.

5.1. ZAMBIA

Zambia has a sophisticated financial sector relative to its size. It has 20 licensed banks, with the four largest commanding 60% of the assets in the industry. Three of the four are foreign-owned (Stanbic, Barclays and Standard Chartered). Zambia National Commercial Bank is locally listed, with Netherlands-based Rabobank as a major shareholder alongside the government. Outside of the top four, Bank of China, Citibank and South Africa's First National Bank also have sizeable operations.

Banks are well capitalised at about 13% of assets and profitable, with RoEs from the low teens to 35% in the case of Standard Chartered. Balance sheets are relatively underexposed to loans, making up around 50% of the assets of the big four banks, with impairment reserves of about 3% of gross loans. Nonperforming loans hit a high of 15% in 2010 but have since declined to under 8%.

The government has attempted various initiatives to try to drive increased lending to the private sector, albeit with limited success (private sector credit extension is only 16.5% of GDP). These initiatives included increasing banks' capital levels, though the government delayed the initial deadlines to give banks more time to raise capital. Financial inclusion is an important government policy, with banks also expected to increase their branch networks

¹² World Bank Findex study.

into Zambia's rural areas, where a large proportion of the population resides. Government is also pressurising banks to increase lending to small businesses.

General economic reforms have supported development of the banking industry, though the election of Michael Sata as president in 2011 led to a change in focus and presaged a weakening of Zambia's fiscal position. Part of the shift in emphasis was an increase in hostility to foreign ownership in the economy, particularly by the Chinese. One casualty was the collapse of South Africa's First National Bank's effort to buy the seventh-largest bank, Finance Bank. Sata died late last year and his successor, Edgar Luna, has signalled his intention to staunch the rapidly weakening kwacha but has maintained Sata's tough line on the mining industry, which is key to any economic recovery. In the circumstances the outlook for the banking industry is uncertain.

5.J. ZIMBABWE

Zimbabwe's economic turmoil over the past 15 years has had its effect on the banking industry. What was a comparatively large and sophisticated financial system was thrown into turmoil by the hyperinflation, leading to dollarisation in 2009. The banking sector was dramatically affected by this, with hugely negative real interest rates making domestic currency lending a fool's game. Anyone with banking connections took out as much debt as they possibly could to invest in real assets and earn dramatic returns on the back of price inflation. Depositors were decimated.

While dollarisation has restored economic rationality to the financial system, the banking industry has had to contend with the government's "indigenisation" policy, which is aimed at ensuring that companies are controlled by Zimbabweans. Policy has flip-flopped over whether this should apply to Zimbabwe's foreign-owned banks, recognising that having weak domestic shareholders would be detrimental to their financial stability. This remains unresolved, with government and the central bank having opposing views. In the circumstances, the foreign-owned banks have put their operations largely on care and maintenance, leaving the market to locally controlled CBZ Bank, which holds 27% of the industry's assets. Because of dollarisation it is difficult to compare activities over time, but the foreign-owned banks that used to dominate the market, including Barclays, Standard Chartered and Stanbic Bank, have clearly shrunk the relative size of their businesses.

The legacy of hyperinflation still hangs over the industry, while the threat of indigenisation acts as a major barrier to banks growing their businesses. The prospects for the industry depend very much on overall political reform, which is currently highly uncertain.

References

Bankscope – Bureau van Dijk (2015). Available at: <https://bankscope.bvdinfo.com/version-2015420/home.serv?product=scope2006>. Bureau van Dijk, London

Global Findex (2014). World Bank. Available at: <http://www.worldbank.org/en/programs/globalindex>. World Bank, Washington DC

African Securities Exchanges Association (2014) Yearbook. Available at: http://www.african-exchanges.org/wp-content/uploads/2014/10/ASEA_Yearbook_2014.pdf. ASEA, Nairobi

Green, P.R. (2013) Loan Market Commentary: Sub-Saharan Africa, in Developing Loan Markets. Loan Market Association, London.

International Monetary Fund (2015) World Economic Outlook. Available at: <http://www.imf.org/external/pubs/ft/weo/2015/01/>. IMF, Washington DC

International Monetary Fund (2014) South Africa: Financial System Stability Assessment. IMF Country Report No. 14/340

KPMG (2014) sector report: Banking in Africa. KPMG, Johannesburg

Committee of Central Bank Governors in SADC (2014). SADC Financial Systems: Structures, Policies and Markets. Secretariat of the Committee of Central Bank Governors in SADC, Pretoria

Banking in East Africa – formal integration following cross-border expansion

HABIL OLAKA¹ AND JARED OSORO²

Executive summary

- The regional expansion of banks in East Africa exhibits the characteristics of an economic bloc that is Kenya-led and a financial system that is bank-led. The expansion has noticeably taken place over the past two decades, leading to the assumption that it is mainly underpinned by the regional integration initiatives within the East African Community (EAC) framework.
- A critical assessment based on recent empirical analyses finds little evidence of EAC integration being at the core of the regional expansion of banks across the region. Instead it is observed that the formal integration process in East Africa is seeking to consolidate the gains of such expansion by putting in place regulatory mechanisms that ensure stability.
- The development of supervisory colleges – multilateral working groups of supervisors that are formed for the collective purpose of enhancing effective consolidated supervision of banking groups on an ongoing basis through continuous collaboration and information sharing – is a notable development that confirms the response of the regulatory regime to market dynamics.
- Expectations are that the inevitable development of convergence criteria for harmonising central banks' legal and prudential supervisory rules and practices in recognition of the market players' lead in regional expansion will buttress the eventual realisation of the benefits of an integrated banking system in East Africa.

1. Introduction

The East African Community integration initiative that brings together the economies of Burundi, Kenya, Rwanda, Tanzania and Uganda aspires to create a single market in terms of both intra-regional investment and of being seen as a single investment destination. Expectations are that the EAC framework will not only ensure a seamless flow of investments between the five economies but also encourage external investments in a particular economy as a springboard into the rest of the region.

The cross-border expansion of financial market players domiciled in East Africa is visible, particularly over the past two decades, and has two characteristics: it is bank-dominated and Kenya-led. It is no wonder that the few studies that have been undertaken in an attempt to understand the motivation of the regional expansion of financial sector players in East Africa

¹ Chief Executive Officer, Kenya Bankers Association.

² Director, Kenya Bankers Association Centre for Research on Financial Markets and Policy.

have basically focused on what drives the cross-border expansion of Kenya-domiciled banks into the rest of the East African region.

As much of the expansion of the financial institutions in the East African region has happened over the last two decades, it is a fair assumption that this is a response to the EAC agenda. The plausibility of this assumption could be largely ascribed to the fact that the EAC Partner States' economies individually, and even collectively, exhibit small open-economy characteristics; this implies that the EAC integration agenda holds out the promise of a bigger regional economy, with the economies of scale arising from cross-border expansion.

To some extent though, this assumption hinges on the fact that a number of non-financial institution small and medium-sized enterprises (SMEs) as well as big enterprises are expanding across the region, which could imply that if such enterprises are responding to the opportunities that the EAC integration agenda offers, then the banks that seek to serve them across the region are in effect doing so as a response to the integration initiative.

The foregoing argument has to countenance the view that the cross-border expansion of some financial institutions begins with economies that are not yet members of the EAC bloc, while others have interests well beyond the EAC region. For instance, Cooperative Bank of Kenya, the country's third-largest bank, first ventured into the South Sudan market before going into the rest of the EAC. Similarly, I & M Bank, Kenya's tenth-largest bank, with subsidiaries in Tanzania and Rwanda, has an interest in Bank One in Mauritius and First Merchant Bank in Malawi.

The argument has to equally confront the view that the international players that have been in the East African banking space for longer than the economies have aspired to formal integration – some from the continent and others from elsewhere in the world – have tended to target the East African economies individually. Suffice it to say though that some of these banks have tended to use the Kenyan market as a base for regional management coordination, an aspect that draws on the fact that it is the largest of all the markets in the region.

It is therefore increasingly emerging that the cross-border expansion of banks in East Africa cannot be taken to imply that the financial system is necessarily integrated. Instead a case can be made for the need to ensure that at the core of the EAC integration framework is the endeavour to ensure that the regional financial system is integrated, now that market players have demonstrated the desire to cross geographical boundaries in pursuit of opportunities. In other words we could be seeing a reverse sequencing, where efforts to have an integrated financial system in East Africa are essentially responding to the market players' initiative to venture across borders. Even then we could argue that such efforts are predicated on the desire for improved efficiency, hence the move to achieve optimal financial and economic benefits from the expansion.

2. Context – the macroeconomic set-up, the EAC integration roadmap and the financial system

2.A. THE MACROECONOMIC SET-UP

The combined nominal GDP of USD 147 billion in 2014 makes the EAC economy just over a quarter of the size of Nigeria's, the largest economy in the continent with a nominal GDP of USD 574 billion. One notable characteristic of the EAC economy is the dominance of the Kenyan economy, which in 2014 accounted for 41 percent of the region's combined GDP and nearly 70 percent of the combined output of the other four economies. The respective share of the region's GDP of the other economies for 2014 was 2 percent for Burundi, 5 percent for Rwanda, 33 percent for Tanzania and 19 percent for Uganda.

It is evident that while the five EAC economies have common characteristics in terms of the broader structures, they are far from being homogeneous. They have unique domestic attributes in terms of political dynamics and the institutional (both political and economic) base that influence performance. This explains why real growth is uneven across these economies. Real GDP growth has been strongest in Rwanda and in Tanzania but erratic in Kenya and Uganda while Burundi – the smallest of the five economies – has almost consistently been the slowest in terms of the rate of output expansion.

Just like real growth, the macroeconomic stability experiences of the five EAC economies are uneven, with episodes of inflationary spikes and troughs not synchronised. The economies, however, exhibit two common characteristics when it comes to the external position. One, they almost all have a current account deficit, whose trend appears to be consistent. Two, they consistently have a savings gap, arising from the fact that their respective total investment levels have remained above the levels of gross national savings. The savings gap is a reflection of the current account positions, which show the extent of reliance on external savings for domestic investment. It also speaks to the external dimensions to domestic macroeconomic stability arising from exchange rate and consequently domestic inflation implications due to the exchange rate pass-through effects.

2.B. THE EAC INTEGRATION ROADMAP

The choice that each of the EAC Partner States has to make pursuant to the integration agenda inevitably has to address their respective national interests as the primary constituency, therefore enabling the building of acceptability at the local level. In view of the size and state of the regional economy, the benefits of the EAC integration framework have been articulated by the World Bank (2012) to include the following:

- an increased market, with a higher combined income and a population estimated at close to 150 million as at the end of 2013 as opposed to the small individual markets;
- the potential for the region to position itself as a single investment destination;
- an opportunity for increased intra-regional trade as a means to the desired diversification of the economies' trade patterns away from the traditional developed economies in the West and emerging Asian markets; and

- the prospects of enhancing synergies arising from diversities resulting from the observed non-homogeneity of the economies concerned.

The EAC integration agenda is evidently ambitious in terms of both its scope and pace. The objective of the EAC partners is “to establish among themselves and in accordance with the provisions of this Treaty, a Customs Union, a Common Market, subsequently a Monetary Union and ultimately a Political Federation in order to strengthen and regulate the industrial, commercial, infrastructural, cultural, social, political and other relations of the Partner States to the end that there shall be accelerated, harmonious and balanced development and sustained expansion of economic activities, the benefit of which shall be equitably shared” (EAC 1999). The objective of the EAC clearly expresses its ambition with regard to scope.

The fact that the EAC Treaty seeks to address issues of “balanced development” and equity in the sharing of benefits informs the expectations of the integration process. The signing of the Treaty in November 1999 (it entered into force in July 2000 following its ratification by the original three Partner States (Kenya, Tanzania and Uganda), with Burundi and Rwanda acceding to the EAC Treaty in June 2007) was followed by the conclusion of three key Protocols. The Customs Union Protocol was signed in March 2004 and took effect from January 2005, while the Common Market Protocol was signed in November 2009 and took effect from July 2010. In quick succession the EAC partners concluded the Monetary Union Protocol, which was signed in November 2013. These key milestones – within the space of only 15 years – are a clear demonstration of the ambitious pace of integration.

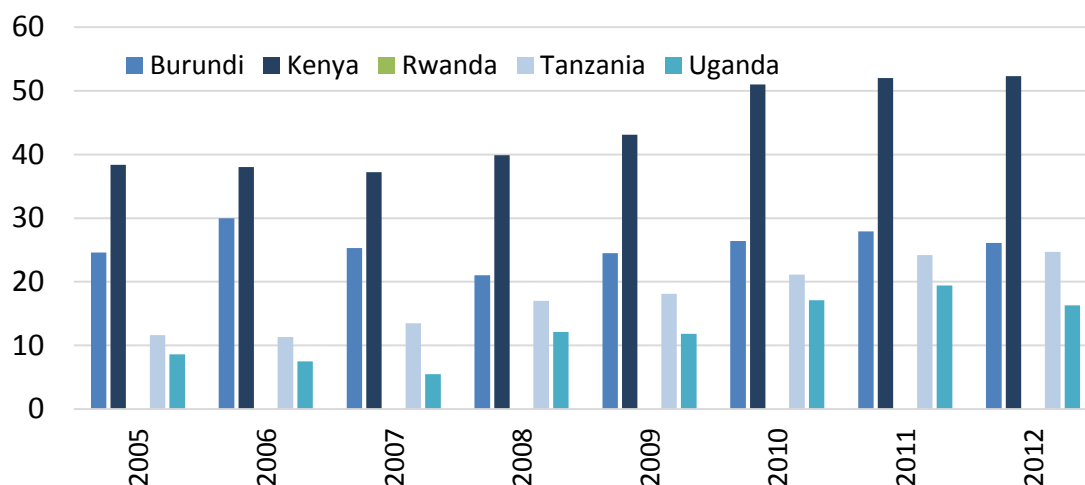
The first two of the four planned stages of EAC integration are currently being implemented. The Customs Union Protocol established duty-free trade and common customs procedures between the Partner States, together with a common external tariff. The Common Market Protocol established a single market, allowing the free movement of goods, capital and labour within the region. Partner States have been required to review domestic rules and regulations and ensure compliance with the Protocol, in order to harmonise policies and regulations within the region; this process entails the removal of restrictions on the free movement of factors of production and on the right of establishment.

The implementation of the Customs Union and Common Market Protocols is still taking place, with a number of challenges – notably myriad non-tariff barriers – being voiced. While the broader legal framework for closer integration is in place in the form of the key Protocols referred to, the free movement of goods, capital and labour across all Partner States is yet to be felt by citizens at large in the EAC. That notwithstanding, intra-regional trade is increasing although the pace could arguably have been faster if the implementation of the Customs Union and Common Market had been seamless. The value of exports to Kenya from the other four economies has been steadily growing in the recent past. However, given Kenya’s dominant position in the region, the value of its exports to the other four economies has been growing faster, hence Kenya’s burgeoning trade surplus.

2.C. THE FINANCIAL SYSTEM

The EAC integration process is backed by a financial system that supports trade and investment both within each economy and across the region. As is the case with the overall size of its economy and trade, Kenya's financial sector is also clearly dominant. The level of domestic credit creation by the financial sector (mainly banks) in Kenya is well above that of the other East African economies (Figure 1).

Figure 1: Domestic credit creation by the financial sector (percentage of GDP)

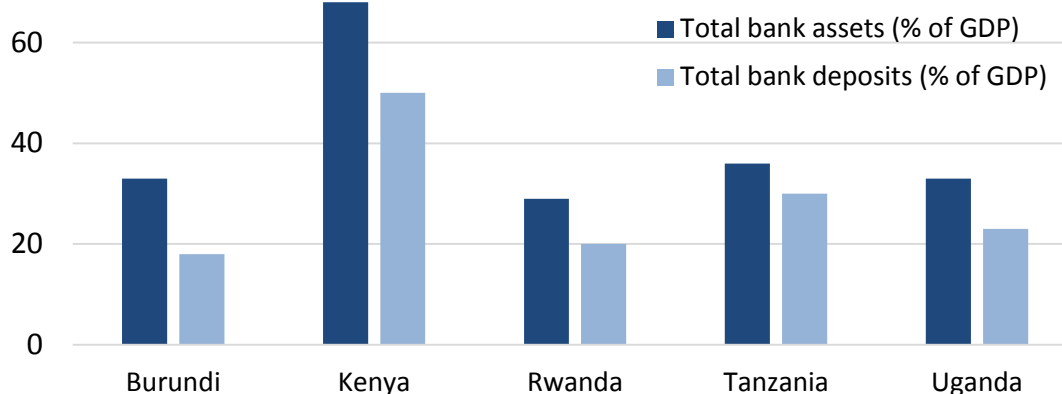


Note: No data available for Rwanda.

Source: World Bank, World Development Indicators; figures for Rwanda not available.

Furthermore, the volume of bank assets and deposits relative to the size of the economy is greater in Kenya than in the other four economies (Figure 2). These two aspects are an indication that the financial system in East Africa can be considered to be dominated by the banking sector in each country and by Kenyan institutions across the region.

Figure 2: Relative depth of the banking industry, 2011



Source: IMF African Economic Outlook; respective central banks, World Bank.

The typically relatively shallow and underdeveloped capital markets in East Africa highlight the dominance of the banking sector. As Table 1 shows, the aggregate capitalisation of the entire EAC region's debt and equity markets was around USD 29 billion (equivalent to 29 percent of the region's aggregate GDP) at the beginning of 2013, of which 81 percent was accounted for by Kenya. The size of the South African market, the largest and most sophisticated in Africa, which is equivalent to nearly 200 percent of GDP, is many times larger than the combined EAC market. In fact Rwanda, Tanzania and Uganda have amongst the smallest and shallowest markets internationally. The fact that the financial system in East Africa is bank-led does not mean that it is at the expense of the capital markets. Instead it can be argued that the two are developing simultaneously, with the thriving banking system supporting the growth of the capital markets (Osoro and Osano, 2014).

Table 1: Selected capital market indicators in East Africa as at the beginning of 2013

	Burundi	Kenya	Rwanda	Tanzania	Uganda	Total
	Number of companies					
Listed companies	-	61	4	17	15	97
Domestic	-	61	2	11	8	82
Cross-listed	-	-	2	6	7	15
Corporate bonds	-	13	1	5	6	25
	Market Capitalisation (USD million)					
Equities	-	14800	1696	8326	6218	31040
Domestic	-	14800	230	1896	815	17741
Cross-listed	-	-	1466	6430	5403	13299
Bonds	10	9080	41	1754	816	11701
Government	10	8330	39	1660	758	10797
Corporate bonds	-	750	2	94	58	904

Source: Stock exchanges and central banks in the respective markets.

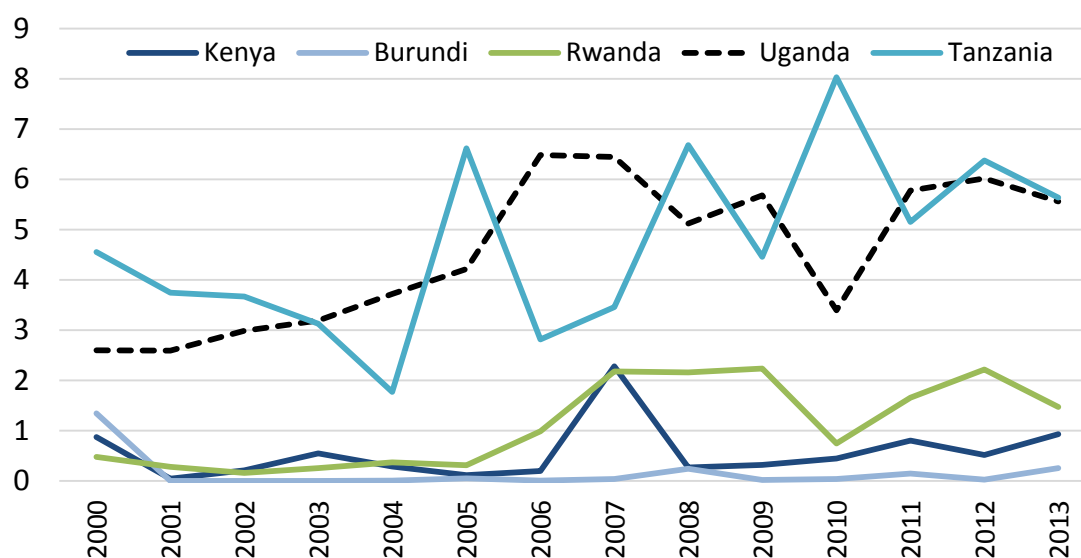
The support of other financial sector players in the intermediation process within the EAC remains weak. Penetration of the insurance sub-sector remains low while the pensions sector – which has considerable potential to play a big role in supporting the availability of long-term funding for regional investment – is likewise small. The opportunities for these segments of the financial system to complement banks in driving the growth in the financial sector are arguably substantial if only the smaller markets in the region could be persuaded that leveraging the resources and capital sourced from the largest financial market in the region would enable them to further develop their own economies.

Ironically, the existing disparities in market size and levels of development seem to impede rather than encourage beneficial integration. Even though, as has already been demonstrated, Kenya's capital market is still small by international standards and is constrained by the paucity of new issues, it has become a regional hub on account of its relative size. As a demonstration of market leadership, Kenya has no restrictions on

investment and investors from the rest of the EAC are accorded similar status to domestic investors, which signals Kenya's supportive stance towards regional integration.

It is still not clear whether investors from outside Kenya are taking advantage of this situation, nor is it evident whether other economies will follow suit and offer similar status to investors from the other EAC Partner States. What is clear though is that some of the policy stances could have a negative effect in that they inadvertently restrict market access. For instance, the fact that Tanzania's capital account was the last to be fully liberalised somewhat marginalised its market by making it the only market in the EAC that is largely inaccessible to other regional investors. By the same token, it restricted Tanzanian investors from investing in other regional markets.

**Figure 3: Foreign direct investment (net inflows)
% of GDP**



Source: World Bank, World Development Indicators.

Given that the banking industry is key in supporting investment – whether local or international – the disparities that we have illustrated above could be expected to play a role in influencing foreign direct investment (FDI) dynamics in the EAC region. However, the investor base attracted to the extractive industry in the region, especially in Tanzania and Uganda – the two economies that have been ahead of the curve in terms of discovering and moving towards harnessing resources – has seen the two economies break the dominance of Kenya observed in almost all other economic spheres. FDI flows to Uganda and Tanzania have in recent years been consistently above those to Kenya (Figure 3). A noteworthy dimension of these flows to the rest of the EAC, however, is that they include investments from Kenya. While the FDI in the region originating in Kenya cuts across all the key economic sectors, it prominently includes Kenyan banks that are seeking to extend their outreach in the EAC region and even beyond.

3. Banks' cross-border expansion – market players' motivation versus host country expectations

3.A. BANKS' MOTIVATION

The cross-border expansion of banks in East Africa is perceived to be as much a response to market dynamics as it is to the allure of the opportunities arising from regional integration. Underpinning these two attributes is the fact that while the recent drive by Kenyan banks to establish subsidiaries in the EAC region and even beyond can *a priori* be linked to the integration process, the desire to “go regional” by some of the players dates back to the early 1990s, when the economies in question undertook comprehensive structural and policy reforms. The reform package included the liberalisation of financial market prices (thus allowing the market to play its role in resource allocation) and a reduction in government ownership of financial institutions.

Following on from these reforms, the regional market became more amenable to foreign banks. Several banks with origins in the Middle East, South Africa and Nigeria have recently established subsidiaries in Kenya as well as other countries in East Africa. As at the end of 2014, the Central Bank of Kenya (CBK) had licensed eight representative offices of foreign banks from India (2), China (1), South Africa (2), the Netherlands (1), Rwanda (1) and Mauritius (1). Representative offices of foreign banks serve only as marketing and liaison offices for their foreign parent banks and affiliates and are not permitted to undertake banking business.

Table 2: Commercial banks operating in the East African region and number of branches (end-December 2013)

		Uganda	Tanzania	Rwanda	Burundi	South Sudan	Total
1	KCB	14	11	13	1	21	60
2	DIAMOND TRUST BANK	27	16		4		47
3	COMMERCIAL BANK OF AFRICA	1	8				9
4	EQUITY BANK	38	6	8		9	61
5	COOPERATIVE BANK					1	1
6	FINA BANK*	7		15			22
7	I&M BANK		6	15			21
8	BANK OF AFRICA	32	18				50
9	ABC BANK	2					2
10	NIC BANK	1	5				6
11	IMPERIAL BANK	3					3
	Total no. of branches	125	70	51	5	31	282

Source: CBK – 2013 Annual Bank Supervision Report. *In 2014 Fina Bank was rebranded as Guaranty Trust Bank following the acquisition of a 70 percent stake in the bank by Guaranty Trust Bank of Nigeria. Guaranty Trust Bank secured the required regulatory approvals from Nigeria and the three East African countries of Kenya, Rwanda and Uganda, implying that the home supervisor will effectively be the Nigerian Central Bank.

The opening of the representative office by Bank of Kigali, a Rwandan-based bank, is notable in at least one respect: it was the first foreign bank from the East African Community to be granted authority to operate a representative office in Kenya. This entry was billed by the CBK as “timely” given the ongoing EAC integration process, with the Bank of Kigali’s presence in Kenya being likely to benefit from the business opportunities that are expected to increase across the region.

We note though that the Bank of Kigali merely represents a promise, in the sense that its presence is to enable the exploration of potential business opportunities in the country, with a view to evaluating the prospects for a long-term presence. Besides Kenyan banks, whose presence in the region is now significant, only two banks from Tanzania – the CRDB Bank and Export Import Bank – have subsidiaries in the region, in Burundi and Comoros respectively. Therefore Kenyan banks continue to dominate cross-border banking in the EAC, and there are indications that they are interested in expanding into the wider African region. The CBK is presently the home supervisor of eleven Kenyan banks with cross-border banking interests in the EAC and beyond. Subsidiaries of Kenyan banks had a total of 282 branches across the East African region as of December 2013 (Table 2).

Table 3: No. of Kenyan commercial banks operating in the East African region

	Uganda	Tanzania	Rwanda	Burundi	South Sudan
1	KCB	KCB	KCB	KCB	KCB
2	DIAMOND TRUST BANK COMMERCIAL	DIAMOND TRUST BANK COMMERCIAL	EQUITY	DIAMOND TRUST BANK	EQUITY BANK
3	BANK OF AFRICA	BANK OF AFRICA	FINA BANK		COOPERATIVE BANK OF KENYA
4	EQUITY BANK	EQUITY	I & M BANK		
5	FINA BANK	I & M BANK			
6	BANK OF AFRICA	BANK OF AFRICA		BANK OF AFRICA	
7	ABC BANK	NIC BANK			
8	NIC BANK				
9	IMPERIAL BANK				
Total no. of Kenyan banks	9	7	4	3	3
Total no. of banks in the economy	25	32	15	10	34

Source: Respective central banks.

With the exception of Cooperative Bank, ABC Bank and Imperial Bank, which are in one other country besides Kenya, all the other Kenyan banks with a regional spread have a presence in at least two other countries, with some – such as KCB – being present in the other four EAC economies as well as South Sudan. Cooperative Bank is apparently using

South Sudan as a launch pad into the EAC market, having indicated its intention of entering the Ugandan market. In terms of numbers these subsidiaries account for as low as 9% of the total number of banks in South Sudan to as high as 36% in Uganda (Table 3). As we argue later, the relative size of these subsidiaries as well as the other international players shapes the host country's market expectations.

As already noted, whereas Kenyan banks have engaged in an aggressive expansion drive into East African countries and even beyond, banks domiciled in other East African countries have not yet entered the Kenyan market. That by no means implies that the activity of new entrants to the Kenyan market is muted; indeed the representative offices and interest from other players in the Kenyan banking market, especially those from Asia, is a sign of the economy's potential to attract new market entrants. It therefore seems paradoxical that while international players are keen on seeking to exploit the opportunities they see in the Kenyan market, Kenyan banks are engaged in aggressive expansion into the rest of East Africa. A compelling question therefore is: What motivates the decision of Kenyan banks to expand regionally?

While this question has in the past received superficial interest, it is now attracting the interest of researchers. Recent empirical studies provide insights into the possible drivers of the regional expansion of Kenyan banks (Kodongo and Natto, 2014; Njoroge and Ouma, 2014). These drivers can be dichotomised into pull factors and push factors, including the compelling need to follow bank clients abroad, the efficiency and size of the banks that make regional expansion compelling, and the potential market opportunities in the host countries. As businesses, banks are always legitimately seeking opportunities to maximise their return on equity.

It is therefore the pursuit of higher profits in an environment where economic growth is expected to be higher and the prospect of capitalising on the inefficiency of local banks that are important determinants for cross-border banking. Furthermore, even with suboptimal implementation, the progress made with EAC integration underpins the promise of opportunities that plays a role in enhancing cross-border banking. Indeed it is confirmed that Kenyan banks seem to follow their clients, who are taking advantage of the deeper integration of the EAC economies to set up businesses across the region. With that motivation in mind, the size of the bank is a key consideration. Larger Kenyan banks, encouraged partly by their high efficiency as measured by profitability, are more likely to expand into the wider EAC region.

Contrary to the empirical studies for developed countries, which show that banks expand into countries with developed financial and banking systems, recent empirical studies indicate that Kenyan banks are attracted by the large potential of the region's economies, as captured by the difference in economic growth rates. The fact that Kenya's banking sector is rather more developed than that of the neighbouring countries implies that that the larger, more profitable banks have been at a competitive advantage when it comes to expanding into the wider region. Essentially, the other EAC economies offer a wider range of possibilities for Kenyan banks to achieve higher profits.

At the centre of all these host economy parameters is the aspect of macroeconomic stability, which suggests, in line with other studies, that Kenyan banks seem to prefer to expand into a country where inflation is relatively low and less likely to cause macroeconomic instability. Ultimately, it is mainly the desire for superior returns, combined with the need to escape intense competition in Kenya, that has lured banks into foreign markets, as well as the favourable regulatory environment. It is no wonder that Kodongo et al. (2015) conclude that EAC integration does not seem to explain the cross-border expansion of banks in East Africa.

3.B. HOST COUNTRY EXPECTATIONS

Host country expectations regarding the entry of Kenyan banks are not any different from those regarding other banks. This is partly because the region has historically had a presence of external banks, implying that the allure of the entry of Kenyan-based banks is not any different, and partly because the EAC integration framework may have provided special advantages for cross-border expansion. It is instructive to note that the four EAC economies that are host to Kenyan banks have consistently seen the percentage of foreign players increase, especially over the last decade. In Kenya, however, the opposite trend is observed, with the percentage of foreign players being consistently below that of the rest of sub-Saharan Africa (Table 4).

Table 4: Foreign banks as a percentage of the total no. of banks

	1995	1996	1997	1998	1999	2000	2001	2002
Burundi	17	17	17	17	17	17	17	17
Kenya	24	24	24	26	26	27	26	26
Rwanda	29	29	29	29	29	14	14	14
Tanzania	55	57	56	55	60	60	60	57
Uganda	47	53	56	60	67	67	71	71
Sub-Saharan Africa	31	32	33	33	37	38	39	38
	2003	2004	2005	2006	2007	2008	2009	
Burundi	17	17	17	20	25	50	50	
Kenya	28	28	30	30	29	31	31	
Rwanda	14	29	43	43	43	57	57	
Tanzania	55	61	65	65	64	64	64	
Uganda	71	71	79	79	79	76	82	
Sub-Saharan Africa	39	41	43	49	50	52	53	

Source: Claessens and Van Horen (2014).

With the picture of foreign banks' presence in local markets presented in Table 4 reinforcing the nature of industry at the local level in terms of institutional ownership that has informed the banks' origin-host arrangement in the EAC economy, the expectations of the host economy are a mixed bag. The menu of both positive and negative attributes of the entry of foreign players into the local banking industry is a function of the foreign banks and host country characteristics. As pointed out in a recent study (Claessens and Van Horen, 2014), the negative attributes of foreign banks are associated with entry into a developing economy and arise from a combination of limited market share, costly enforcement of

contracts, limited availability of credit information and the fact that the foreign banks may come from distant home countries.

It is clear from their share of total assets that foreign banks have a controlling stake in those markets where Kenyan banks have ventured aggressively (Table 5). For instance in Uganda, where the presence of Kenyan banks is the highest, the share of foreign bank assets is well over three-quarters. Combine this attribute with the fact that proximity to headquarters in the home country may be considered a positive attribute and the view that progress is being made with regard to the availability of credit information and contract enforcement and you will infer that the entry of Kenyan banks into the region can only be for the better. That will confirm the general view that foreign banks add to domestic competition and so lower the cost of intermediation, enhance the financial and economic performance of borrowers, and bring greater financial stability.

Table 5: Foreign banks' assets as a percentage of total bank assets

	2004	2005	2006	2007	2008	2009
Burundi	38	36	33	58	64	66
Kenya	46	46	46	39	38	38
Rwanda	32	53	54	48	43	27
Tanzania	...	92	93	93	58	57
Uganda	88	89	95	95	86	89
Sub-Saharan Africa	13	25	26	28	26	29

Source: Claessens and Van Horen (2014).

Given that the typical enterprises in East Africa are small to medium-sized, the benefits of having large foreign banks operating are often associated with increased access to financial services for such firms. This is because the bigger the operations of foreign banks, the stronger the commitment to the market as opposed to smaller banks, which tend to serve niche enterprises. This argument is bolstered by another study (Presbitero et al., 2014), which contends that the hierarchical structure of banks – in terms of whether they are “more local” or “less local” depending not only on ownership but also on the extent of their domestic operations – and therefore the degree of their commitment matter.

The “less local” a bank is, the more vulnerable its borrowers are. In any case, “less local” banks may find it hard to lend to small and medium-sized enterprises given the difficulties associated with producing and transmitting *soft* information. The “functional distance” between a loan officer and the head office where the lending decision is made is a constraint for relationship-based lending. A large number of Kenyan banks with operations in the EAC region indicate that they do not face this challenge.

The fact that foreign entry has the positive attribute that we have outlined above hardly implies that negative expectations are ruled out. There are instances where foreign banks may engage in “cherry picking” borrowers, thereby undermining overall access to financial services. Similarly, the positive expectations of foreign banks are predicated on the assumption that both local and home operations are operationally healthy. Given the lessons of the global financial crisis, this assumption is bound to be relaxed. While local

affiliates of foreign banks would most likely be supported by the parent bank, the opposite is also true in the sense that shocks affecting the parent bank may be transmitted to the local subsidiary. Therefore the view that the entry of external players into the local banking space promotes stability is not necessarily a foregone conclusion.

3.c. ALIGNMENT OF THE BANKING INDUSTRY AND THE INTEGRATION AGENDA

The motivation of the cross-border expansion of banks in East Africa and the respective host economies needs to be aligned if the mutual benefits are to be realised. It is emerging that the thrust of the economic integration so far has focused generally on trade and investment-related aspects, with financial integration being subsumed where it is considered necessary. Even as integration progresses and is at times “fast-tracked”, the EAC is making little progress in transitioning from its current intergovernmental state of cooperation to a supranational stage. It is against this backdrop that we contemplate the ramifications of the move towards Monetary Union, the penultimate level of EAC integration, for the financial sector generally and the banking industry in particular, especially for those banks with a regional presence.

The EAC’s Monetary Affairs Committee (MAC), which comprises the governors of the EAC partners’ central banks, is principally tasked with ensuring full integration of the region’s financial system. Indeed the MAC had by April 2012 developed convergence criteria for harmonising the central banks’ legal and prudential supervisory rules and practices. The development of the convergence criteria at this deeper stage of the integration process gives credence to the criticism that throughout the initial stages of EAC integration, financial sector integration remained implicitly subsumed at best, or even peripheral.

With the missed opportunity to front-load financial integration initiatives, the MAC is arguably playing catch-up in response to the progress that the market has made. Notably, a supervisory college framework has been developed, to be applied to all Kenyan banks with a significant regional presence. Supervisory colleges are multilateral working groups of supervisors that are formed for the collective purpose of enhancing effective consolidated supervision of banking groups on an ongoing basis through continuous collaboration and information sharing (CBK, 2013).

The CBK formed the initial supervisory college for KCB in 2012 and convened the inaugural supervisory college meeting for the group in October 2012. KCB was chosen because this banking group operates in all the five East African Community member states and in South Sudan. The CBK subsequently issued a prudential guideline on consolidated supervision, which came into effect from January 2013 and empowered the regulator to supervise banking groups on a consolidated basis. Subsequently, supervisory colleges for Equity Bank and Diamond Trust Bank were formed in 2013 as the two banks have operations in most of the EAC region. It is clear therefore that the CBK, as the primary regulator of local banks expanding across East Africa, is proactively addressing the supervisory challenges associated with such expansion highlighted by the IMF (2015).

4. Conclusion

The foregoing analysis provides a critical glimpse into the EAC integration process, specifically highlighting the aspect of how it relates to the regional expansion of banks. We can infer that the financial markets – in particular the banking industry, which has seen aggressive cross-border investment from Kenya – seem to be forging ahead with the integration process. The drivers of the cross-border expansion of banks in East Africa are well known (and have been articulated in recent studies) and so are the expectations of the host economies.

The challenge that remains is to bring the official attitudes towards the integration process into line with market realities when it comes to ensuring true integration of the financial markets generally and the banking industry in particular. That is why the EAC integration agenda has progressed to the conclusion of a Monetary Union Protocol, while the fact that the full benefit of the initial stages of integration has not been felt explains why banks' outreach expansion in East Africa in pursuit of economies of scale is asymmetric; institutions from smaller markets are observed not to be moving into bigger economies. All is nonetheless not lost as progress is now noticeable on the regional regulatory front. Indeed the MAC has developed convergence criteria for harmonising central banks' legal and prudential supervisory rules and practices that will underpin the eventual realisation of the benefits of an integrated banking system in East Africa.

References

CBK, 2013, Bank Supervision Annual Report 2013, Central Bank of Kenya.

Claessens, S. and Van Horen, N., 2014, "Foreign Banks: Trends", *Journal of Money, Credit and Banking*, Supplementary Volume 46, No. 1, pp. 295-326, February.

EAC, 1999, Treaty Establishing the East African Community.

IMF, 2015, "Pan-African Banks: Opportunities and Challenges", IMF Policy Paper, January.

Kodongo, O. and Natto, D., 2014, "The Drivers of Banking Expansion: Evidence from East Africa", Kenya Bankers Association Centre for Research on Financial Markets and Policy Working Paper, Series No. 8, March.

Kodongo, O., Natto, D., and Biekpe, N., 2015, "Explaining Cross-Border Bank Expansion in East Africa", *Journal of International Financial Markets, Institutions and Money*, Volume 36, Issue C, pp. 71–84, May.

Njoroge, L. and Ouma, S., 2014, "Determinants of Banks Expansion in the East African Community: An Empirical Analysis of Kenyan Banks", Kenya Bankers Association Centre for Research on Financial Markets and Policy Working Paper, Series No. 9, March.

Osoro, J. and Osano, E., 2014, "Bank-based Versus Market-based Financial System: Does Evidence Justify the Dichotomy in the Context of Kenya?", Kenya Bankers Association Centre for Research on Financial Markets and Policy Working Paper, Series No. 10, December.

Presbitero, A. F., Udell, G. F and Zazzaro, A. (2014), "Home Bias and Credit Crunch: A Regional Perspective", *Journal of Money, Credit and Banking*, Supplementary Volume 46, No. 1, pp. 53–866, February.

World Bank, 2012, Kenya: Economic Update – Edition No. 6, June.

Recent Trends in Banking in Central and West Africa

ANGUS DOWNIE

Executive Summary

- The West and Central African banking sectors are unique in Middle Africa in that they continue to exhibit similar pricing and balance sheet dynamics.
- However, just like their peers in East and Southern Africa, the two markets remain loan-driven, with loans and advances accounting for half of their balance sheets on average.
- The two regions' telecommunication and banking sectors have yet to fully converge in increasing financial inclusion, one of the regions' unique characteristics. And this is where we see the growth opportunities over the next decade, especially for markets such as Nigeria, UEMOA, Cameroon and the Democratic Republic of the Congo (DRC).

1. Nigeria: Oil price collapse puts strain on balance sheets but risks are manageable

1.A HIGHLIGHTS

The nearly USD 50 per barrel (b) plunge in oil prices since mid-2014 in our view presents benign balance sheet risks to Nigerian banks but may still affect them to some extent. Taking into consideration all the demand/supply dynamics, we still forecast an average price of USD 65/b in 2015. That price level has already triggered a tempering of the oil and gas sector's capital expenditure (capex) programmes, which may in turn reduce planned capex borrowing from banks.

The upstream oil sector presents benign risks. Banks' upstream exposures are mainly to international oil companies (IOCs), and we believe lending to IOCs is not only properly collateralised but also that IOCs have the balance sheet muscle to plug any possible cash flow gaps. On the downstream side, where we believe there is significant exposure, consisting mainly of inventory financing, the risks are also benign because pump prices are fixed.

Exposure to marginal oilfield operators, however, presents some medium-term risks, primarily because these do not have the balance sheet muscle to plug any possible cash flow gaps. As a result, banks will have no choice but to downgrade and restructure some of these accounts. Additionally, the plunge in oil prices exposes banks to refinancing and repricing risks, stemming from the fact that oil and gas clients are the biggest source of non-interest-bearing (NIB) foreign currency (FCY) deposits (mainly through domiciliation).

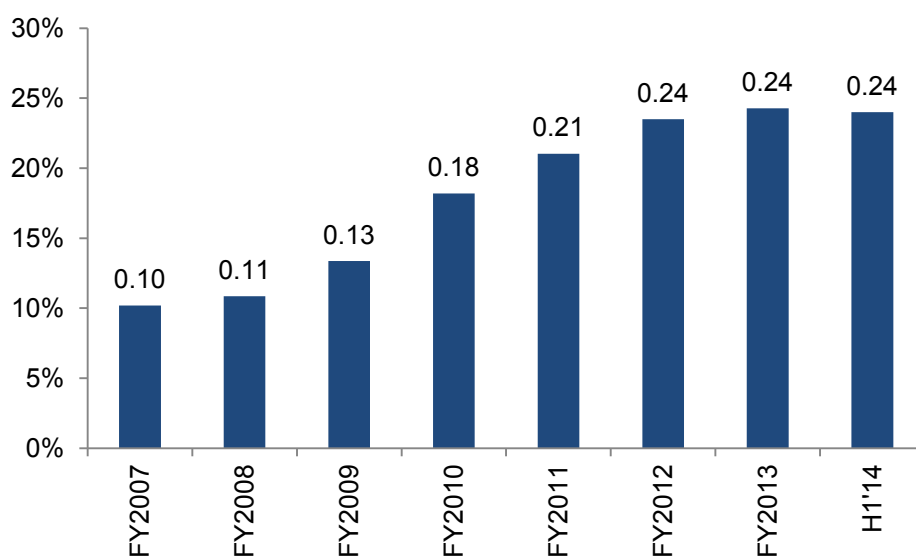
1.B MARKET OVERVIEW

Oil price plunge presents benign risks

There has been a USD 50/b fall in oil prices since mid-2014, which is largely a result of surging oil supplies and a strategic decision by OPEC not to cut back output. In this paper, we assess the potential risks this plunge in prices could have for Nigerian banks. As shown in Figure 1, Nigerian banks increased their exposure to the oil and gas sector following the 2008/09 banking crisis. This increase was driven by the exit of IOCs from onshore production and the resultant entry of local indigenous players (marginal oilfield operators). The exit of IOCs from some onshore fields was driven by the following main factors:

- The fields are more mature. They have been in operation for many years and, as they age, they become more expensive to operate, since artificial means are required to pump the oil to the surface.
- Security. Key oil installations often come under frequent attack.
- Portfolio rationalisation. As a field becomes more expensive to operate, it makes good sense to sell off the assets and invest in increasing offshore production.

Figure 1: Share of loans to oil and gas sector as percentage of total loans



Sources: CBN, NDIC, Ecobank Research.

1.C. MINIMAL RISKS FROM UPSTREAM EXPOSURE

Upstream exposure accounts for more than half of banks' overall exposure to the oil and gas sector. At the close of Q3 2014, upstream exposure among the top ten banks alone stood at 13% on average, compared with the average exposure to the sector of 24% (see Table 1 below for a more detailed breakdown). Upstream exposure is mainly to IOCs. Table 2 below lists the IOCs and summarises their wellhead (field) crude oil production as at February 2014. We believe that lending to IOCs is not only properly collateralised but also that IOCs have the balance sheet muscle to plug any possible cash flow gaps. Consequently, we take the view

that upstream exposure presents minimal balance sheet risks to banks.

Table 1: Breakdown of Oil and Gas Exposure among the Top 10 Banks (Q3 2014)

	Upstream	Midstream	Downstream	Total exposure to oil & gas sector
FirstBank	12%	9%	19%	40%
Zenith	7%		11%	18%
UBA	15%		1%	16%
GTBank	18%		10%	28%
Access Bank	5%	9%	11%	25%
Diamond Bank	11%	4%	11%	25%
Ecobank Nigeria	9%	3%	6%	18%
Skye Bank	21%	3%	3%	27%
Fidelity Bank	18%	3%	7%	28%
FCMB	13%		1%	14%
Average	13%	5%	8%	24%

Sources: Company disclosures, Ecobank Research.

Table 2: Summary of IOCs and Wellhead (field) Crude Oil Production (February 2014)

	Number of wells	Crude oil production		Daily average (barrel)	% of total production
		(barrels)	(m ³)		
SPDC	n/a	7 651 475	1 216 485	255 049	13.0
Mobil	201	13 069 333	2 077 854	435 644	22.2
Chevron	320	6 789 072	1 079 374	226 302	11.6
Total E&P	129	3 020 648	480 244	100 688	5.1
NAOC	177	2 541 946	n/a	84 732	4.3
Chevron-Texaco	21	651 555	n/a	21 719	1.1
Total	848	33 724 029	4 853 957	1 124 134	57.4

Sources: NNPC, Ecobank Research.

1.D. MINIMAL RISKS FROM DOWNSTREAM EXPOSURE

At the close of Q3 2014, downstream exposure accounted for a third of banks' overall

exposure to the oil and gas sector (Table 1). Downstream exposure mainly consists of inventory financing since Nigeria imports refined petroleum products. In 2013, Nigeria consumed 19 kilotonnes of refined petroleum products, which represented an 11% y-o-y growth over 2012, with gasoline, kerosene, and gas oil accounting for 93% of total imports. Typically, financing of inventory imports is through documentary credit, in most cases via issuance of letters of credit (LCs), and as such they are booked off-balance sheet. However, documentary credits only appear on-balance sheet when they crystallise. In this regard, downstream exposure also presents minimal risks for the following reasons:

- Documentary loans are self-settling and have short turnaround times, typically ranging between 90 and 180 days. Additionally, they are properly collateralised against inventory (and the collateral can also be easily liquidated without haircuts).
- Pump prices in Nigeria are fixed and hence do not present pricing risks to fuel importers.

1.E. POTENTIAL RISK AREAS

Reduction in FCY collections and liquidity

Upstream lending is entirely foreign currency-denominated. Downstream, settlement of most documentary lending is also FCY-denominated. We estimate that banks derive up to 80% of their non-interest-bearing FCY deposits from oil and gas clients, through domiciliation. Indeed, domiciliary deposit liabilities, as a percentage of total deposits, have grown tremendously over the past six years from just 12% at the close of 2008 to 25% as at Q2 2014. With the plunge in oil prices, we expect the amount of domiciliation to drop by as much as 40%, largely in line with the extent of the oil price plunge since mid-2014. This will put a considerable strain on banks' FCY liquidity positions and their ability to fund their FCY loan pipelines. As a result, this will further exacerbate existing FCY funding gaps. FCY deposit liabilities currently account for 25% of total deposit liabilities; on the assets side, FCY loans account for nearly 38% of the total loan book. Total FCY loans of the top banks alone accounted for 38% of their overall loan books. On the liabilities side, FCY deposit liabilities accounted for 26% of total deposits. Typically, banks have financed the resulting gap in two main ways:

- the issuance of eurobonds: between 2013 and 2014, Nigerian banks issued eurobonds totalling USD 2.5bn at an average cost of 7.45%, which we believe is a significant premium;
- the Interbank FX market, which, apart from being equally costly, brings on board significant conversion risks, especially in the current unstable macro-environment, where the Central Bank of Nigeria (CBN) has even had to devalue the naira by 8%.

Exposure to marginal oilfields

Exposure to marginal oilfield operators also presents some medium-term risks, primarily because, unlike IOCs, these do not have the balance sheet muscle to plug any possible cash flow gaps in their books. As a result, banks will have no choice but to downgrade and restructure some of these accounts.

2. Ghana: Bank lending likely to tighten further in 2015

2.A. HIGHLIGHTS

As Ghana's economy remains weak, overall bank lending is likely to tighten in 2015 on account of high lending rates and rising obligor risks. Most affected will be lending to small and medium-sized enterprises (SMEs) and large corporates (wholesale lending), where demand is already tipping downwards. Demand for consumer lending, too, is already weak, since households see the prevailing lending rates as prohibitive; however, consumer lending accounts for only 17% of total credit.

Banks are also becoming increasingly cautious about consumer lending on account of surging obligor risks as the high cost of living continues to eat into households' disposable income. As for wholesale lending, we expect a rise in demand for debt restructuring and working capital financing as corporates employ strict liquidity conservation measures in the face of growing uncertainties. We also expect banks to face significant challenges in funding their balance sheets, especially in meeting foreign currency loan requests

2.B. ECONOMIC INDICATORS CONTINUE TO WEAKEN

Ghana's economy remains in a weak state. The fiscal deficit remains large, at around 9% of GDP, while the current account deficit, at 11% of GDP, is also a concern. Additionally, the Ghanaian cedi (GHS) depreciated 17.2% between January and May 2015, and annual inflation in April 2015 accelerated to 16.8% from 13.5% in December 2014. In response to these challenges, the Bank of Ghana (BoG) raised the Monetary Policy Rate to 22% at its May 2015 meeting. Looking ahead, inflation is likely to remain above 16% in the second half of 2015, driven by ongoing fiscal looseness and GHS weakness. However, the March 2015 slowdown in producer price inflation to 19.1% suggests consumer price inflation could have peaked. Fiscal problems largely centre on the large public sector wage bill, which accounts for nearly 70% of total revenues, and reducing this level of expenditure will prove difficult despite IMF recently coming on-board for both technical and financial assistance. If government spending remains high, it will continue to stoke demand, which will lead to an acceleration of inflation, although the IMF's assistance, through successful implementation of fiscal reforms, will help slow down spending, which in turn will help narrow the fiscal deficit in the medium term.

2.C. BANKS LIKELY TO TIGHTEN LENDING

In response to the weakening economy, we see banks' risk appetite declining in 2015, which means that they are likely to tighten lending across the board. The BoG's latest credit conditions survey corroborates this view. Most affected will be lending to small and medium-sized enterprises and large corporates (wholesale lending), which in total accounted for 74% of total credit at the close of 2013, with demand already tipping downwards. Demand for consumer lending, too, is already weak, since ordinary households see the prevailing lending rates as prohibitive, and therefore consumer lending accounts for only 17% of total credit. Banks are also becoming increasingly cautious with regard to consumer lending on account of surging obligor risks as the high cost of living continues to eat into households' disposable income.

2.D. CREDIT SURVEY: MEASURING CREDIT STANCE AND DEMAND USING THE NET PERCENTAGE RATE (NPR)

The BoG uses NPR to gauge demand for credit. The BoG defines NPR as the difference between the sum of the percentages for “tightened considerably” and “tightened somewhat” and the sum of the percentages for “eased somewhat” and “eased considerably”. The net percentages for the questions relating to the contributing factors are defined as the difference between the percentage of banks reporting that a given factor contributed to a tightening and the percentage reporting that it contributed to an easing.

Generally, a rise in the NPR denotes tightening.

As Figures 2.A and Figures 2.B illustrate, there is a direct relationship between lending rates and both overall credit demand and credit demand among SMEs and large corporates. We have noted some weakness in all the demand indicators since Q2 2014.

Figure 2.A: Overall Credit Stance vs Cost

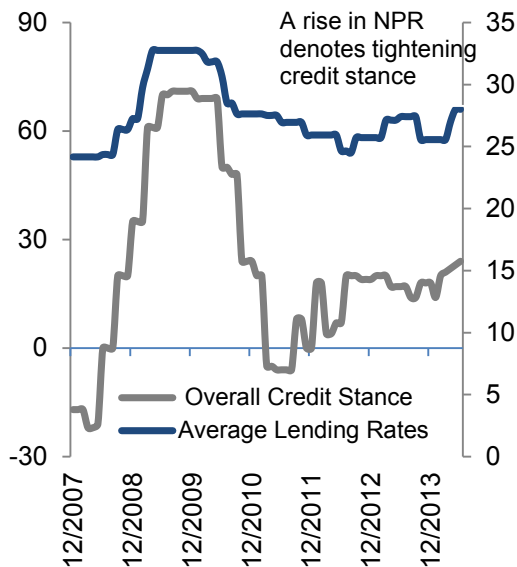
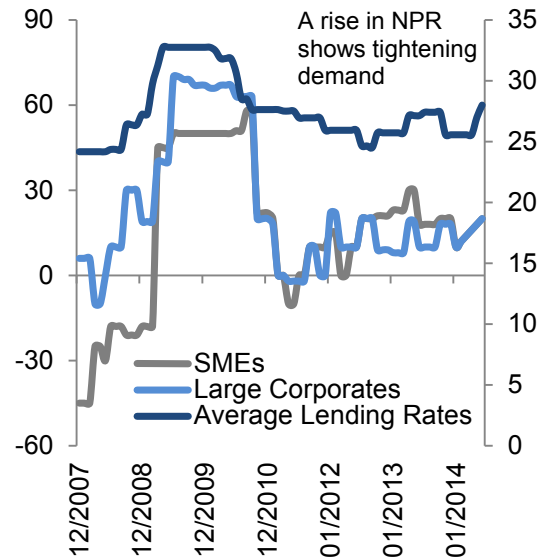


Figure 2.B: SMEs and Large Corporate Credit Demand vs Cost



Sources: Bank of Ghana and Ecobank research.

On the other hand, lending rates have continued to rise, with industry base rates now ranging between 26% and 30% on the local currency (LCY) and 11-15% on FCY. If the key economic indicators underperform further in Q4 through to Q1 2015, then we expect a rise in demand for debt restructuring and revision of some of the loan terms from corporate and SME accounts.

More specifically, we see a growing appetite for conversion of existing local currency loans into foreign currency, especially for customers whose receivables are foreign currency-denominated, in order, where possible, to take advantage of the favourable pricings relating to FCY. Meanwhile, we also see a rise in demand for working capital financing, since borrowing SMEs and corporates, especially those engaged in cash-intensive businesses, employ strict liquidity conservation measures in the face of growing uncertainties.

2.E. CONSUMER CREDIT SUPPLY ALREADY WEAK

Consumer credit supply is already constrained (see Figures 3.A and 3.B), and banks are becoming increasingly cautious on account of rising obligor risks as the high cost of living continues to eat into households' disposable income (and with it comes the growing fear that obligors might find it hard to keep up with loan repayments). To compensate for the rising obligor risks, we expect banks to continue to increase premiums on the cost of borrowing, with average lending rates now circling at around 29% (from around 25% in January 2013). On the demand side, we see the prevailing premium lending rates weakening demand growth in Q4.

Figure 3.A.: Credit Usage vs Cost

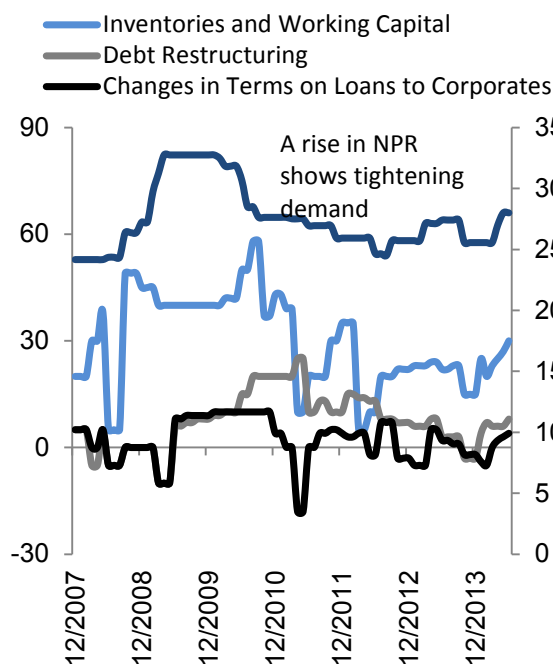
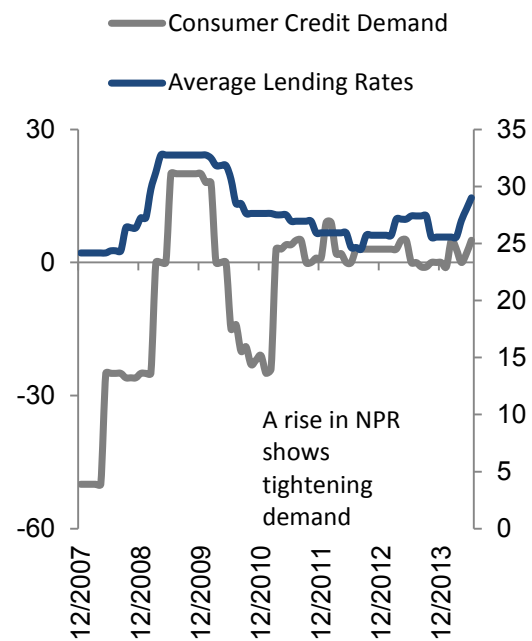
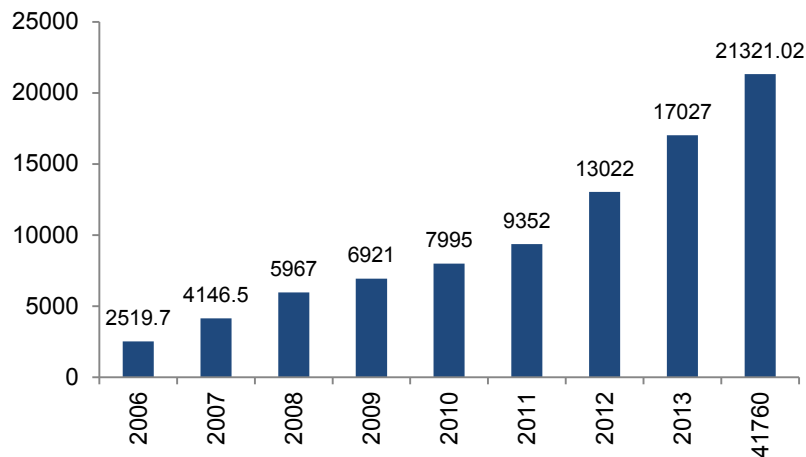


Figure 3.B.: Consumer Credit Demand vs Cost



Sources: Bank of Ghana and Ecobank research.

Figure 4: Gross NPLs (GHS millions)



Sources: Bank of Ghana, Ecobank Research.

2.F. ASSET QUALITY IS STILL A CONCERN

Gross non-performing loans (NPLs) rose by 34% YTD at the close of May 2014; consequently, asset quality, as measured by the ratio of gross NPLs to gross loans, continued to deteriorate, from 12% at the close of 2013 to 12.84% as at May 2014 (Chart 5). This raises notable asset performance concerns, given the prevailing macro conditions. Of particular concern will be the wholesale lending book, especially wholesale accounts linked to central government payments.

2.G. FUNDING CHALLENGES

We also expect banks to face significant challenges in funding their balance sheets, especially in meeting foreign currency loan requests. First, on the LCY front, key liquidity pricing benchmarks continue to remain high. In Q2 2014, the top six listed banks (Ecobank Ghana, GCB, Standard Chartered, CAL Bank, UT Bank and Société Générale) reported an 18% quarter-on-quarter (q-o-q) growth in funding costs despite 27% y-o-y growth overall. This suggests that LCY funding costs are likely to remain elevated in Q4 and into Q1 2015, as has been evidenced by banks adjusting their base rates upwards.

3. UEMOA: Increasing banking sector penetration

3.A. MARKET STRUCTURE: ROBUST DISTRIBUTION CHANNELS

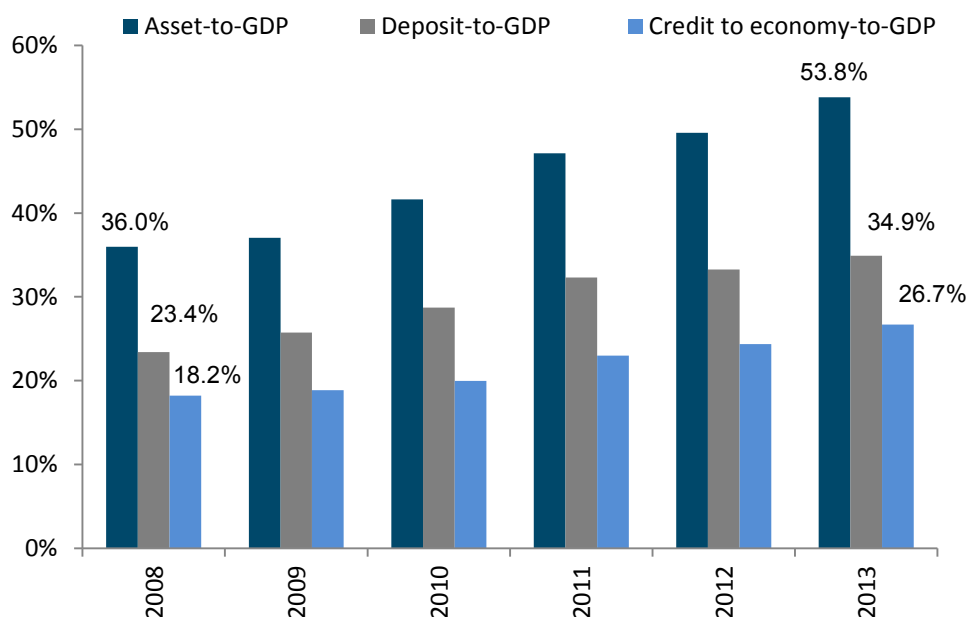
The UEMOA (West African Economic and Monetary Union) banking sector comprises 127 credit institutions, including 114 commercial banks and 13 other quasi-bank financial institutions. The distribution channels remained robust at the close of 2013, with 2 133 agencies, offices and retail outlets as well as 2 272 automated teller machines (ATMs) spread across the eight member countries. This makes it Middle Africa's second-largest distribution network after Nigeria. The close-knit eight-member UEMOA sub-region shares common regulatory authorities and financial tools that make it easy for banks to expand across the eight member countries. This has resulted in the emergence of banking groups with a presence in several countries across the region. The top five banks, which account for about 53.0% of the total assets of the UEMOA banking sector, are all banking groups. They include Ecobank, BOA Group, Société Générale, Attijariwafa Bank and ABI. In terms of the country presence of banks, Côte d'Ivoire has the largest share of banks with 25, followed closely by Senegal, which has 21. Guinea-Bissau has the lowest number of banks in the region (4).

3.B. BALANCE SHEET ANALYSIS: A GROWTH STORY, EXHIBITED BY STRONG IMPROVEMENT IN BANKING PENETRATION

The growth of the UEMOA banking sector is among the lowest in our coverage universe in Middle Africa, and we attribute this to the reluctance of most banks to significantly expand their operations because of political risks. The total assets and deposits of the UEMOA banking sector each grew by a five-year CAGR of 12.9% to XOF 20.68trn (USD 44.38bn) and XOF 13.41trn (USD 28.14bn) respectively in 2013 owing to the entry of new African banks into the region from countries such as Nigeria and Gabon. Credit to the economy also grew by a five-year CAGR of 12.5% to XOF 10.26 trn (USD 21.52bn) in 2013. Although the level of growth is not as large as in other regions of Middle Africa, we are clearly seeing a growth

story in the UEMOA banking sector, which has been exhibited by a strong improvement in banking penetration in the last five years. The total assets-to-GDP ratio rose from 36.0% in 2008 to 53.8% in 2013 and the deposits-to-GDP ratio moved from 23.4% in 2008 to 34.9% in 2013, while the credit to the economy-to-GDP ratio improved from 18.2% to 26.7% over the same period, as shown in Figure 5.

Figure 5: UEMOA - Banking Penetration



Sources: BCEAO, Ecobank Research.

3.C. HOWEVER, FUNDING MISMATCH REMAINS A KEY CONSTRAINT ON LOAN GROWTH

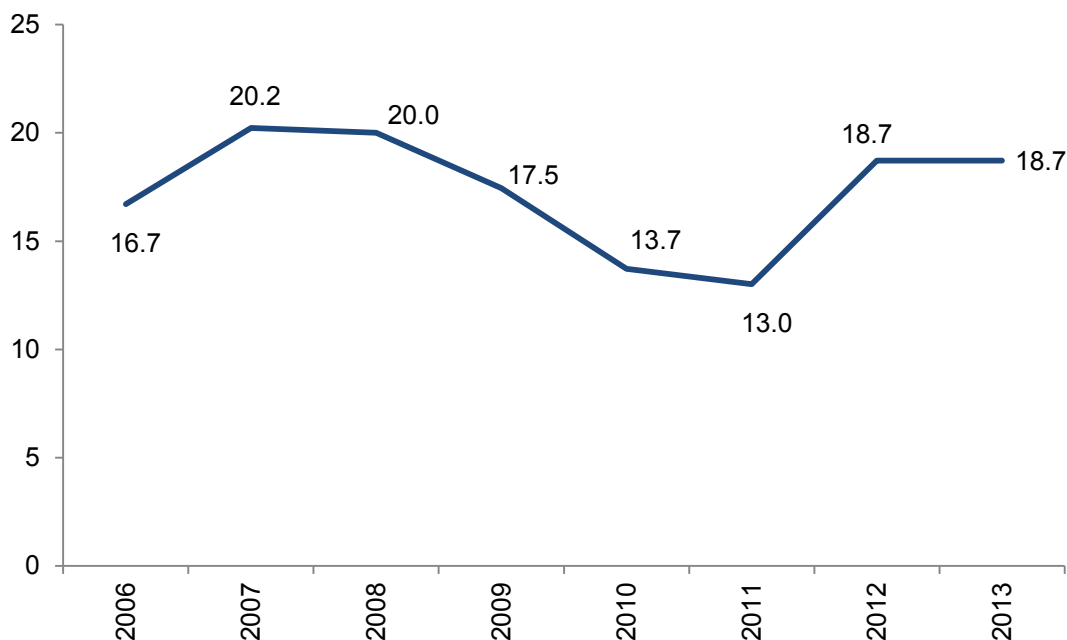
The improved penetration of credit to the economy was mainly driven by increased demand for credit to key sectors of the UEMOA economy. However, we believe that the funding mismatch arising from the inability of banks to generate long-term liabilities to fund long-term lending will continue to hamper the growth potential of credit in UEMOA. The Central Bank of West African States (BCEAO) requires that long-term lending must be backed by a minimum of 50% long-term liabilities, a situation that has created keen competition for long-term deposits from corporate institutions. In the current liability structure, a huge proportion of deposits are short-term, thereby limiting the capacity of banks to create long-term assets. About 46 banks holding 44% of sector deposits complied with the regulation at the close of 2013.

3.D. PROFITABILITY ANALYSIS: CONTINUED PROFITABILITY HINGES ON PEACEFUL ELECTIONS IN CÔTE D'IVOIRE AND BURKINA FASO

UEMOA's banking sector profitability continues to rank lower than that of its key Middle African peers. And the reason behind this is the fact that yields on earning assets in UEMOA remain below 10% from the perspective of both the lending-deposit spread and yields on government securities. UEMOA's ROE averaged 17.3% from 2006 to 2013. However, it is important to note that Côte d'Ivoire is home to the biggest banking sector in the region and

as such its performance depends very much on the regional banking sector, as shown in Figure 6. ROE was down in 2010 and 2011 as a result of the poor performance of the Ivorian banking sector following the 2010 political crisis.

Figure 6: UEMOA - Average ROE for Listed Banks, %



Sources: BCEAO, Ecobank Research.

In 2012 Ivorian banks returned to profitability as the economy continued to normalise, with a return on equity of 17% (from -5% in 2011), which reflected positively the profitability of the regional banking sector in 2012 and 2013. We expect robust economic growth to boost the ability of banks to mobilise deposits to support the creation of earning assets in the next two years. However, this will hinge on the peaceful organisation of elections in Côte d'Ivoire and Burkina Faso in the final quarter of 2015.

3.E. RISKS AND CHALLENGES

Asset quality

The regional banking sector has remained vulnerable to credit risk, partly because of legacy issues and the absence of credit referencing bureaux to provide guidance on the creditworthiness of borrowers (especially SMEs and retail customers). In addition, banks are unwilling to write down NPLs for fear that this may cripple recovery. The gross NPL ratio for UEMOA has remained high during the past nine years, posting an average ratio of 16.8%. Although the gross NPL ratio fell from 17.0% in 2009 to 15.1% in 2010, it unsurprisingly rose to 16.3% in 2011, largely because of the impact of the political crisis on the country with UEMOA's biggest economy and banking sector, Côte d'Ivoire. This ratio subsequently slowed to 15.2% in 2013, as the Ivorian economy continued to normalise, complementing improvements in Senegal, Mali, Niger and Togo. We expect a sustained drop in the NPL ratio to 15% in 2014.

Political risks

There is a general element of risk associated with banks' not being insulated from the region's political upheavals. This was epitomised by the 2011 political crisis in Côte d'Ivoire, where the then government nationalised all the major banks, which had suspended their activities. In 2012 alone, military coups occurred in Guinea-Bissau and Mali, and the northern part of Mali was taken over by terrorist groups, and more recently, a 2014 Burkinabe uprising ousted president Blaise Compaoré.

Capital Adequacy Ratio (CAR)

The regional banking industry remains well capitalised, with the prevailing CAR of 12.9% being above the regulatory minimum of 8.0%, despite the inability of some banks to meet the minimum capital requirement. However, we believe that this failure to meet the minimum capital requirement or comply with the single obligor limit (25% of equity) is an indication of the need to inject funds into UEMOA's banking sector via a recapitalisation programme.

3.F. OUTLOOK

We expect improved banking penetration in the next five years to be driven by ongoing and planned infrastructure projects, trade financing, and banking sector expansion into mining areas and new business centres. Although the infrastructure projects may be financed by governments and development financing institutions (DFIs) such as the International Monetary Fund (IMF) and the African Development Bank (AfDB), we expect banking opportunities in the form of cash management and pre-finance facilities for subcontractors.

We believe that the challenge of a funding mismatch would continue to limit the growth potential of the UEMOA loan book, which means that banks seeking to achieve above industry-average loan growth must seek long-term funding either in the form of corporate deposits or equity capital from investors.

While financial inclusion in UEMOA has been driven by rising banking penetration on the back of new entrants (and branch expansion) as well as the emergence of microfinance institutions and mobile money, we think that a decision in October 2014 by BCEAO and commercial banks to provide 19 banking services free of charge in UEMOA will further boost financial inclusion in the region this year and beyond. In addition, if the upcoming elections in Côte d'Ivoire and Burkina Faso are peaceful, this will boost the confidence of foreign banks operating in UEMOA and support the case for expanding their businesses, which could further boost banking penetration in the region.

4. Cameroon: Mobile financial services is the next growth story

4.A. OVERVIEW

Banking penetration is still low in Cameroon, with an estimated 5% of the adult population having access to formal financial services, compared with 25% in sub-Saharan Africa as a whole. Foreign-owned banks dominate the commercial banking scene, with 11 of the 13 commercial banks having majority foreign ownership (Table 3).

Table 3: Banking sector ownership structure

	Ownership	Majority shareholder
Standard Chartered Bank Cameroon (SCBC)	Foreign	Standard Chartered Bank Plc
Atlantic Bank of Cameroon	Foreign	Atlantic Financial Group Central and East
BGFIBank Cameroon	Foreign	BGFIBank SA
UBA	Foreign	UBA Plc
National Financial Credit Bank	Local- private	Awanga Zacharia
Ecobank Cameroon	Foreign	Ecobank Transnational Incorporated (ETI)
Union Bank of Cameroon	Foreign	Oceanic Bank International Plc
Commercial Bank of Cameroon	Foreign	CFH Luxembourg
Citibank	Foreign	Citibank NA New York
Afriland First Bank	Local- private	SBF & Co
Société Générale de Banques au Cameroun (SGBC)	Foreign	Société Générale
Crédit Agricole - Commercial Bank Corporation (SBC-CA)	Foreign	IUB Holding
Banque Internationale du Cameroun pour l'Epargne et le Crédit (BICEC)	Foreign	Banques Populaires Caisses d'Epargne

Source: Ecobank Research, BEAC.

The industry is still largely oligopolistic, principally due to the fact that Afriland First Bank, Banque Internationale du Cameroun pour l'Epargne et le Crédit (BICEC) and Société Générale de Banques au Cameroun (SGBC) dominated both the loans and deposits market in 2013, with a combined market share of 50% (loans) and 52% (deposits).

4.B. ASSETS AND LIABILITIES DYNAMICS

Over the last decade the banking and finance sector in Cameroon has been characterised by improved national coverage, with the opening of new branches by banks and MFIs, a stable lending rate and increase in deposits and loans. Customer deposits amounted to USD 6.4 billion in 2013, up from USD 5.3 billion in 2012, a 21% year-on-year growth rate. Deposits are mostly from individuals, private companies and, to a lesser extent, the central government and public corporations. Credit to the economy totalled USD 4.85 billion in 2013 against USD 3.81 billion in 2012, a 27.5% year-on-year growth rate. By customer segment, loans are granted to private companies, individuals and public corporations.

4.C. MICROFINANCE

The MFIs' role in providing alternative access to credit has continued to grow strongly and currently accounts for 10% of overall financing to the economy, up from around 5% in 2010. However, there is a big issue regarding their compliance with prudential guidelines. The situation is compounded by the fact that they are regulated by three different laws: national law, Economic and Monetary Community of Central Africa (CEMAC) law and Organization for the Harmonization of Business Law in Africa (OHADA) law. Generally, MFIs remain fragile due to credit portfolio challenges, insufficient own funds or legacy funds and the resulting non-compliance with solvency standards. About fifteen experienced difficulty or insolvency in 2013, and further consolidation measures led to the withdrawal of the de-licensing of 33 MFIs in July 2013.

4.D. CHALLENGES AND OPPORTUNITIES

The regulatory framework is still a challenge, particularly because of insufficient human resources. The Central African Economic and Monetary Community (CEMAC) created a banking division (COBAC) with responsibility for administering, regulating, supervising and licensing banks. COBAC is still understaffed, limiting the frequency of on-site inspections and resulting in flaws in offsite supervision and hindering early detection of problems in distressed banks. The situation is further compounded by the failure of distressed financial institutions to provide robust recapitalisation plans to the authorities. Another major challenge is the deficit in corporate governance in both banks and MFIs as exposure to related parties (shareholders and senior staff) has not been capped while internal controls are, in most cases, not effective in most MFIs. Furthermore, the lack of a robust land registry system has made collateral perfection a serious challenge for financial institutions.

Growth opportunities for Cameroon lie in one key area: the convergence of mobile telephone companies (telcos) and commercial banks to enhance financial inclusion. World Bank data show that in 2013 mobile phone subscriptions (per 100 people) in Cameroon stood at 70%. On the other hand, banking penetration stood at 5%. This shows that in order to increase Cameroon's financial inclusion and access to financial services, convergence of the telcos and financial services sector must be enhanced. Future mobile banking technologies must encourage mobile phone-based saving and loan origination (as is already happening in Kenya).

5. Democratic Republic of the Congo (DRC): Dollarisation at its Best

5.A. OVERVIEW

Formal financial access in DRC still remains very low, with only one commercial bank branch per 100 000 people (World Bank estimates in 2012). However, the growth rate in the banking sector in DRC has been extremely high in recent years, with total banking sector assets rising from just USD 300 million in 2002 to USD 4.1 billion at the end of 2013. Opportunities within the sector lie in off-balance sheet activities, since the country remains a net importer in most aspects of the economy.

5.B. MARKET OVERVIEW

The financial system in DRC still remains small and underdeveloped. Formal financial access remains very low, with only one commercial bank branch per 100 000 people (World Bank estimates), and bank penetration remains at 2%. Financial sector breadth remains limited, as loans accounted for 3.6% of GDP in 2011, below our threshold of 25% for countries in SSA, while both equities and corporate bonds are still absent. The demand side is still dominated by the informal economy due to adverse economic shocks, but confidence in the financial services sector is gradually increasing. Consequently, a substantial proportion of savings (approximately 46% of deposits) is tied up and kept out of the economic circuit, which means that it is not available for investment by private productive enterprises. This continues to constitute an additional obstacle to general economic growth in the country.

5.C. LENDING RATES HAVE EASED

Local currency lending rates eased from a peak of 65% in 2009 to 19.2% as at December 2013. Foreign currency lending rates also eased from a peak of over 30% to 14.8% in the same period under review (Figures 7.A and 7.B).

Figure 7.A: Lending Rates (%)

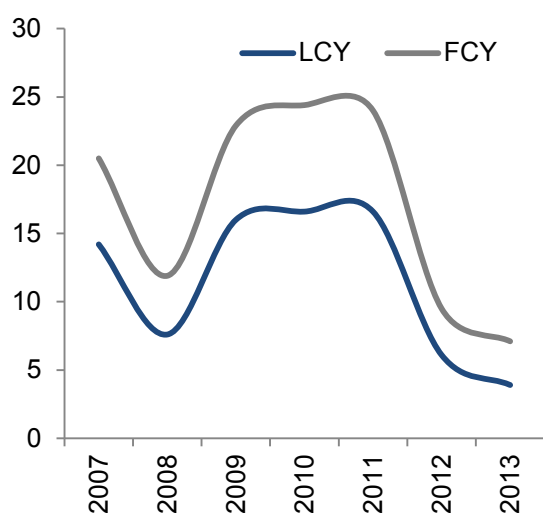
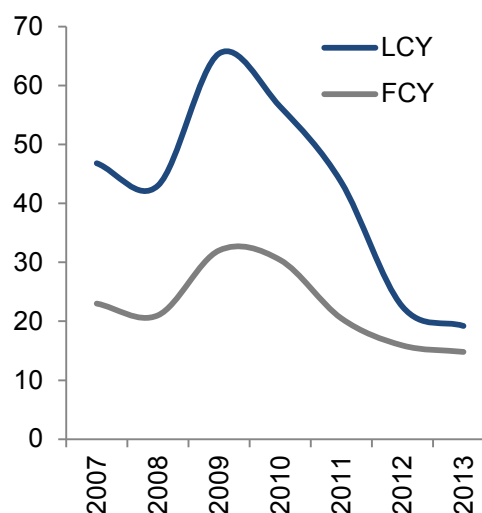


Figure 7.B: Deposit Rates (%)



Source: Banque Centrale du Congo.

On the funding side, LCY deposit rates plummeted from double-digit levels between 2009 and 2011 to a single-digit level of 3.9% as at December 2013. On the FCY front, funding costs also plummeted (to 3.2%). The easing of both lending and funding rates was largely down to the improving macro-environment. Specifically, the significant decline in the Central Bank's policy rate, the low levels of inflation and banks' improving risk perception collectively contributed to the declining interest rate environment. For instance, in mid-November 2013, the Central Bank of DR Congo's key rate was reduced to 2%, its historic low.

However, there are still risks to the current interest rate environment, as the low level of savings in a country like DRC with substantial investment needs can easily drive up interest rates, as there is a shortage of savings to finance investment at "normal" interest rates. We

do not expect significant change in savings patterns, as they appear to be mostly structural (as a result of the low employment levels due to the small production base).

5.D. PERFORMANCE

The growth rate in the banking sector has been extremely high in recent years, with total banking sector assets rising from just USD 300 million in 2002 to USD 4.1 billion at the end of 2013, buoyed largely by the growth in deposits and capitalisation of profits (as a balance sheet strengthening strategy). On-balance sheet lending still dominates, accounting for 80% of total credit, while off-balance sheet activity accounts for 20% of total lending activity. Short-term credit dominates the on-balance sheet lending, accounting for 64% as at December 2013 (a 500 basis points drop compared to 2012). The share of long-term credit in 2013 grew by 560 basis points to 36.2% from 30.6% in 2012, a reflection of gradually expanding consumer lending activities.

5.E. INDUSTRY DYNAMICS

The informal economy and low penetration

A large share of the DRC's economy remains very informal, and back-of-the-envelope calculations suggest that up to 80% of the money supply is held outside the formal banking system. Banking sector penetration, as measured against three key barometers, therefore remains extremely low. First, the ratio of bank accounts to the total population stood at 3% at the close of 2012; second, the ratio of bank customers to the total population stood at 1.8%; and, third, the ratio of banking sector assets to GDP was 20% at the close of 2013, suggesting extremely low levels of financial intermediation.

Bank ownership: foreign banks dominate

Of the 18 active commercial banks that formed the DRC's banking sector at the close of 2012, only two were locally owned: BCDC (which was majority-owned by the State) and Trust Merchant Bank (which was majority-owned by a local investor). The remaining 16 banks were foreign majority-owned (see Table 4 below for the ownership structure).

Loan-driven market: USD lending predominates

The market remains loan-driven, with total loans and advances accounting for nearly half of total assets. Also, 95% of lending is in foreign currency, with USD lending constituting nearly 100% of the foreign currency loan book.

Funding: USD liabilities predominate

Funding remains exclusively in USD, with banks' foreign currency liabilities accounting for an aggregate 86% of their total deposit liabilities at the close of 2013 (87% in 2012).

Table 4: Banking Sector Ownership Structure in DRC

Bank	Majority ownership
RawBank	Foreign
BCDC	Local
BIAC	Foreign
TMB	Local
BIC	Foreign
ProCredit	Foreign
Standard Bank	Foreign
Citi	Foreign
Afriland First Bank	Foreign
Ecobank	Foreign
Access Bank	Foreign
Advans Bank	Foreign
FIBank	Foreign
Byblos (Solidaire)	Foreign
Sofibanque	Foreign
BGFIBank	Foreign
BOA (Bank of Africa)	Foreign
UBA	Foreign

Source: Ecobank Research.

Unlocking the potential of African regions¹

THIERRY GIORDANO², BRUNO LOSCH², ARTHUR MINSAT³, HENRI-BERNARD SOLIGNAC-LECOMTE³

Executive Summary

- Structural transformation is Africa's overarching priority. But despite some progress over the last decade, current policies have not proved effective enough at speeding up job creation in productive sectors.
- New approaches are all the more necessary to accelerate structural transformation in the face of Africa's unique demographic and spatial dynamics. In the decades to come, a fast rise in urban and rural populations, acute regional disparities and the constraints of global competition will make the challenge of transforming the continent a unique undertaking, although with wide variations between North, South and sub-Saharan Africa.
- Africa's transformation path will thus have to cross uncharted territory. Past experiences of demographic, urban and economic transition may inspire action, but they cannot provide blueprints. As for current strategic options hinging on specific sectors, they may not be enough to meet the double challenge of massive job creation and productivity growth on their own. Pragmatic, context-specific approaches combining their merits will have to be crafted. Africa has no choice but to innovate.
- But how? One way is to start from the unique structural features of African economies: the demographic boom demands to place job creation at the centre of development strategies; its stark regional disparities call for regional approaches to development – multi-sectoral and place-based –, so as to better tap African regions' diversity and unlock their potential by building on specific local resources which too often escape the attention of national policy makers.

1. Africa's growth has accelerated in the 21st century, but it has not been inclusive enough

1.A. AFRICA'S GROWTH PERFORMANCE IMPROVED MARKEDLY AT THE TURN OF THE CENTURY

Africa's gross domestic product (GDP) growth is expected to strengthen to 4.5% in 2015 and

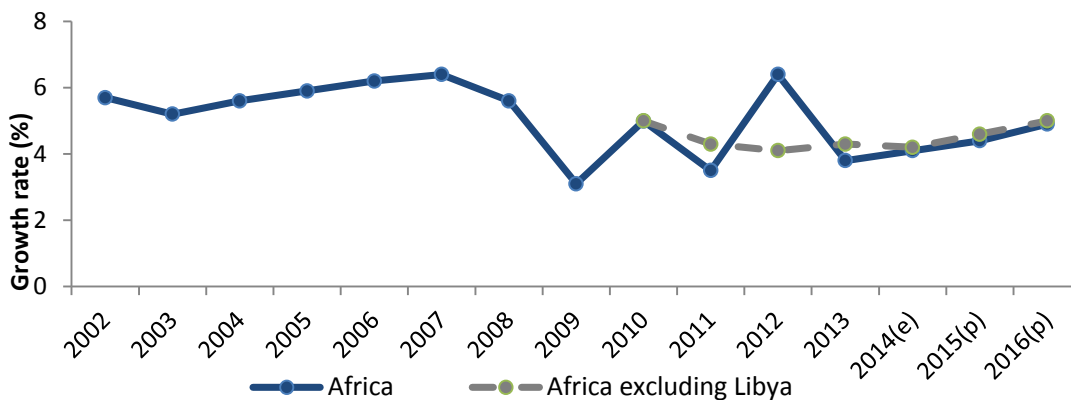
¹ The article draws on the 2015 edition of the *African Economic Outlook* (AEO), a joint publication of the African Development Bank, the OECD Development Centre and the UNDP, in collaboration with the French Agricultural Research Centre for International Development (CIRAD). It builds in particular on key contributions from Willi Leibfritz (African Development Bank) on Africa's economic outlook and Mario Pezzini (OECD Development Centre) on regional development. The full report is available at www.africaneconomicoutlook.org.

² CIRAD

³ OECD DEVELOPMENT CENTRE

5% in 2016 after subdued expansion in 2013 (3.5%) and 2014 (3.9%). 2014 growth was about 1 percentage point lower than predicted in last year's African Economic Outlook (AEO), as the global economy remained weaker and some African countries experienced severe domestic problems of various kinds. But the world economy is improving and if the AEO's 2015 predictions are right, Africa will soon be approaching the impressive growth levels seen before the 2008/09 global economic crisis.

Figure 1. Africa's economic growth, 2002-16



Note: (e) estimate; (p) projections.

Source: Statistics Department, African Development Bank.

Africa's medium-term trend of positive growth – 5% per year on average since the turn of the century – was upset in 2009, when demand fell from OECD countries hit by the global crisis, and in 2011, when the Arab Spring suddenly froze growth in Egypt, Libya and Tunisia. However, on both occasions, the continent's average growth rates recovered. This episode of growth is in sharp contrast with the 1980s and 1990s, Africa's so-called "lost decades". When comparing the performance of individual countries between 1986-2000 and 2001-14, three main factors appear to have accelerated growth:

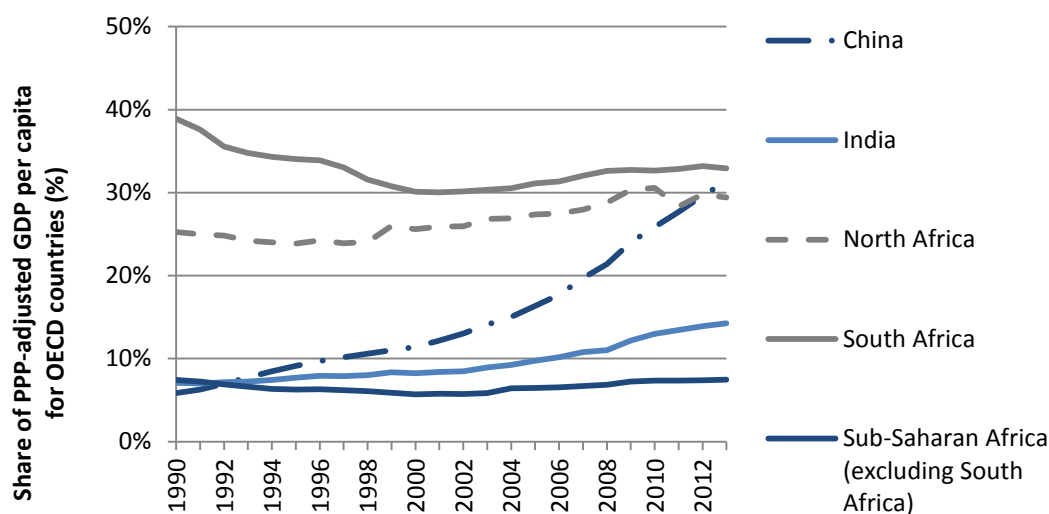
- *Greater political stability*: Many countries that recorded growth of below 2% during the period 1986-2000 suffered from civil wars, military coups or social unrest. By contrast, between 2001 and 2014 violent conflict receded overall and political stability improved – although several economies suffered again, at least temporarily, from political unrest.
- *High commodity demand and soaring prices*: During the 2000s, Africa has been benefiting from a shift of global wealth. World output growth has accelerated, mainly driven by China and other emerging nations. This has boosted demand for oil and minerals and increased commodity prices, which has benefited Africa's resource-rich countries, whose reserves are among the least exploited globally (AfDB et al., 2011; AfDB et al., 2013). Over the first decade of the century, African exports to Europe doubled, exports to emerging economies quadrupled and exports to China alone increased by a factor of 12. By the middle of that decade, foreign investment, stimulated by a global savings glut, poured into mines and agriculture (e.g. biofuels), but also into the infrastructure necessary to exploit them, such as ports, roads, electricity and support services (e.g. banking, insurance, transportation).

- *Improved economic policies:* Lower inflation and stronger budgets due to more prudent fiscal policies, helped by debt relief, have improved macroeconomic stability and supported growth in many countries.

1.B BUT CONVERGENCE AND STRUCTURAL TRANSFORMATION HAVE BEEN SLOW

Assessing the performance of African countries in terms of GDP per capita shows that only a few of them have engaged in a convergence process with high-income countries. In particular, sub-Saharan Africa's GDP per capita as a share of the OECD average has stagnated: it declined slightly in the 1990s before returning to only 7% in 2013 (Figure 2). Convergence is thus the exception rather than the rule. Between 1950 and 2009, King and Ramlogan-Dobson (2015) identified six converging countries: Botswana, Egypt, Lesotho, Mauritius, the Seychelles and Tunisia. Another six – Cabo Verde, Chad, Ethiopia, Gambia, Tanzania and Uganda – initiated the process, mostly in the 2000s. The more recent convergence of Algeria, Cameroon, Ghana, Namibia, Niger and Senegal must continue to be consolidated. The World Bank (2015) forecasts that by 2030, despite major efforts in the context of current policies, 19% of Africa's population will still live in poverty. Those 300 million people will then represent 80% of the global population living on less than USD 1.25 a day in 2005 purchasing power parity.

Figure 2. Gross domestic product per capita in Africa, China and India, expressed as a share of GDP per capita in OECD countries (%), 1990-2013



Sources: World Bank national accounts data, and OECD National Accounts data files.

Relatedly, job creation has been slow. Although structural transformation has increased slightly since 2000, the change has been insufficient (AfDB et al., 2013). Overall, between 1990 and 2005, “labour seems to have moved” from relatively high-productivity sectors (wholesale and retail trade, and manufacturing) to low-productivity sectors (informal services and agriculture). As a result, labour productivity fell by 1.3 percentage points per year and eliminated more than half of within-sector productivity gains. Some countries did experience positive structural transformation (Ghana, Ethiopia and Malawi), but not enough to fundamentally transform their economies (UNECA/AU, 2014). As a result, the benefits of

Africa's recent growth episode have been shared unequally between countries and within them, raising the question of their sustainability and effectiveness. Growth so far has failed to create the number and quality of jobs that young entrants in labour markets demand: the African Economic Outlook 2012 found that only some 7% of the population aged 15-24 in low-income African countries had a decent job, and 10% in middle-income countries (AfDB et al., 2012). Overall, growth in most African countries has not been inclusive (Ncube, Shimeles and Younger, 2013).

2. African economies must prepare for global and domestic changes

In the coming decades changes in the global context, rapid population growth and growing social demands will create new opportunities and new challenges for Africa. In order to sustain or enhance the pace of economic growth and make it more inclusive, policymakers will have to adapt their development strategies.

2.A THE GLOBAL CONTEXT MAY BE LESS FAVOURABLE THAN IN THE 2000s

The medium to long-term prospects for the global economy are less favourable than during the last decade. According to Braconier, Nicoletti and Westmore (2014), growth in the OECD and emerging G20 countries is likely to decelerate from 3.4% in 1996-2010 to 2.7% in 2010-60. In addition, the growth-driving effect of emerging economies on Africa may also decrease: while the "shifting wealth" phenomenon seems set to continue, growth in those economies has been slowing down. A number of them now look unlikely to catch up with average OECD income levels by 2050, even if they were to maintain the average growth rates they enjoyed between 2000 and 2012 (OECD, 2014a). These include lower-middle-income countries (e.g. India, Indonesia and Vietnam) as well as upper-middle-income ones (such as Brazil, Colombia, Hungary, Mexico and South Africa). While China remains among those countries likely to catch up, it is "shifting to a lower but still rapid and likely more sustainable growth path" (OECD, 2015).

In addition, African economies will continue to face stiff competition on global markets in terms of costs, quality of goods and services, and production potential. Last year's AEO demonstrated the opportunities offered by greater participation in global value chains and upgrading in the agricultural, manufacturing and services sectors but showed the limited impact in terms of business development and job creation in formal companies so far (AfDB et al., 2014).

2.B. AFRICA IS VULNERABLE TO CLIMATE CHANGE

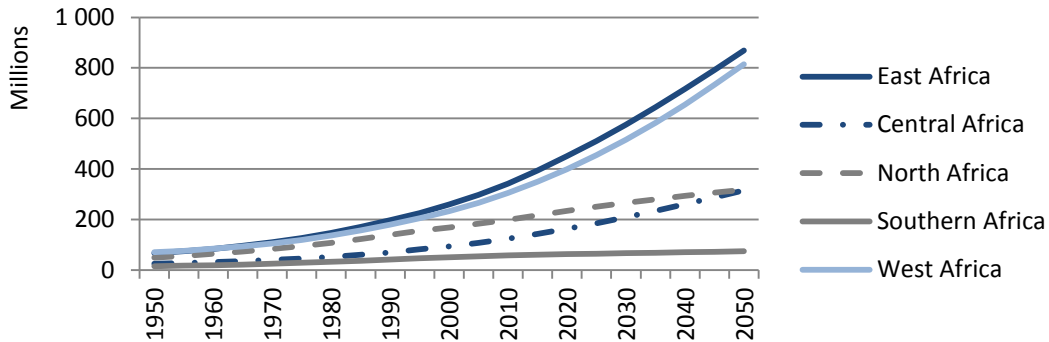
Unlike countries that industrialised earlier, African economies face the challenge of structural transformation in a global context of climate change. The negative effects of climate change-related hazards on agricultural resources greatly affect the poorest, who largely depend on those resources not only for food but also for jobs. Pressure on already limited water supplies is expected to increase sharply due to changes in water cycles caused by erratic rainfall and to affect negatively the production of annual crops such as cereals and cotton, or perennial crops such as coffee, cocoa and palm oil. Livestock may also suffer from shrinking water supplies, as grazing land is divided and damaged, and new diseases arise. As

the demographic pressure on land grows, gathering wood for fuel will cause deforestation, as will developing agriculture and felling for timber.

2.C. DEMOGRAPHIC GROWTH WILL CREATE BOTH OPPORTUNITIES AND CHALLENGES

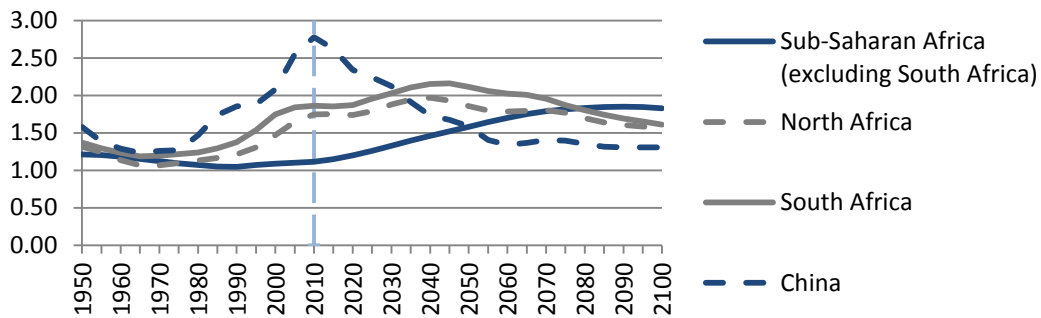
Africa’s population of 1 billion in 2010 should double by 2050, although the magnitude of the increase will vary across the continent. Southern Africa and the North Africa region will be less affected (Figure 3).

Figure 3. Population increase in Africa, 1950-2050



Note: Medium-fertility scenario.
Source: UNDESA, 2014.

Figure 4. Activity ratios in sub-Saharan Africa, North Africa, South Africa and China, 1950-2100

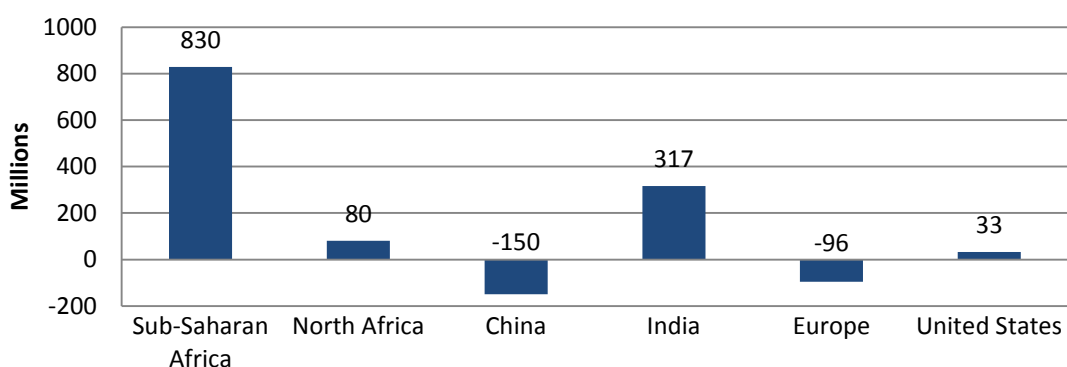


Note: Aggregate ratios are population-weighted. The activity ratio is the ratio between the working age population (15-64) and dependent age population (under 15 and more than 65). Projections are modelled using the medium-fertility variant.
Source: Authors’ calculations based on data from UNDESA (2012).

Those demographic changes bring about both opportunities and challenges. On the one hand, the ongoing demographic transition opens a window of opportunity as the working-age population increases. The ratio between those inside and those outside the workforce – the activity ratio – will increase over the next few decades and possibly create a demographic dividend for sub-Saharan Africa. The number of active people supporting inactive people will increase due to lower birth rates; this will free up resources to improve living conditions (e.g. education, health care and housing) and boost savings and investment.

And it will remove a long-lasting, heavy burden from Africa, although differences between countries will be significant. In the 1990s, there was practically one active person for each inactive one. The average activity ratio is expected to steadily rise and this should continue well beyond 2050. By that time it is forecast to reach 1.6 active people per inactive person in sub-Saharan Africa (still less than China’s current level) (Figure 4). Ahmed et al. (2014) estimate that Africa’s demographic dividend could contribute 10-15% of gross GDP volume growth by 2030.

**Figure 5. Projected workforce growth, 2010-50:
Sub-Saharan Africa, North Africa, China, India, Europe and the United States**



Source: UNDESA, 2012.

On the other hand, the rapid growth of Africa’s workforce will increase the pressure on labour markets. The workforce is expected to increase by 910 million people between 2010 and 2050, of which 830 million in sub-Saharan Africa and 80 million in North Africa. Creating more productive jobs, a major stake in Africa’s structural transformation, becomes even more pressing. The estimated numbers of youth joining labour markets in 2015 are about 19 million in sub-Saharan Africa and 4 million in North Africa. Over the next 15 years, the figures will be 370 million and 65 million respectively, or a yearly average of 24.6 million and 4.3 million new entrants. The upcoming growth in Africa’s workforce represents two-thirds of the growth in the workforce worldwide (Figure 5).

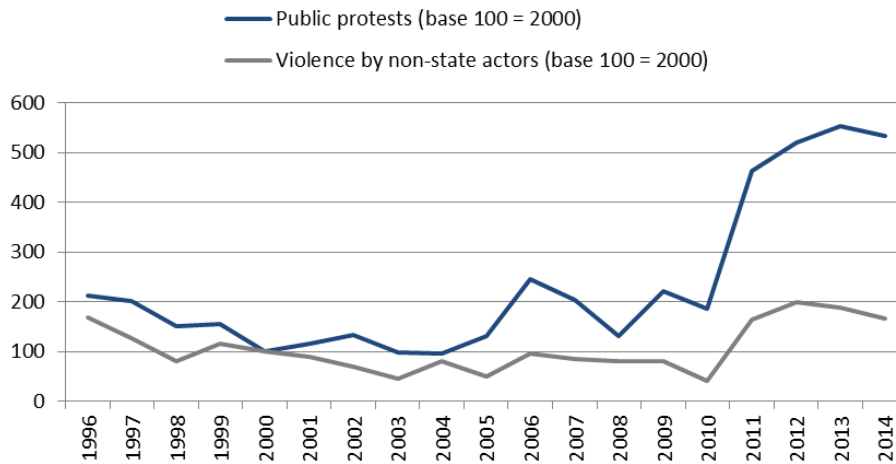
2.D. AFRICAN CITIZENS’ EXPECTATIONS OF MORE INCLUSIVE GROWTH WILL INCREASE

The *African Economic Outlook’s* indicator of public protests monitors strikes and demonstrations with political, economic or social motives (Figure 6). Since the mid-1990s the intensity of the protests has experienced three successive movements: a reduction by half by 2004; a rebound in 2005-07, when high levels of inflation hit African households, notably through hikes in prices for food and fuel; and a sharp increase in the wake of the revolutions of the Arab Spring.

Remarkably, this rise in public protests contrasts with the relatively more “stable” trend of violence by non-state actors. Also worth noticing is the fact that, while some governments have resorted to violence against demonstrators, most have shown a growing tolerance for freedom of expression. After peaking in 2013, at levels more than five times higher than ten years before, protests started to decrease slightly in 2014. This trend reflects an easing of

tensions in most African countries, which contrasts with heightened tensions in a limited number of hot spots. The political normalisation of countries that had been in crisis, particularly since the Arab Spring, partly explains the overall decline in the intensity of protests.

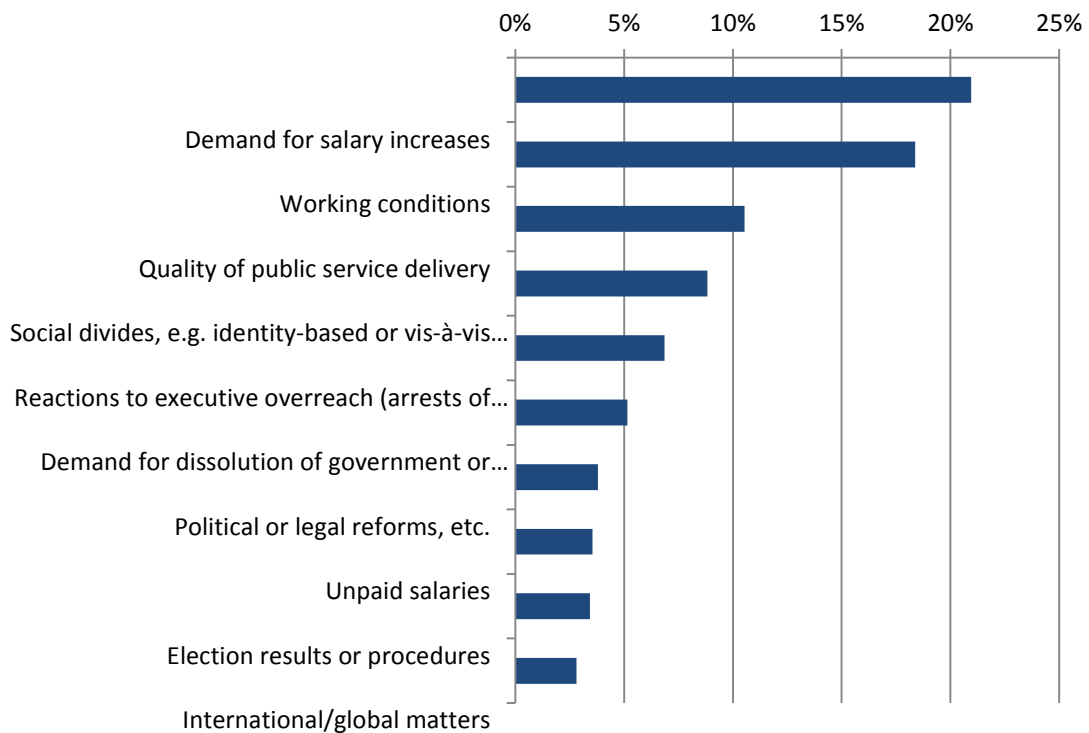
Figure 6. Public protests and violence by non-state actors in Africa, 1996-2014



Note: Calculations based on news verified by press agencies (*Marchés Tropicaux et Méditerranéens* for 1996-2005, AFP and Reuters for 2006-14). See full methodology and data by country in the Statistical Annex of AfDB et al. (2015).

Source: AfDB et al., 2015.

Figure 7. Top drivers of public protests in Africa, 2014



Source: Authors' calculations based on news verified by AFP and Reuters.

Importantly, in 2014 as in previous years, the top drivers of public protests continued to be employment-related claims for wage increases and better working conditions, followed by demands for better public services (Figure 7). This confirms Afrobarometer's findings in 34 countries that Africans are increasingly dissatisfied with the public provision of basic services and that "lived poverty at the grassroots remains little changed" despite the recent growth episode (Asunka, 2013; Dulani, Mattes and Logan, 2013). Similarly, according to the Ibrahim Index of African Governance, while "sustainable economic opportunity" had been a driver of positive governance trends over 2005-09, it contributed slightly negatively to the index over 2009-13 (Mo Ibrahim Foundation, 2014). Lack of decent jobs and participation in the wealth accumulated over a decade of steady growth thus stand out as sources of frustration.

That citizens should increasingly turn to mostly peaceful means of expressing social and political claims is good news, as the demand for better opportunities and more accountability is a prerequisite for improved governance. It does, however, increase the pressure on governments to provide viable answers to these claims, especially in the context of fast demographic growth.

3. Africa needs innovative development strategies

Despite some progress over the last decade, current policies have not proved effective enough at speeding up job creation in productive sectors. In the decades to come, a fast rise in urban and rural populations and the constraints of global competition will make the challenge of transforming the continent a unique undertaking, although with wide variations between the various subregional and national contexts. Africa's transformation path will thus have to cross uncharted territory.

3.A. PAST EXPERIENCES OF DEMOGRAPHIC, URBAN AND ECONOMIC TRANSITION MAY INSPIRE ACTION, BUT THEY CANNOT PROVIDE BLUEPRINTS

Structural transformation typically sees productivity growth in agriculture release workers from farming, pushing them towards urban areas, where higher productivity sectors locate as they benefit from higher economies of agglomeration and knowledge spill-overs. Progress in income, health and education are usually associated with a demographic boom, which also fuels urbanisation until fertility eventually decreases. Strikingly, however, this traditional model of structural change does not seem to apply to most African countries:

- Firstly, both cities and rural communities are booming. The majority of Africa's population is likely to remain rural until the mid-2030s, while the majority of the world's population has lived in urban areas since 2007. Continued demographic growth in the rural areas means that productive opportunities must be created everywhere: policies focusing mainly on moving the rural labour force to productive activities in the cities may not be enough.
- Secondly, urbanisation in Africa has so far occurred without industrialisation (Losch, Fréguin-Gresh and White, 2012). Most rural migrants have moved from low-productivity activities in rural areas to those in the urban sector, where informal settlements have

been mushrooming in the absence of comprehensive urban development strategies (Kayizzi-Mugerwa, Shimeles and Yameogo, 2014; see Special theme section). Lack of opportunities in the cities has even led some migrants to return to rural areas.

- Finally, the pattern of Africa's insertion in international trade – dependency on commodity exports and increased openness to cheap food imports – has altered the market relations between cities and the countryside. For earlier industrialisers in Asia or Europe, the hinterland supplying the city with goods it produces was an essential driver of structural transformation.

Effective transformation strategies need to draw on Africa's own experiences and those of others, but they must also focus on the uniqueness of Africa's transformation challenge.

3.B. CURRENT POLICY OPTIONS MAY BE INSUFFICIENT TO EXPLOIT AFRICA'S FULL POTENTIAL FOR STRUCTURAL TRANSFORMATION

Given the unique set of challenges confronting the continent, "business as usual" will not be enough. African institutions are thus giving priority to structural transformation, an overarching objective of the African Union's Agenda 2063. Experts have put forward several policy options in pursuit of that objective, but none of them alone may be sufficient to address the continent's challenges. Although each option holds part of the answer, they tend to prioritise a particular sector, overlook the importance of demographic dynamics and sometimes underestimate the constraints imposed by the global context (Table 1; Losch, 2015).

African policymakers thus need innovative, effective ways of articulating those policies. While there is little doubt that job creation must be the central priority, the options are not necessarily exclusive. Drivers of change differ according to the context: "Perhaps it will be agriculture-led growth. Perhaps it will be services. But it will look quite different than what we have seen before" (Rodrik, 2014).

4. Regional development strategies can help find innovative solutions to Africa's structural transformation challenge

New development strategies must combine the merits of existing options so as to build on each economy's unique assets and chart original paths towards structural transformation. At the continental level, those assets represent an immense potential, for instance:

- a young and growing active population;
- a fast-growing domestic market of 1.1 billion people, expected to grow by about 1.2 billion by 2050, with an emerging middle class of urban consumers (Africa's combined consumer spending was USD 680 billion in 2008 and is projected at USD 2.2 trillion in 2030; AfDB, 2011);
- a diversity of ecosystems: Africa hosts a quarter of the world's approximately 4 700 mammal species, a fifth of the world's 10 000 bird species and 40 000 to 60 000 plant species (UNEP, 2006);

Table 1. Alternative strategic options for accelerating Africa’s transformation: strengths and weaknesses

Strengths	Weaknesses
<p>Industrialisation</p> <ul style="list-style-type: none"> Increasing manufacturing costs in Asia, the shift to task-based production, outsourcing and intra-firm trade (global value chains) open up new opportunities for light manufacturing, which requires less capital, fewer technical and managerial skills and remains viable in fragile environments. Africa may emulate the export-led strategies of developed and emerging economies by improving trade facilitation, increasing access to energy, investing in skills and implementing smart industrial policies. 	<ul style="list-style-type: none"> The hurdles related to appropriate public policies, institutions, governance systems and sustainability are many. Technical change has gradually rendered manufacturing more capital and skills-intensive, triggering premature deindustrialisation in many developing countries. Manufacturing is increasingly service-intensive: underdeveloped service sectors may thus hamper its emergence and competitiveness. Industrialisation alone may not suffice to create the almost 30 million additional jobs Africa will need every year on average between 2015 and 2030.
<p>Services-led growth</p> <ul style="list-style-type: none"> Jobs in services continue to expand. Services related to outsourcing, new information and communication technologies, and cloud computing present multiple possibilities. 	<ul style="list-style-type: none"> Services are becoming increasingly tradable. The challenges associated with winning effective market shares are numerous. Productive services require high-skilled workers, whereas the African workforce is mostly low-skilled. It is uncertain whether opportunities are sufficient enough to enable countries to bypass industrialisation.
<p>Natural resource-based development</p> <ul style="list-style-type: none"> Investing natural resource revenues wisely and simultaneously developing industrial policies could diversify economies. Under adequate conditions, extractive sectors can generate linkages and support the upgrading of suppliers. Improving transparency, tax collection, public spending, the management of public companies, and the social and environmental impacts of mining would sustain growth. 	<ul style="list-style-type: none"> Governance deficits exist in the extractive sector. There are environmental limits. International prices are volatile and global demand is uncertain as emerging economies slow down.
<p>Green growth</p> <ul style="list-style-type: none"> Dramatic changes in Africa’s production and consumption modes could initiate the world’s energy transition and lead to a more sustainable development path. The potential to leverage renewable energy sources is huge. 	<ul style="list-style-type: none"> Such a transition would take a long time. The current resource extraction model will most likely continue to mobilise significant investments in the short to medium term.
<p>Agriculturally-based growth</p> <ul style="list-style-type: none"> Agriculture is the first employer; the population in rural areas and overall demand for agricultural products will continue to grow. Agriculture plays an important role in structural transformation and directly reduces poverty. Improved agricultural performance played a major role in the economic successes of East and Southeast Asia. 	<ul style="list-style-type: none"> There is uncertainty about how to reconcile absorbing a significant share of the workforce while dramatically improving agricultural productivity. The debate over the best type of development model for agriculture, e.g. small vs. large-scale farming, is inconclusive.

- abundant and largely underexploited natural resources, including an estimated 10% of the global reserves of oil, 40% of gold and 80-90% of chromium/platinum group metals (AfDB et al., 2013);
- large-scale and vast land areas, with around 24% (600 million hectares) of the world's arable land.

However, in a context of wide spatial disparities, those assets are not easily identified and exploited by private and public actors, who tend to focus on a limited range of large urban centres and natural resource enclaves.

4.A. AFRICAN REGIONS AND THEIR RESOURCES TOO OFTEN ESCAPE THE ATTENTION OF POLICYMAKERS

Considering instead the daily practice of policy management, two major factors stand out that hamper effective regional policy-making: strictly sectoral approaches and inadequate information.

Box 1. Definitions

Region: Spatial units at the supranational, subnational and cross-border levels.

Regional development: Policies that improve welfare and increase economic productivity in the different regions of a country; a positive approach to developing the potential of the places that usually fall below the radar of national policymakers.

Regional, context-specific policies should not work in isolation from national and sectoral policies. Yet in practice, *narrowly-defined sectoral approaches* tend to almost exclusively frame governmental action, hampering effective problem-solving at the local level:

- Sectoral policies alone overlook local knowledge, aspirations, resources and dynamics.
- Ministries may intervene along administrative boundaries, instead of focusing on functional areas, where social and economic activities effectively take place.
- Top-down, sectoral policies are exposed to risks of insufficient coordination, duplication and inter-ministerial competition.
- Sectoral lenses tend to limit action to a few specific tools, overlooking the complexity of problems. For instance, Paulais (2012) finds that, despite the significance of the urbanisation challenge, only three out of 30 African countries that prepared a Poverty Reduction Strategy Paper (PRSP) have urban strategies with relatively well-defined budgets.

In addition, a *salient lack of knowledge* about African regions and local economies drastically impedes the capacity of policymakers to identify and unlock their potential:

- In particular, subnational statistics are limited to a few basic variables, which are insufficient to understand regional economies.
- In several countries, entire groups within a population and sectors of the economy are

overlooked. A case in point is the “informal sector”: although it accounts for the bulk of employment in most countries, it remains insufficiently understood and its potential insufficiently captured.

- While a number of initiatives, such as the ECOLOC programme (SWAC/PDM, 2001) or the West African Long-Term Perspective Study (Cour and Snrech, 1998), have aimed to fill the gap in information on local economies, most have been discontinued.
- This inadequacy of information is compounded by rapidly-changing regional dynamics in many African countries. The static categories of “rural” and “urban” no longer capture the appearance of hybrid lifestyles and socioeconomic behaviours related to intensifying and diversifying rural-urban migration patterns and diffusing new technology (Berdegué and Proctor, 2014; Losch, Magrin and Imbernon, 2013; Agergaard, Fold and Gough, 2010; Tacoli, 2002).

4.B. THE NEW PARADIGM OF REGIONAL DEVELOPMENT CAN HELP SEIZE THE POTENTIAL OF AFRICA’S REGIONS

African economies need to liberate the potential of their many regions to foster endogenous growth and accelerate structural transformation. Top-down, subsidy-based interventions aiming to temporarily alleviate regional inequalities must give way to a broader family of policies increasing regional competitiveness and innovation, mobilising untapped resources and stimulating the emergence of new activities (Table 2). *Regional development* thus takes a positive approach to developing the potential of the spaces that usually fall below the radar of national policymakers: it aims to increase economic productivity and improve well-being in the different regions of a country.

Table 2. Old and new paradigms of regional policy

	Old paradigm	New paradigm
Objectives	To compensate temporarily for disadvantages due to the location of lagging regions	To tap underutilised potential in all regions, enhancing regional competitiveness
Strategies	Sectoral approach	Integrated development projects
Tools	Subsidies and state aids	Mix of soft and hard capital (capital stock, labour market, business, environment, social capital and networks)
Actors	Central government	Different levels of government

Source: Based on OECD (2009).

Promoting regional development requires revamping the entire policy process, and therefore adopting place-based, multisectoral and participative *development strategies* that do the following:

- *Focus on local assets* that constitute untapped resources for development: those assets

can be either *generic resources* – e.g. natural resources such as gas – or *specific resources*, e.g. cultural heritage, the rural landscape and certain types of know-how. The latter are only “activated” when they are used and obtain a market value (Table 3).

- *Articulate various sectoral policies* and public investments in a regional framework, as complementarities and trade-offs come with the place where they are located.
- *Engage different actors* in multi-level government settings, and in particular promote the active participation of local stakeholders, so as to reduce asymmetries in information and knowledge between national and local actors.

Table 3. Examples of specific African resources activated through the participation of local stakeholders

<i>Specific local resources</i>	<i>Country</i>	<i>Development outcome</i>
Dry figs from Béni Maouche	Algeria	Productivity increase and diversification, added value to product, enhanced competitiveness, creation of skilled jobs
Pepper from Ighil Ali		
Ghardaïa’s biotechnology of arid zones		
Protected Communal Forests of Benin	Benin	Sustainable use of natural resources and green jobs creation
Regional Park W’s natural and cultural endowments.	Benin, Burkina Faso, Niger, Nigeria	Ecotourism, cultural tourism, tree-planting using indigenous species, processing of goods made from natural resources
Pepper (PGI*) from Penja	Cameroon	Profit rate increase, income increase, product protection
White honey from Oku (PGI*)		
Coffee from Ziama-Macenta (PGI*)	Guinea	Revenue increase
Malindi-Watamu Biosphere Reserve	Kenya	50% of locals are directly employed in tourism related to the Reserve
Amboseli National Park		Community-based ecotourism, processing of goods made from natural resources
Fine garments	Madagascar	Massive creation of employment, industrialisation, increased exports
Tedla’s landscape heritage	Morocco	Ecotourism, employment creation as local tour guides
Dry figs and weaving from Béni Khedache	Tunisia	Commercialisation and valorisation of the product, income increase
Kruger National Park	South Africa	Covers 1 962 362 ha of land, attracts investment, source of foreign exchange, each tourist spends on average ZAR 4400

Note: *Protected Geographical Indication.

Sources: AFD/CIRAD (2014); Campagne and Pecqueur (2014); Fukunishi and Ramiarison (2012); SWAC/OECD (2005).

4.C. HOW TO CRAFT DEVELOPMENT STRATEGIES FOR REGIONAL DEVELOPMENT

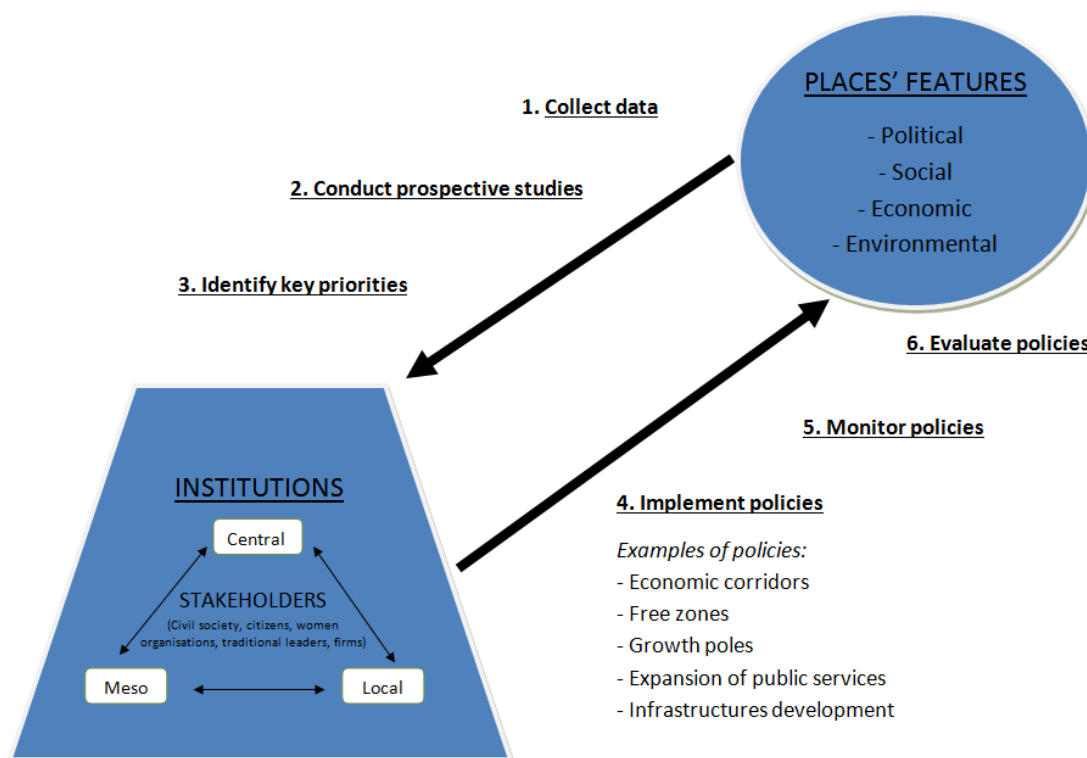
Seven main steps may guide the formulation of development strategies at regional level (Figure 8):

1. Stakeholders and traditional institutions collect reliable data, including statistics, to obtain the most knowledge possible about the region. A dearth of data should not prevent the process from continuing.
2. Scenarios for the region’s future are laid out through foresight studies and

participatory processes, taking into account uncertainties related to missing data. This leads to building a vision for the country's future based on local potential and opportunities.

3. Based on the scenarios and the economic, demographic and spatial conditions underpinning them, stakeholders and government identify a limited number of integrated priorities and spell out multiannual policies for achieving them. The priorities are those that contribute the most to the country's long-term development strategy.
4. Multiple levels of government, civil society and traditional institutions implement these policies, particularly as they participate in the scenario planning, priority setting and policy design steps. They coordinate their actions and use formal and informal checks and balances to ensure transparency.
5. Policy implementation is monitored according to the key priorities. A predefined incentives framework ensures that the various levels of government responsible for implementing those policies are rewarded or penalised based on their achieving specific goals.
6. Policy outcomes are evaluated to enable the various levels of government to address inefficiencies, adjust their multiannual plans and, if outcomes are not met, reassess and redefine their vision and priorities.
7. Fiscal revenues are used to support the overall strategy (not represented in the figure below).

Figure 8. A strategic process for regional development



4.D. FOUR PRIORITIES FOR IMPROVING THE EFFECTIVENESS OF REGIONAL DEVELOPMENT IN AFRICA

In order to improve the effectiveness of regional development strategies, four aspects deserve particular attention in many countries.

Firstly, a number of initiatives in Africa illustrate ways of *improving the mechanisms that inform policy design and implementation*.

- An *evidence-based culture of policymaking* helps set targets and track progress in public sector performance. South Africa is one of the most advanced countries in disseminating socioeconomic information as a participatory mechanism. For example, after Statistics South Africa published a national Multidimensional Poverty Index in 2014, the Gauteng City Region Observatory produced its own index the following year.
- The *data revolution* – a fundamental pillar of the post-2015 development agenda for improving governmental statistical capacity – will help policymakers understand the specificities of regions and adopt timely measures as the needs of their jurisdictions evolve (PARIS21, 2015). New technologies provide reliable and cost-efficient means to map local resources:
 - The Africapolis project estimates urban growth in 16 West African countries by combining demographic surveys and geographic information systems (GIS; see AFD et al., 2009).
 - A local project in Burkina Faso using very high spatial resolution (VHSR) satellite images produced a detailed regional map of land used for agricultural and other purposes with less than 2% errors in area estimation (Imbernon, Kabore and Dupuy, forthcoming).
 - Measuring the intensity of nightlights captured from satellites can complement official measures of income or inequality (Mveyange, 2015).
 - Mobile phone data may serve to assess the impact of policies; it has been used to optimise bus routes in Abidjan.

Secondly, *defining integrated strategic priorities* can be done even with limited data thanks to innovative approaches. Regional *foresight studies*, for instance, bring together different levels of government – national, regional and local – as well as non-state actors to map possible futures, identify opportunities and challenges, stimulate debates on pathways to development and lead to place-based solutions (Alvergne, 2008). The scope for progress is significant: while many African countries plan for the long term, few use regional foresight studies or a genuine participatory process. Out of 37 countries surveyed in the AEO 2015 report, 27 have medium-to-long-term strategies, but while most span 20 years or more, only about a third foresee alternative scenarios. Finally, they tend to overlook the multisectoral nature of development and ignore local specificities.

Thirdly, *capacity must be strengthened at multiple levels of government* so as to make multi-level governance effective. This may be achieved by putting in place “binding” mechanisms – e.g. legal mechanisms or contracts between local and national administrations – or “soft” mechanisms, such as platforms for discussion. Rwanda’s Joint Action District Forum is one

example of such a participatory process where local stakeholders articulate development plans, set budgets and allocate district resources. Involvement of subnational governments in policymaking takes time, but medium-to-long-term benefits should outweigh the costs of coordination.

Finally, *resources* for multi-level governance must be substantially scaled up, and public and private institutions strengthened.

- Central governments will have to provide most of the funding. New resources may be mobilised through more effective taxation of natural resource extraction, the curbing of illicit financial outflows, effective channelling of resource revenues to production transformation (or from innovative finance mechanisms such as funding from emerging economies, sovereign wealth funds (SWFs), funding from remittances or diaspora bonds).
- At the local level, fiscal systems must be bolstered across the board through transparent and predictable transfers from central governments, expanding the local fiscal base – for instance, through more effective use of property taxes – and by progressively tapping capital markets, provided local governments respect national guidance for macroeconomic stability. Regional development requires strong local fiscal systems and transparent governance to finance local economies and the necessary infrastructure. Greater fiscal legitimacy of local governments is necessary to improve the local fiscal capacity: taxpayers are more likely to comply with paying taxes and to accept new forms of taxation if they perceive the benefits of related public spending, and thus consider the taxes to be legitimate.

In sum, place-based, multisectoral and participative development strategies are one way of “decompartmentalising” existing policies, so as to better tap the potential of African regional resources. They provide an avenue for implementing the African Union’s agenda of integration and structural transformation, including through its *Rural Futures* programme, which aims to reconnect rural and urban development within a regional perspective (NEPAD, 2010; Losch, Magrin and Imbernon, 2013). An international dialogue and exchange of experience will be essential to inspiring country-specific processes.

References

AFD et al. (2009), *Africapolis : dynamiques de l'urbanisation, 1950-2020, approche géostatistique, Afrique de l'ouest*, Agence Française de Développement, Paris, www.afd.fr/webdav/site/afd/shared/PUBLICATIONS/THEMATIQUES/autres-publications/BT/Africapolis_Rapport.pdf.

AFD/CIRAD (2014), *2014, Année de l'agriculture familiale : l'AFD présente 9 grands produits d'Afrique et d'Asie du Sud-Est et se mobilise en faveur de l'agriculture familiale*, Agence Française de Développement, Paris, www.afd.fr/webdav/site/afd/shared/PRESSE/Evenements/2014%20annee%20de%20l%27agriculture/DP%20AFD%20salon%20agri%20-%20maj%2019%2002%202014.pdf.

AfDB et al. (2015), *African Economic Outlook 2015: Regional Development and Spatial Inclusion*, OECD Publishing, Paris.

AfDB et al. (2014), *African Economic Outlook 2014: Global Value Chains and Africa's Industrialisation*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/aeo-2014-en>.

AfDB et al. (2013), *African Economic Outlook 2013: Structural Transformation and Natural Resources*, OECD Publications, Paris, <http://dx.doi.org/10.1787/aeo-2013-en>.

AfDB et al. (2012), *African Economic Outlook 2012: Promoting Youth Employment*, OECD Publications, Paris, <http://dx.doi.org/10.1787/aeo-2012-en>.

AfDB et al. (2011), *African Economic Outlook 2011: Africa and its Emerging Partners*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/aeo-2011-en>.

Agergaard, J., N. Fold and K. Gough (2010), *Rural-Urban Dynamics: Livelihoods, Mobility and Markets in African and Asian Frontiers*, Routledge, Oxford.

Ahmed, S. et al. (2014), "How significant is Africa's demographic dividend for its future growth and poverty reduction?", *Policy Research Working Paper*, No. 7134, World Bank, Washington, DC, www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/12/08/000158349_20141208151209/Rendered/PDF/WPS7134.pdf

Alvergne, C. (2008), *Le défi des territoires : comment dépasser les disparités spatiales en Afrique de l'Ouest et du Centre*, Karthala, Paris.

Asunka, J. (2013), "What people want from government: Basic services performance ratings, 34 countries", *Afrobarometer Policy Brief*, No. 5, December, www.afrobarometer.org/files/documents/policy_brief/ab_r5_policybriefno5.pdf.

Berdegú, J. and F. Proctor (2014), "Inclusive rural-urban linkages", *Working Paper Series*, No. 123, Working Group: Development with Territorial Cohesion, Territorial Cohesion for Development Program, Santiago.

Bird, K., K. Higgins and D. Harris (2010), "Spatial Poverty traps: An overview", *Overseas Development Institute*, London, www.odi.org/publications/4533-spatial-poverty-traps-chronic-poverty.

Braconier, H., G. Nicoletti and B. Westmore (2014), "Policy Challenges for the Next 50 Years", *OECD Economic Policy Papers*, No. 9, OECD Publishing, Paris, www.oecd.org/economy/Policy-challenges-for-the-next-fifty-years.pdf.

Campagne, P. and B. Pecqueur (2014), *Le développement territorial : une réponse émergente à la mondialisation*, Charles Léopold Mayer, Paris.

Cour, J. M. and S. Snrech (1998), "Preparing for the Future: A Vision of West Africa in the Year 2020", *West Africa Long-Term Perspective Study*, OECD Publishing, Paris, <http://hdl.handle.net/10253/132>.

Dulani, B., R. Mattes and C. Logan (2013), "After a decade of growth in Africa, little change in poverty at the grassroots", *Afrobarometer Policy Brief*, No. 1, www.afrobarometer.org/files/documents/policy_brief/ab_r5_policybriefno1.pdf.

Fukunishi, T. and H. A. Ramiarison (2012), "Madagascar's garment industry: Success of Africa's garment exports?", in *Dynamics of the Garment Industry in Low-Income Countries: Experience of Asia and Africa (Interim Report)*, Institute of Developing Economies: Japan External Trade Organization,

www.ide.go.jp/English/Publish/Download/Report/2011/pdf/410_ch7.pdf.

Imbernon, J., B. Kabore and S. Dupuy (forthcoming), "Les surfaces cultivées en Afrique de l'Ouest vues à très haute résolution: apport d'une cartographie du parcellaire cultivé", *Mappemonde*, Toulouse.

Kayizzi-Mugerwa, S., A. Shimeles and N. D. Yameogo (eds.) (2014), *Urbanization and Socioeconomic Development in Africa: Challenges and Opportunities*, Routledge African Studies, New York.

King, A. and C. Ramlogan-Dobson (2015), "Is Africa actually developing?", *World Development*, Vol. 66/0, Elsevier, pp. 598-613, www.sciencedirect.com/science/article/pii/S0305750X14002885.

Losch, B. (2015), "The elusive quest for inclusive growth in sub-Saharan Africa: Regional challenges and policy options", in L. Haddad, H. Kato and N. Meisel, *Growth Is Dead, Long Live Growth: The Quality of Economic Growth and Why It Matters*, JICA Press, Tokyo, pp. 217-242.

Losch, B., S. Fréguin-Gresh and E. White (2012), "Structural transformation and rural change revisited: Challenges for late developing countries in a globalizing world", *Africa Development Forum Series*, World Bank and Agence française de développement, Washington, DC, and Paris.

Losch, B., G. Magrin and J. Imbernon (2013), *A New Emerging Rural World: An Overview of Rural Change in Africa*, Atlas for the NEPAD Rural Futures Programme, Centre de Coopération Internationale en Recherche Agronomique pour le Développement, Montpellier.

Mo Ibrahim Foundation (2014), Ibrahim Index of African Governance (database), Mo Ibrahim Foundation, www.moibrahimfoundation.org/iiaag/.

- Mveyange, A. (2015), *“Night lights and regional income inequality in Africa”*, World Bank.
- Ncube, M., A. Shimeles and S. Younger (2013), *“An Inclusive Growth Index for Africa”*, African Development Bank Group, Tunis.
- NEPAD (2010), *The Rural Futures Programme: Rural Transformation across the African Continent*, The New Partnership for Africa’s Development Secretariat, Midrand.
- OECD (2015), *OECD Economic Surveys: China 2015*, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-chn-2015-en.
- OECD (2014a), *“Shifting gear: Policy challenges for the next 50 years”*, *OECD Economics Department Policy Notes*, No. 24, OECD, Paris, www.oecd.org/eco/growth/Shifting%20gear.pdf.
- OECD (2014b), *OECD Territorial Reviews: Colombia*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264224551-en>.
- OECD (2009), *Regions Matter: Economic Recovery, Innovation and Sustainable Growth*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264076525-en>.
- PARIS21 (2015), *A Road Map for a Country-Led Data Revolution*, PARIS21, Paris, http://datarevolution.paris21.org/sites/default/files/Road_map_for_a_Country_led_Data_Revolution_web.pdf.
- Paulais, T. (2012), *Financing Africa’s Cities: The Imperative of Local Investment*, Africa Development Forum Series, World Bank and Agence française de développement, Washington, DC.
- Rodrik, D. (2014), *“An African growth miracle?”*, *Richard H. Sabot Lectures*, Center for Global Development, Washington, DC, www.sss.ias.edu/files/pdfs/Rodrik/Research/An_African_growth_miracle.pdf.
- SWAC/OECD (2005), *“One park, three countries”*, *Cross-Border Diaries: Bulletin on West African Local-Regional Realities*, OECD Publishing, Paris.
- SWAC/PDM (2001), *Écoloc, gérer l’économie localement en Afrique : évaluation et prospective*, Sahel and West Africa Club and Partnership for Municipal Development, Paris.
- Tacoli, C. (2002), *“Changing rural-urban interactions in sub-Saharan Africa and their impact on livelihoods: A summary”*, *Working Paper Series on Rural-Urban Interactions and Livelihood Strategies*, No. 37, International Institute for Environment and Development.
- UNDESA (2012), *World Population Prospects: The 2012 Revision* (database), <http://esa.un.org/wpp/> (accessed 5 March 2015).
- UNECA/African Union (2014), *“Dynamic industrial policy in Africa: Innovative institutions, effective processes and flexible mechanism”*, in *Economic Report on Africa*, United Nations Economic Commission for Africa, Addis Ababa.
- UNEP (2006), *“Biodiversity”*, in *African Environment Outlook 2: Our Environment, Our Wealth*, *United Nations Environment Programme*, www.eoearth.org/view/article/150570.
- World Bank (2015), *Global Monitoring Report 2014/2015: Ending Poverty and Sharing*

Prosperity, World Bank, Washington, DC,

www.worldbank.org/content/dam/Worldbank/gmr/gmr2014/GMR_2014_Full_Report.pdf.

Yatta, F. P. (2015), “La décentralisation en Afrique : peut-elle aider les pays africains à mieux gérer leurs inégalités spatiales et territoriales?”, *OECD Development Centre Think Piece*, OECD, Paris.

Pan-African banks: stylised facts and results of a pilot survey

JEAN-PHILIPPE STIJNS¹

Executive summary

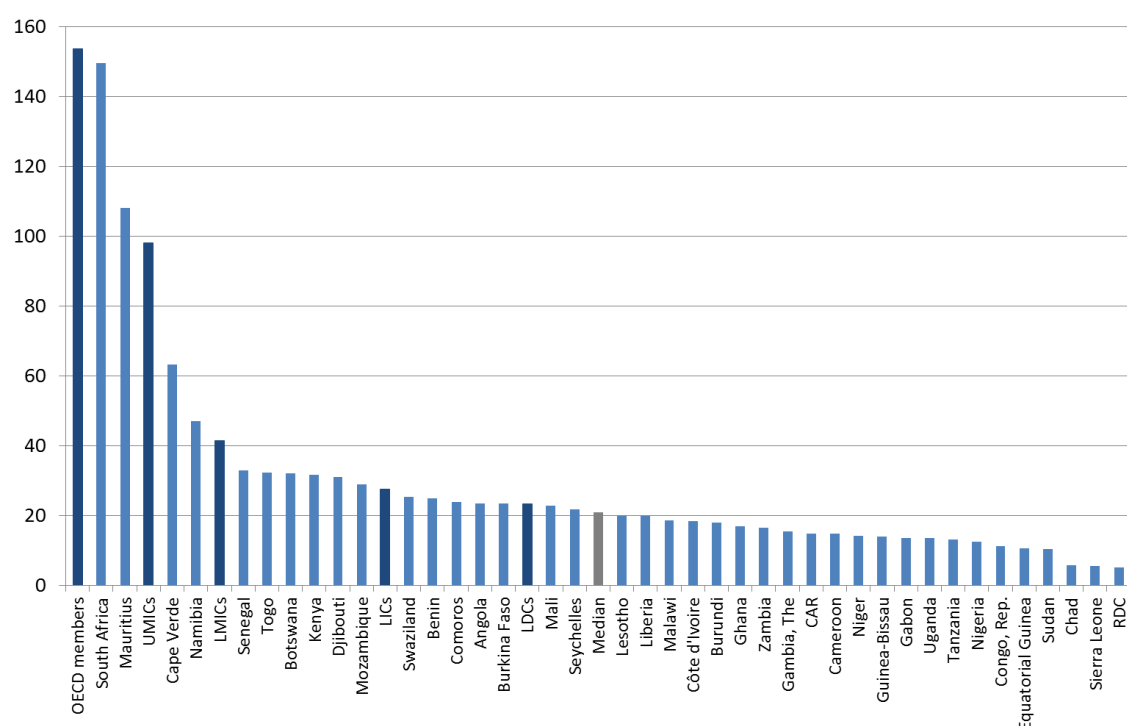
- In recent years, most SSA banking sectors have been deepening rapidly and access to finance has been improving, albeit from a very low base. Within this shifting context, pan-African banks (PABs) operate on a much higher scale than most other banks in SSA and have witnessed a steady increase in scale since the onset of the financial crisis. This higher and growing scale is being reflected in lower costs and greater profitability. Three quarters of PABs generate more than a quarter of their revenues outside their home market. PABs tend to expand outside their home market pulled by higher profitability and market growth in the target markets and pushed by rising competition in their home market.
- The footprint of PABs has grown so large that only Eritrea, Ethiopia, Somalia and Sudan do not have a subsidiary or branch of at least one of the PABs included in our pilot survey. Tanzania has as many as six of these PABs, Ghana, Kenya, Mozambique, Uganda, Zambia and Zimbabwe as many as five. Large parts of West, Central and East Africa have three or more PABs. This is resulting in increased competition for loans and deposits, stronger intermediation and the deepening of SSA banking sectors.
- PABs plan to continue the expansion of their cross-border activities over the short and medium term. However, some PABs report a desire to take time to digest their long expansionary stretch, refocus on core markets and ensure that cross-border investments are matched by declining operational costs. Ghana, Kenya and Tanzania are reported most often as presenting high growth potential, followed by Nigeria, Rwanda, Uganda and Zambia. Angola, Kenya, Tanzania and Zambia are mentioned most often as target countries for expansion.
- PABs report an improving cost-to-income ratio and expect this ratio to improve further going forward. They often report committed efforts to deploy mobile banking and e-banking technologies. They plan to keep on growing their loan books, financed by a mix of deposit collection, longer-term funding and support from IFIs. SMEs are often mentioned as a top target for expansion, alongside the usual large local and multinational corporates.

¹ European Investment Bank, Department of Economics. The author wishes to thank Michel Kalalo, Debora Revoltella, Robert Schofield, Souleyman Toure, Christoph Weiss and other colleagues for their helpful comments and suggestions. All remaining errors remain the author's responsibility. The views expressed are those of the author and do not necessarily reflect the position of the EIB.

1. Recent trends in sub-Saharan Africa's banking sectors

The overall depth and financial sophistication of the banking sectors of sub-Saharan Africa (SSA) remain generally low, even when the level of per capita income of the corresponding countries is taken into consideration. However, there is a high degree of heterogeneity across African countries with respect to the depth and financial sophistication of their banking sectors. Furthermore, SSA banking sectors have been deepening quite rapidly, especially in recent years, and this trend is affecting all SSA countries, with very few exceptions, and is resulting in rapidly improving access to finance, albeit from a very low base.

**Figure 1: Credit to the private sector
(as a share of GDP – 2013)**



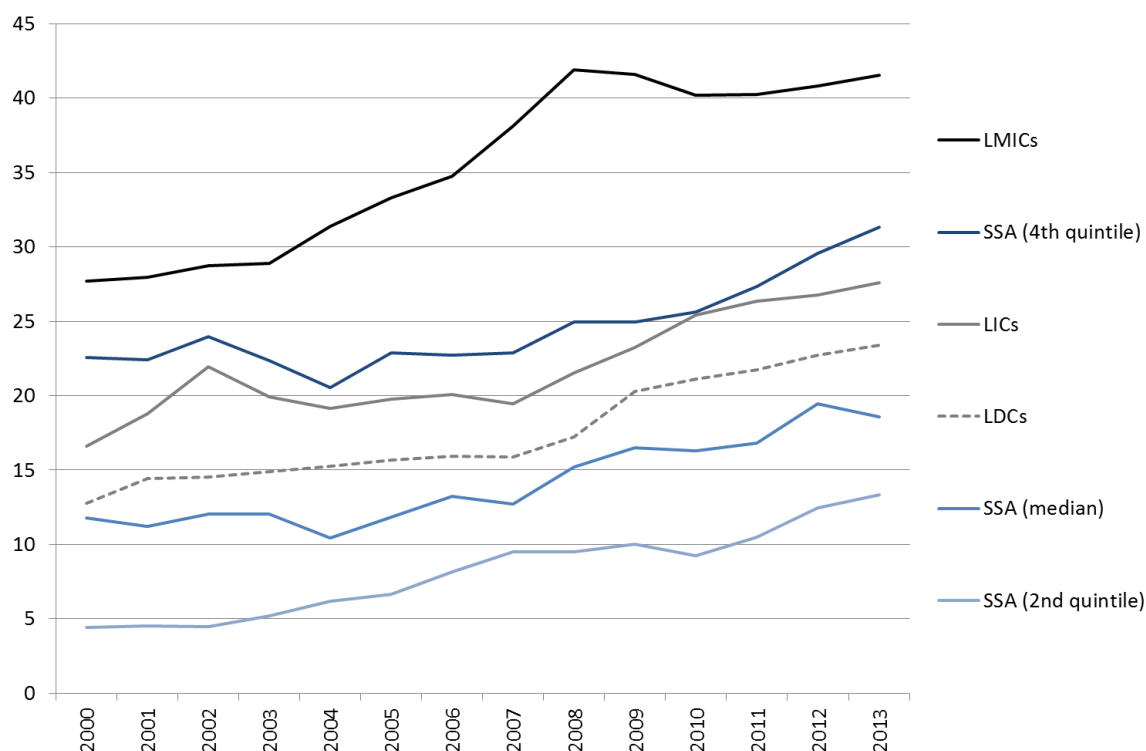
Source: World Bank FINDEX.

A limited number of relatively developed banking sectors contrasts with a high proportion of shallow banking sectors (Figure 1). SSA includes countries with world-class financial sectors such as South Africa and Mauritius, where the ratio of credit to the private sector as a share of GDP exceeds 100 percent, above the average for upper-middle-income countries² (UMICs). SSA also includes countries like Cape Verde and Namibia, where credit to the private sector as a share of GDP is over 40 percent, above the average for lower-middle-income countries (LMICs). A few countries such as Senegal, Togo, Botswana, Kenya, Djibouti and Mozambique have a ratio of private credit to GDP higher than the low-income countries (LICs) average of 28 percent. Besides, there is a long tail of shallower banking sectors, with

² For 2015 FY, the World Bank defines as low-income economies those with a GNI per capita, calculated using the *World Bank Atlas* method, of USD 1 045 or less in 2013; lower-middle-income and upper-middle-income economies are those with a GNI per capita of more than USD 1 045 but less than USD 4 125. Upper-middle-income economies are those with a GNI per capita of more than USD 4 125 but less than USD 12 746. Least developed countries are those that, according to the United Nations, exhibit the lowest indicators of socioeconomic development, on the basis of the Human Development Index.

credit to the private sector ranging from 20 percent in Lesotho to 5 percent in DRC, significantly below even the average for the least developed countries (LDCs) of 23 percent, and where, typically, only rudimentary financial services are offered. Consequently, the median SSA banking sector is substantially less developed than that of even the global average of LDCs.

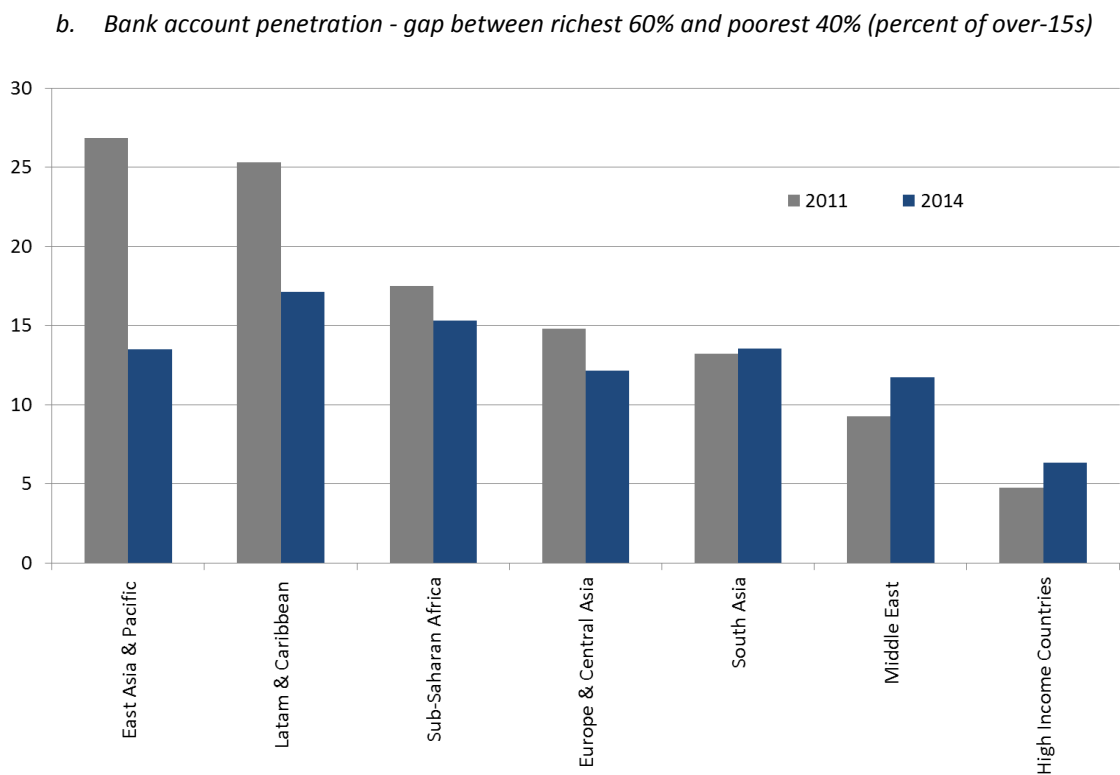
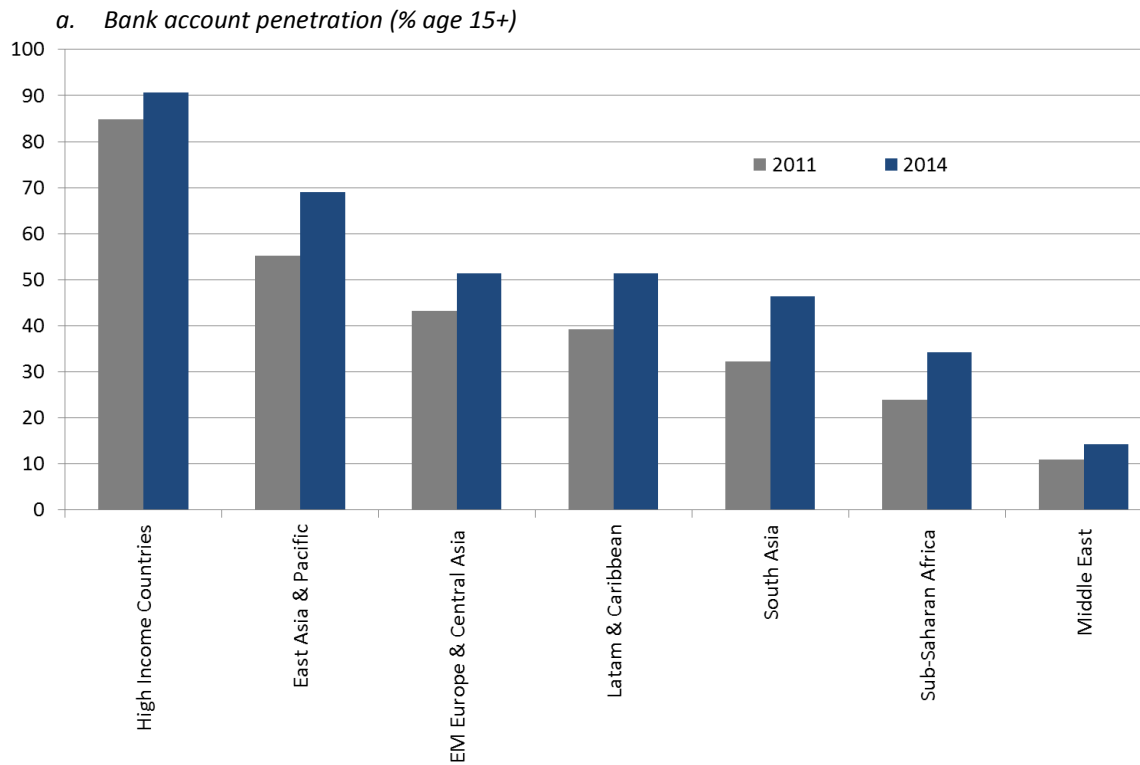
Figure 2: Credit to the private sector by groups of countries (2000-2013)



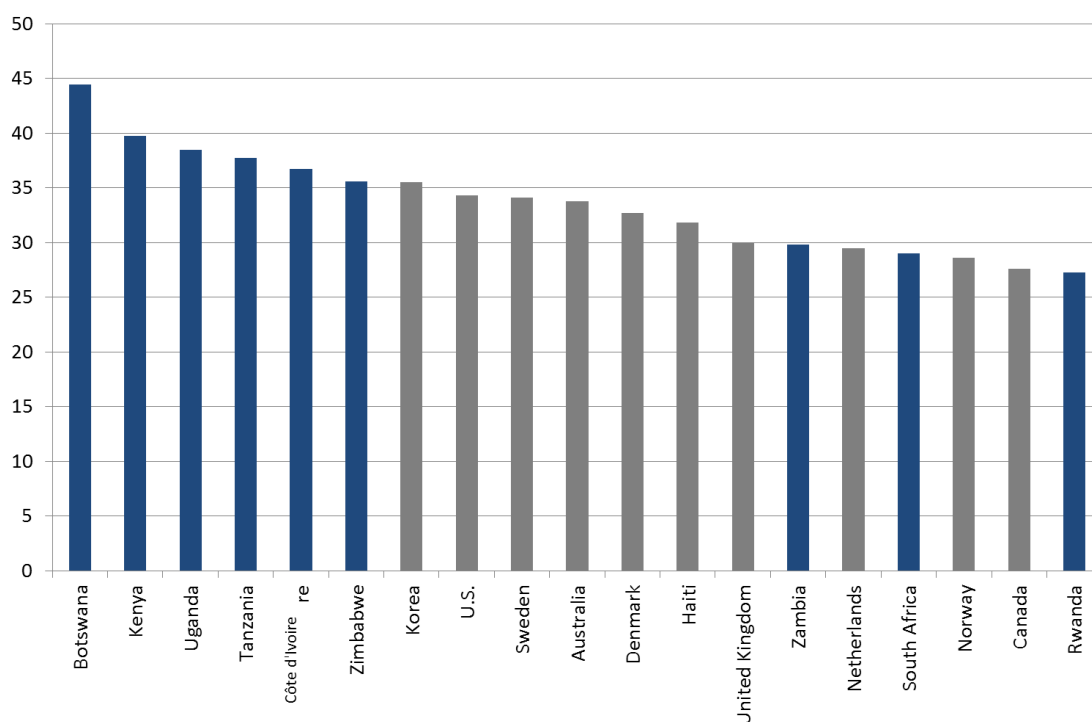
Source: World Bank FINDEX; author's calculations.

Over the last decade, SSA banking sectors have deepened noticeably. Financial intermediation is on the rise in nearly all 45 SSA countries but banking sectors in SSA still have a remarkably long way to go (Figure 2). Financial depth is increasing for the second quintile of sub-Saharan countries (i.e. the nine least developed banking sectors in SSA in our sample), albeit from a very low starting point (below 5 percent) at the turn of the century. A growing number of countries are expected to eventually join the league of South Africa, Mauritius, Cape Verde and Namibia and catch up with lower-middle-income countries in terms of banking sector depth. Yet, there is ample room for banking sector deepening even at the top of the distribution. The clear upward trend followed by credit to the private sector as a share of GDP is observed even for the fourth quintile of SSA banking sectors, perhaps unsurprisingly as the fourth quintile still stands barely above the trend of low-income countries. Of greater concern is the fact that the 10 percent gap in financial depth between the median of SSA countries and least developed countries does not yet show signs of narrowing over time. In other words, LDCs have not really been catching up in terms of financial depth in recent years.

Figure 3: Financial inclusion in SSA vs. other regions (2011-2014)



c. *Percentage of respondents who used a mobile phone to undertake a transaction via a bank account in 2014 (Top 20 countries)*



Source: World Bank FINDEX.

Access to finance in SSA is still lower than in most other regions but it is improving markedly over time and the SSA region leads the world in mobile money accounts (Figure 3). While banks in SSA are typically well-capitalised and profitable, they focus most of their lending activity on short to medium-term financing of large corporate clients and local governments³. Consequently, SMEs and low and middle-class individuals often remain unbanked, at least on a formal basis. According to the World Bank's Financial Inclusion Database (FINDEX), only 34 percent of adults in SSA had a bank account in 2014, up from 24 percent in 2011 (Figure 3.a). Among the over-15s, the gap in bank account ownership between the richest 60 percent and poorest 40 percent is wide compared to most other regions (Figure 3.b). However, this gap narrowed from 17 percent to 15 percent between 2011 and 2014 and is currently lower than in Latin America and the Caribbean region. In addition, while just 2 percent of adults worldwide have a mobile money account, 12 percent in SSA have one, and six SSA countries top the rankings in terms of the share of the population that used a mobile phone to undertake a transaction via a bank account in 2014 (Figure 3.c). Financial inclusion, while still unsatisfactory, is improving rapidly.

The generally high cost of banking services across the region is driven in large part by the typically small scale of banking markets in SSA, the high concentration of banks prevailing in most of them⁴ and the low population density outside the major urban centres. Historically, while foreign banks have played an important role, particularly with respect to infrastructure financing, they have been marginally involved in SME financing. Indeed, in many SSA

³ See for example Beck and Cull (2013), Allen et al. (2012) and Beck et al. (2011).

⁴ See Gulde (2006); Beck and Cull, *ibid*.

countries it is not profitable to offer bank accounts to a large share of SMEs and individual clients, particularly using branch banking models designed outside the region in markets that are typically larger-scale⁵ and have a higher population density. Other characteristics contributing to high costs include policy-driven factors such as a weak financial infrastructure (fragmented payment, clearing, settlement and credit registry systems), inadequate contractual frameworks and ineffective commercial courts, client income volatility due to economic concentration on a narrow spectrum of commodities and rampant informality⁶.

A growing wave of liberalisation has been taking over African banking systems since the late 1990s/early 2000s and is considered to be the cause of the recent deepening of SSA banking sectors, together with the general improvement in the macroeconomic management of SSA countries (and favourable trends in commodity prices up until the financial crisis, driven by the emergence of China). Prior to the last two decades, heavy-handed state intervention, including through nationalisation, also contributed to stifling the development of many SSA banking sectors, especially in the three decades spanning the 1960s-1980s. Despite notable progress, governance, regulation and supervision issues continue to hold back the development of a large number of SSA banking sectors. Against this backdrop, foreign banks have staged a partial retreat or put a brake on their expansion plans in SSA markets since the onset of the financial crisis (Beck et al., *ibid.*) due to new prudential and compliance constraints imposed by home supervisors. Africa-headquartered cross-border banks, referred to as pan-African banks (PABs), have taken advantage of this situation and have therefore been attracting a lot of attention in SSA, culminating with the founding of Atlas Mara in November 2013 by former Barclays executive Bob Diamond and the African entrepreneur Ashish Thakkar. The following section focuses on these banks and on recent trends in their sector.

2. The rise of pan-African banks

Low-scale and weak competition in many SSA markets set the stage for banks ready to operate across borders and compete with local banks. In SSA, such local cross-border banks have been dubbed pan-African banks (PABs). There are currently seven major PABs with a presence in ten or more SSA countries according to the IMF⁷. Pan-African banking groups are headquartered in a variety of countries spanning large banking markets like Angola, Kenya, Morocco, Nigeria and South Africa but also several smaller ones. They have become lead arrangers of syndicated loans in the region⁸. Such banks operating across country borders are expected to achieve economies of scale by leveraging group-wide functions and transferring know-how and locally adapted banking skills. Economies of scale allow PABs to stimulate competition in the banking markets they have penetrated. PABs have the potential to offer higher-quality, lower-cost banking services and to widen financial intermediation to unserved SMEs and individuals. Potentially, they are also prime actors for the financing of cross-border infrastructure.

⁵ See Beck (2013), for instance.

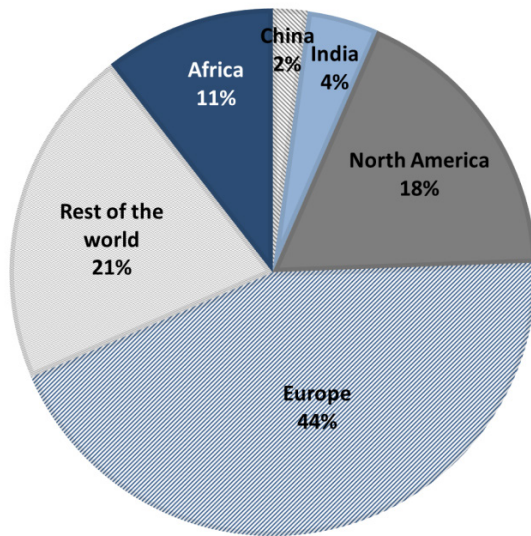
⁶ See Beck et al. (2014), Beck and Cull, *ibid.*

⁷ See IMF (2014) and Beck et al. (2015).

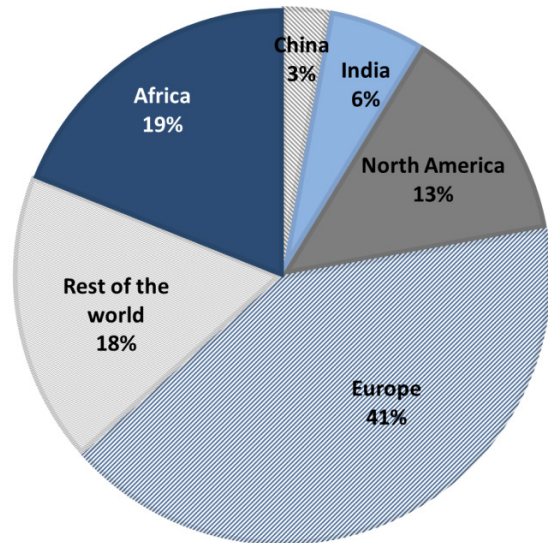
⁸ See IMF (2015), Chapter 1 in this study.

Figure 4: Increasing investment and trade integration in Africa

a. Greenfield investment in Africa (2003-08)

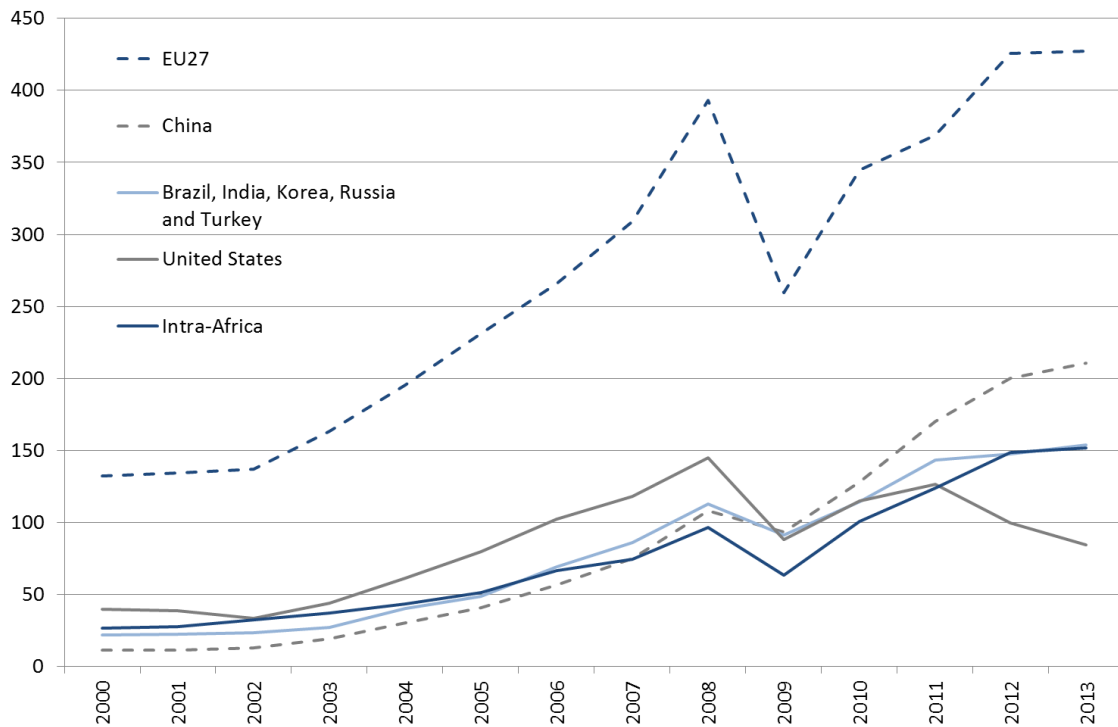


b. Greenfield investment in Africa (2009-14)



Source: AfDB-OECD-UNDP (2015) calculations, based on fDi Markets (2014) and UNCTAD (2014).

c. Africa's total trade flows with selected global and intra-African partners (2000-13) in USD billion



Source: AfDB-OECD-UNDP (2015) calculations based on UN COMTRADE (database), wits.worldbank.org/wits/

PABs are best placed to finance intra-regional trade and investment across the countries in which they operate. Although starting from a low base compared with trade and investment flows between African countries and their traditional partners, intra-regional trade and investment flows are clearly on the rise (Figure 4.a-b). The share of intra-African greenfield investments rose from 11 percent in 2003-08 to 19 percent in 2009-14. Similarly, intra-African trade increased steadily from the turn of the century to around USD 150bn in 2013, in line with trade with Brazil, India, Korea, Russia and Turkey, and supplanting trade with the US from 2012. Indeed, the rise of PABs can also be seen as the financial corollary of growing regional integration of trade and investment, as PABs follow their clients and finance their cross-country deals. In this sense, they are a domestic variant of the rise of Africa’s partnerships with other emerging economies, such as Brazil, China and India, since the turn of the 21st century⁹.

Figure 5: The rising scale of pan-African banks



Source: Author’s calculations, based on Bankscope data.

While PABs¹⁰ share common features with the overall sample of SSA banks¹¹, they also differ in some notable respects (Figure 5). Both PABs and banks operating in SSA have witnessed a

⁹ See AfDB-OECD-UNDP (2011).

¹⁰ For the purpose of analysis in this section, and to optimise result comparability, the list of PABs tracked by the IMF (2014, p.51) has been adopted. The BSIC has been excluded because of data unavailability. For most reported data series, the number of reporting banks is up to 34. For 2014, it goes down to 25.

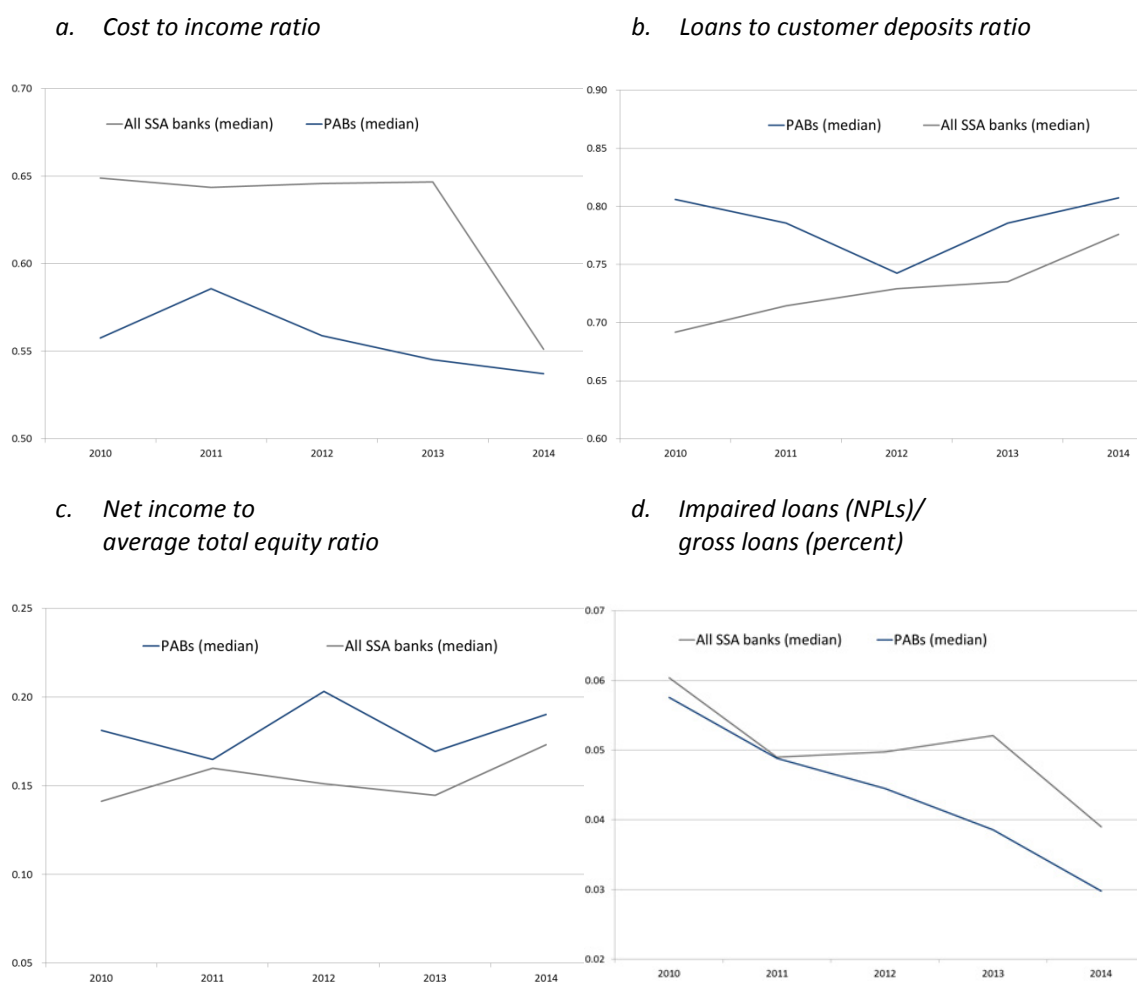
clear upward trend in scale during the past five years. Results for 2014 should be considered as tentative, as not all banks had filed their 2014 financial statements at the time of writing. Subject to this caveat, there seems to be an acceleration, and this acceleration seems even more pronounced amongst SSA banks in general than amongst PABs, especially in terms of profits before taxes. The tendency of smaller banks to report later than larger banks on average, calls all the more for caution about this result.

The overall pace of growth in market activity does not differ markedly between PABs and other banks but PABs typically operate at a much higher scale than banks operating in SSA in general. Whereas the median PAB reported a total capital of around EUR 1.4bn, the median bank operating in SSA reported total capital of the order of EUR 100m. This is not entirely obvious, as the distribution of the size of SSA banks is so skewed, with banking sectors such as South Africa's and Nigeria's being larger than those of most other countries. In other words, the domestic activities of a South African bank could exceed those of a PAB. It turns out that large banks operating in large domestic markets tend to be PABs, as they seek to maintain growth and profitability by branching out from their saturated home markets. However, not all PABs are based in large markets, e.g. BancABC is Botswana-based and Ecobank is headquartered in Togo. Indeed, the other argument can equally be made that when the domestic market is very small, some banks branch out to achieve better returns and scale. In any case, this significant difference in median scale is one reason why PABs are expected to increase competition in markets where they operate and, thanks to economies of scale, to lower the cost of supplying banking services. These lower costs could, in turn, allow PABs to reach out to previously unprofitable market segments such as SMEs and retail clients with lower or less secure incomes.

The difference in scale, and possibly other factors, between PABs and SSA banks is indeed reflected in lower costs, higher intermediation and higher profitability (Figure 6). Of course causality also runs from cost to scale as banks that come from markets where tougher competition prevails have lower costs, which enable them to contest lower-competition, higher-cost markets. The median cost-to-income ratio remained around 65 percent until 2013 for SSA banks, while for PABs it is closer to 55 percent, nearly 10 percentage points lower. Given that not all banks have reported for 2014, the recent fall in the cost-to-income ratio for SSA banks would have to be confirmed by future data. The median loan-to-customer deposit ratio is around 80 percent for PABs compared to 75 percent for SSA banks. Increased competition from PABs seems to be pushing smaller-scale, more local SSA banks into serving client segments they have hitherto neglected (Figure 6.b). Yet the net income to average total equity ratio grew around 18 percent during the period 2010-14 for PABs compared to around 15 percent for all SSA banks, illustrating the high – and rising – profitability of banks in SSA (Figure 6.c). Figure 6.a shows that the rising profitability of both PABs and SSA banks is linked to improving costs rather than a decrease in competition, in line with anecdotal evidence and the results of our survey (see below).

¹¹ As a comparator, the full sample of banks operating in SSA that is covered by Bankscope is used. For each group the median of each sample is used to report trends that are not driven by outlying observations at the extreme of both distributions.

Figure 6: The rising efficiency of pan-African banks



Source: Author’s calculations, based on Bankscope data.

Between 2010 and 2014, non-performing loans (NPLs) trended down from around 6 percent to 4 percent of gross loans for all SSA banks (Figure 6.d). During the same period, NPLs also trended down for PABs, from 6 down to 3 percent. This encouraging level and trends in NPLs should not deter us from asking tougher questions, however. Low NPLs for PABs can indicate that they are better at managing credit risk and/or that their dominant position allows them to cherry-pick the best clients in markets where they have a significant presence. Diminishing NPLs can be the result of rapid credit origination (which itself could be a reflection of an improvement in the credit cycle and/or of “ever-greening” practices) and/or of an improvement in credit risk management practices. Reassuringly, the decline for the median NPL ratio for PABs has been steeper than for the median SSA bank despite faster growth in the size of the loan portfolio for the median SSA bank than for the median PAB. This indicates that the improving trend for PABs’ NPLs reflects better credit risk management practices.

3. Pilot survey of pan-African banks

Account statements and other public documents required by local regulators are extremely important in assessing the basic market dynamics of banks in general. SSA banks and PABs in particular are no exception. However, additional information is required to understand the operational and strategic imperatives that PABs are responding to as they expand throughout SSA. The European Investment Bank has therefore designed¹² and administered¹³ a simplified bank lending survey aimed specifically at PABs and other cross-border banks operating in SSA. This survey is based on a bank lending survey designed in the context of Central, Eastern and South-eastern Europe (EIB 2013 and 2014).

The objectives of the survey therefore include monitoring the expansion (and occasional retrenchment) of cross-border banking activities, improving the collective understanding of the determinants/constraints influencing credit growth in SSA, and gaining some forward-looking insights into cross-border banks' strategies and market expectations regarding local financial conditions. Taking into account the unique nature of SSA banking sectors, the survey investigates both the group strategies of cross-border banks active in SAA and the market conditions and expectations at the subsidiary level.

3.A. OVERVIEW

The group of targeted banks for this pilot stage of the survey is clustered around major PABs and other foreign cross-border banks operating in SSA¹⁴. The countries included in the survey are SSA countries. It is worth noting that our sample of major PABs is not exhaustive and there are many regional banks that operate across borders, typically in neighbouring countries, and that also contribute to banking sector deepening. However, with 10 major PABs, this pilot survey already offers a good initial snapshot of large PABs. The detailed survey questionnaire is contained in the Appendix. The survey is divided into two sections: the first addresses the group's presence, market assessment and strategy by country, the second strategic and funding issues at group level in SSA.

The coverage of PABs across SSA is such that, with the exception of Sudan, Eritrea, Ethiopia and Somalia, there is no SSA country without at least one PAB in our sample operating with a subsidiary or a branch (Figure 7.a). Tanzania has as many as six PABs, while Ghana, Mozambique and Zambia have as many as five in our sample. Twenty-seven SSA countries have three or more PABs, and 43 one or more. In terms of geographic distribution, large parts of West, Central and East Africa have three or more PABs. Coverage in Central Africa is typically less dense. At least one PAB plans to expand in each SSA country over the medium

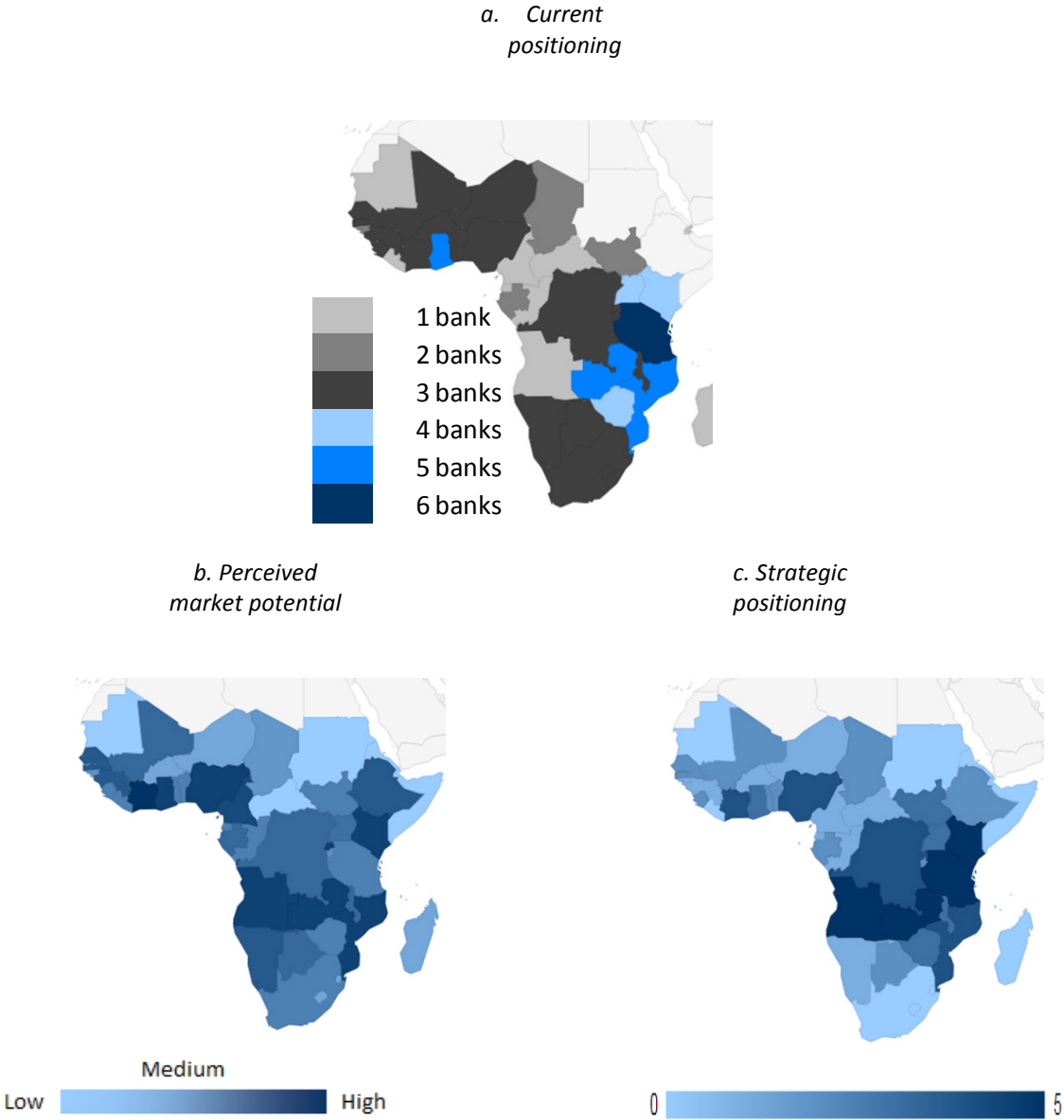
¹² The author gratefully acknowledges insightful guidance from Debora Revoltella, Luca Gattini and Robert Schofield, and outstanding IT support from Tomasz Olejnik. Any errors or shortcomings are the sole responsibility of the author.

¹³ The diligent help of our Global Partners/Financial Sector Division and of colleagues based in our Dakar, Sandton and Nairobi regional offices is gratefully acknowledged.

¹⁴ The sample of responses to this pilot survey is limited to 10 seven major banks. The list of these major PABs is not exactly the same as the list of 10 major PABs with 10 subsidiaries or more focused on by the IMF (2015), but there is considerable overlap. The survey was carried out by the European Investment Bank, under a confidentiality agreement with the individual participating banks. It was addressed to senior officials of the banks involved. For this pilot version of the bank lending survey, PABs were only surveyed at the group level, it being left to the groups to collect information from their subsidiaries. Banks that are not compliant with European Investment Bank policies were explicitly excluded. However, the inclusion of a particular bank in the survey cannot be taken as a comment on business preference or compliance with EIB policies.

term but PABs tends to cluster around a few “high-potential” markets with an attractive combination of interest margin and growth potential (Figure 7.b-c). Ghana, Kenya and Tanzania are reported as presenting high potential by six of the PABs included in our survey, and Nigeria, Rwanda, Uganda and Zambia by five of those PABs. Accordingly, Kenya, Tanzania and Zambia are mentioned by five PABs as target countries for expansion, but also Angola. Four or more PABs report plans to expand in Benin, Botswana, Burundi, Burkina Faso, Côte d’Ivoire, DRC, Gambia, Guinea, Mozambique, Senegal, Sierra Leone and Zimbabwe. Most PABs plan to proceed with these expansions via new capital provided by the parent company or reinvested earnings, some PABs via increased cross-border lending activity. The cases where PABs plan to expand via new acquisitions are rare, as the cost of these has risen recently in most SSA countries.

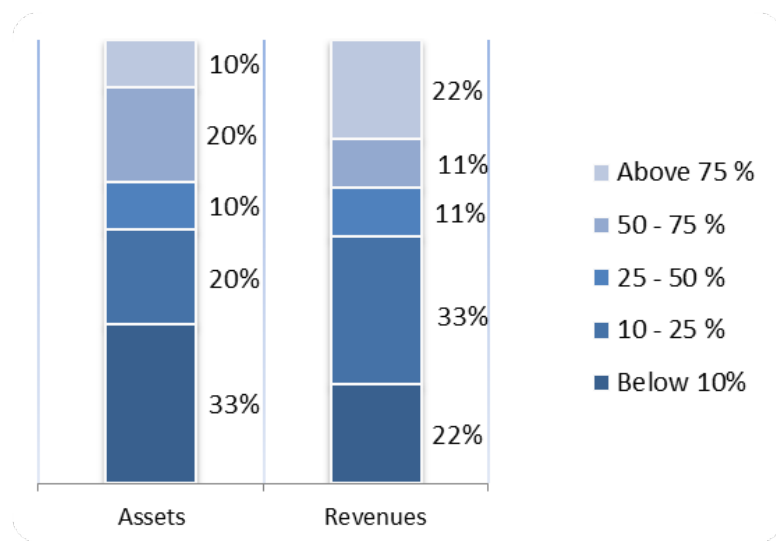
Figure 7: Current and prospective positioning of PABs in SSA¹⁵



Source: EIB PAB survey.

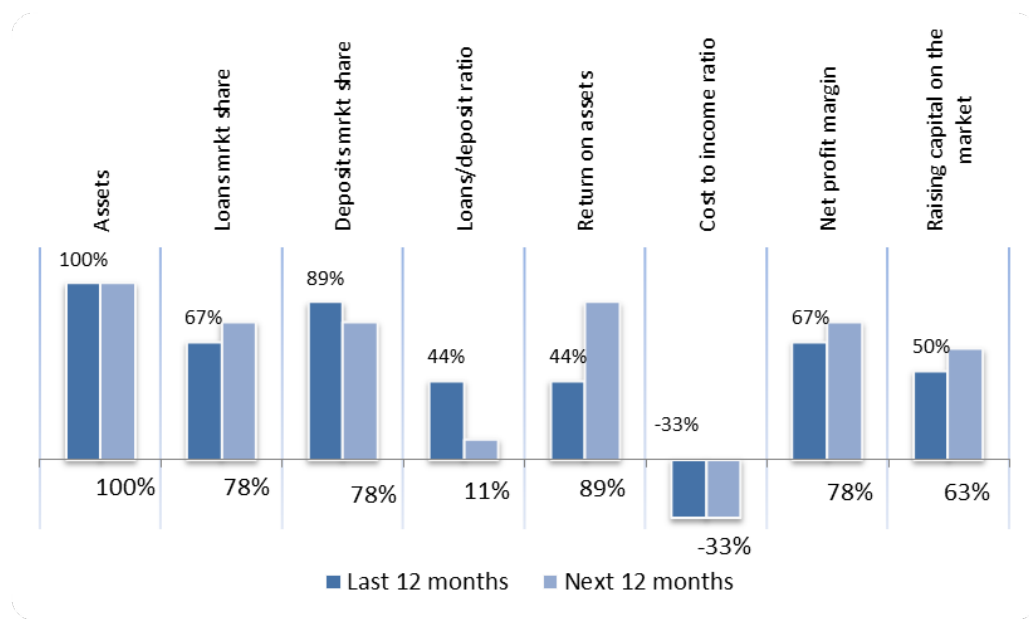
¹⁵ Refer to Q1 in appendix. Figure 7.a reports the number of banks answering a, b or c; 7.b reports the number of banks identifying a country as presenting high potential; 7.c. reports the number of countries where banks answer a, b or c.

Figure 8.a: Share of operations outside the base country¹⁶



Source: PAB survey.

**Figure 8.b: Key ratios of pan-African banks¹⁷
(net percentage of responding PABs expecting an increase)**



Source: EIB PAB survey.

PABs have expanded significantly outside their home markets but roughly a third of them still hold less than 10 percent of their assets outside their home market (Figure 8.a). However, more than three quarters of them generate more than 25 percent of their revenues cross-border. Significantly, there is a higher proportion of PABs whose revenues outside their base country make up more than three quarters of their revenues than those

¹⁶ Refer to Q10; Figure 8.a reports the absolute share of banks falling into each category.

¹⁷ Refer to Q2 in the appendix. Each bar in Figure 8.b reports the net percentage of banks answering (a), i.e. 'rising', therefore netting out banks answering (c), i.e. 'decreasing'; (b) answers, i.e. 'constant', are counted in the denominator, non-answers are not.

whose assets make up more than three quarters of their assets. This is consistent with PABs generally reporting higher and growing profitability in countries other than their base countries. Two non-mutually exclusive explanations for these observations coexist. One is that PABs tend to expand outside their home market pulled by higher profitability and typically pushed by rising competition in their home market. Another plausible explanation is that PABs take the cream of the market outside their home market while passing most of their costs on to their largest subsidiary, which is naturally located in their home market.

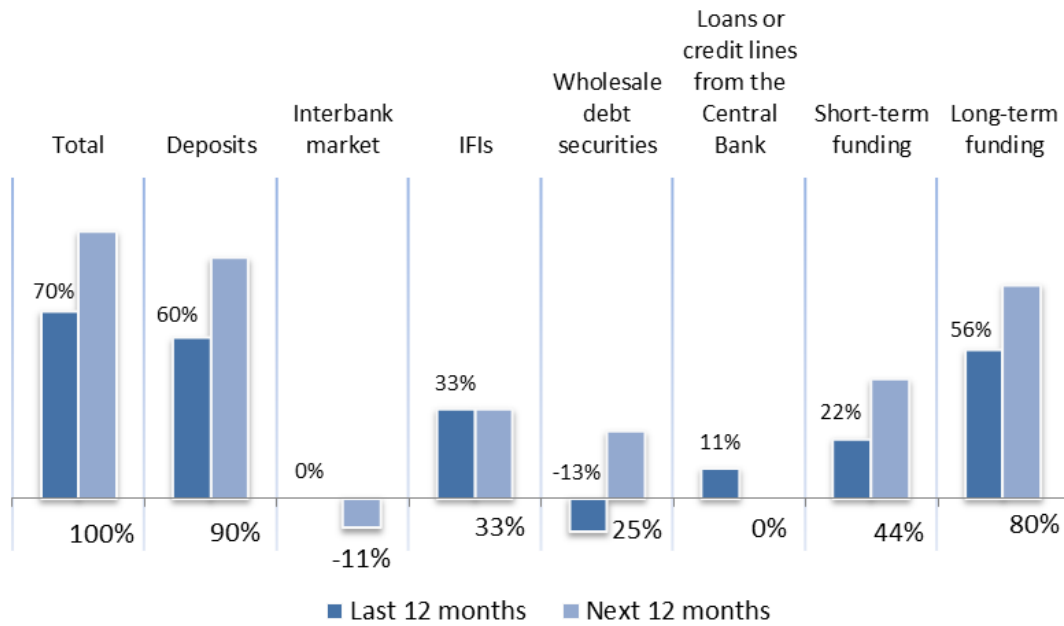
The general trend is that of continued expansion of cross-border activity on the back of expanding loan books, financed by a mix of deposit collection and other types of funding (Figure 8.b). PABs in our sample have been expanding over the last 12 months in terms of assets and loans, in line with observations made in the previous section. They also report having increased their loans and deposit market shares. PABs plan to keep expanding over the following 12 months, although we gather that some PABs are strategically inclined to digest their expansionary stretch and ensure that cross-border investments are matched by declining operational costs.

Half of the PABs in our sample have been raising capital and a majority of them expect to continue to do so over the next 12 months. Some have seen their loan-to-deposit ratio rise over the last 12 months, while few report having seen it decrease. However, most PABs see the loan-to-deposit ratio remaining unchanged over the next 12 months. Indeed, PABs report that they plan to finance the expansion of their loan portfolios primarily by increasing their deposits. On less competitive markets, the cost of funding via deposits is reported to have come down. On the more competitive markets, however, banks have had to offer higher interest rates to customers to attract deposits. This represents a push factor into neighbouring markets for PABs based in or operating in a competitive market. Most PABs report that their return on assets and net profit margins have been on the rise and are expected to keep on rising. For most PABs, the cost-to-income ratio has been improving and is expected to improve further. Some PABs report that they are reaping the rewards of deploying mobile banking and e-banking technologies.

3.B. GROUP FUNDING CONDITIONS

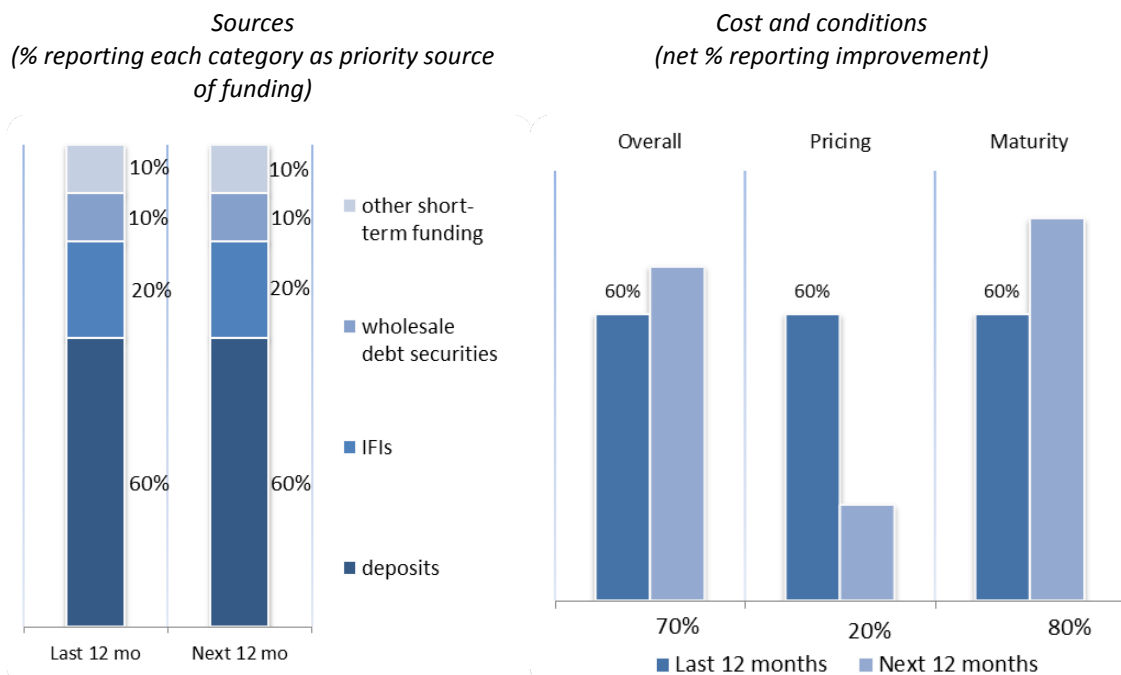
Group funding remains on an expansionary footing, except for funding on the interbank market (Figure 8.c). Practically all PABs in our sample have been expanding their funding base over the last 12 months, mostly through deposits and longer-term funding, some with IFIs. All plan to keep expanding their funding base, with continued reliance on deposits and long-term funding, some from IFIs. However, there is a tendency to switch to longer-term funding and away from short-term funding and credit lines from central banks. A few PABs plan to issue paper on the market for wholesale debt securities. Most PABs do not plan to increase their reliance on interbank funding and some plan to reduce it.

Figure 8.c: Group funding access for pan-African banks¹⁸
(net percentage of responding PABs expecting an increase)



Source: EIB PAB survey.

Figure 8.d: Funding for subsidiaries of PABs¹⁹



Source: EIB PAB survey.

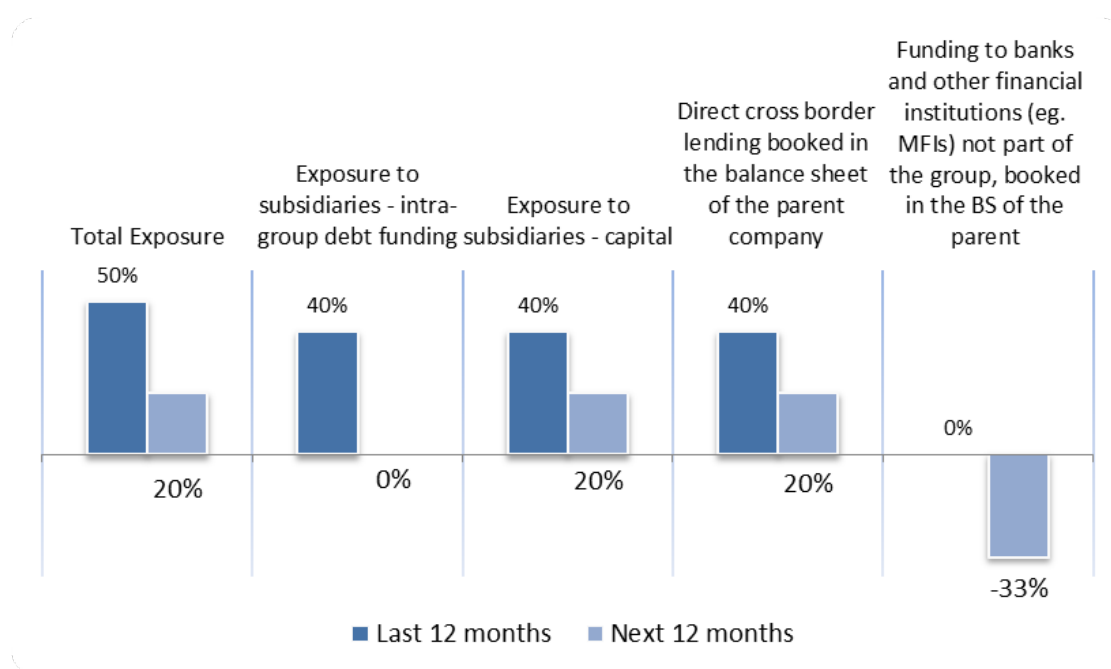
¹⁸ Refer to Q3 in the appendix. Each bar in Figure 8.c reports the net percentage of banks answering (a), i.e. 'rising', therefore netting out banks answering (c), i.e. 'decreasing'; (b) answers, i.e. 'constant', are counted in the denominator, non-answers are not.

¹⁹ Refer to Q8 in the appendix. For sources, figure 8.d reports the share of banks answering a particular funding category. For funding conditions, figure 8.d reports the net percentage of banks answering (a), i.e. 'improving', therefore netting out banks answering (c), i.e. 'deteriorating'; (b) answers, i.e. 'stable', are counted in the denominator, non-answers are not.

3.c. FUNDING SOURCES, COST AND CONDITIONS FOR SUBSIDIARIES

The majority of PABs' subsidiaries have primarily relied on deposits as a source of funding and plan to continue to do so (Figure 8.d). Some PABs have also relied on IFIs and wholesale debt securities as a source of funding. PABs plan to maintain the same structure of funding for their subsidiaries over the next 12 months. Most PABs report that the overall funding conditions for their subsidiaries have been improving over the last 12 months thanks to improvements in the cost of funding and in the maturities on offer. However, they are somewhat less sanguine about the next 12 months. While most PABs expect overall funding conditions and the maturities offered to improve during the coming twelve months, they are divided about expectations regarding funding prices.

**Figure 8.e: Medium-term exposure to sub-Saharan Africa²⁰
(net percentage of responding PABs expecting an increase)**



Source: EIB PAB survey.

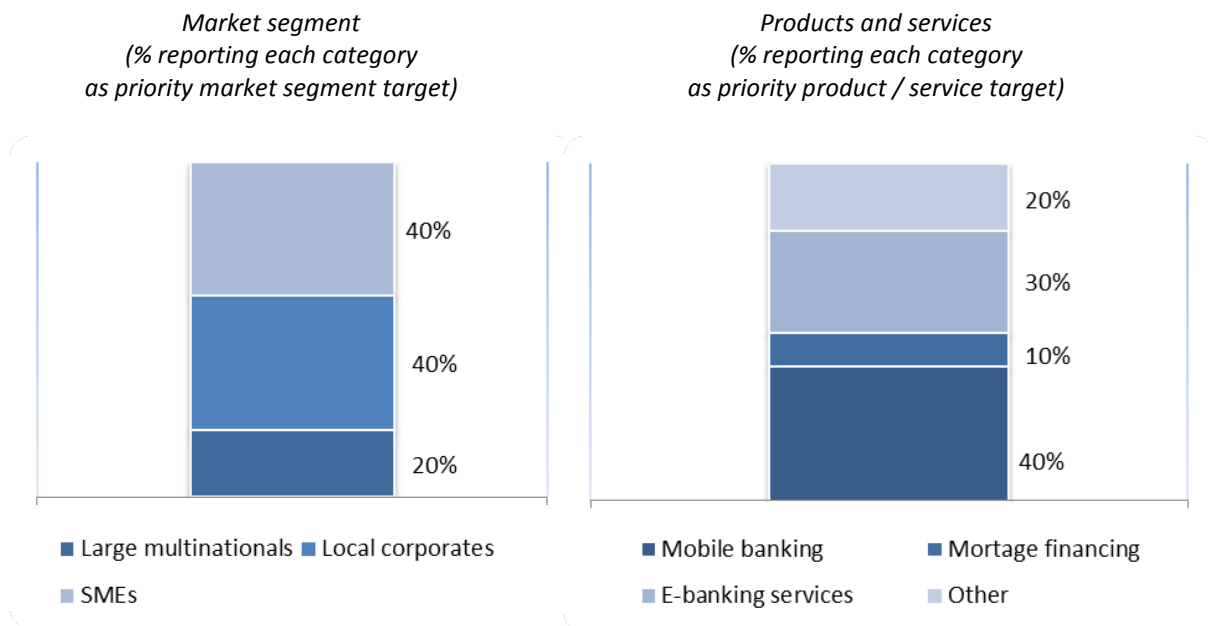
3.d. MEDIUM-TERM EXPOSURE TO SUB-SAHARAN AFRICA

Most PABs report having increased their overall cross-border exposure within SSA over the last 12 months, but a few have reduced it. While some PABs report plans to increase their cross-border exposure, there seems to be a somewhat weaker appetite in the short term at least for further aggressive expansion (Figure 8.e). Several PABs report having increased their cross-border exposure via subsidiaries funded by both intra-group debt funding and capital, as well as through direct cross-border lending booked in the balance sheet of the parent company. Some PABs plan to continue to increase their exposure through greater exposure to subsidiaries funded by intra-group debt or capital and, to a lesser extent, through direct cross-border lending booked in the balance sheet of the parent company. A

²⁰ Refer to Q5 in the appendix. Each bar in Figure 8.e reports the net percentage of banks answering (a), i.e. 'expand(ed)', therefore netting out banks answering (c), i.e. 'reduce(d)'; (b) answers, i.e. 'maintained', are counted in the denominator, non-answers are not.

few PABs intend to reduce funding to other financial institutions (e.g. microfinance institutions) that are not part of the group but booked on its balance sheet.

Figure 8.f: Long-term strategic focus of pan-African banks²¹



Source: EIB PAB survey.

3.E LONG-TERM STRATEGIC APPROACH

Over the longer-term horizon, all PABs report plans to expand operations overall. While some PABs report plans to step back from certain less profitable markets and others report that they are putting their plans to expand their footprint over the coming 12 months on hold, they all expect to see the amount of deposits collected and loans extended grow. SMEs are mentioned most often, on an equal footing with large local corporates, as their top expansion target, followed by multinationals (Figure 8.f). This is a relatively new trend that is explained by the combination of increasing competition on traditional market segments, by PABs gradually managing to reduce the cost of servicing SMEs and, in some cases, by efforts by IFIs to encourage and support PABs in expanding more aggressively into that segment.

In contrast, if all PABs planning to focus on large domestic or multinational companies are lumped together, they represent 60 percent of replies, a clear majority. However, this observation has to be balanced by the fact that most banks report that they plan to focus on both retail and commercial banking and that a primary focus on large corporates does not preclude the objective of expanding coverage of SMEs. Indeed, the PABs in our sample plan to roll out a broad range of new products, with mobile banking and e-banking being reported as top priorities. The survey does suggest, however, that retail banking, consumer lending, credit cards and leasing programmes are not considered priority areas for business development by PABs for the time being.

²¹ Refer to Q4 in the appendix. Each bar in Figure 8.f reports the net percentage of banks answering in each category. For the graph on the right-hand side, leasing products and consumer credit / credit cards are not reported as no banks answered by choosing either category.

4. Challenges and opportunities

Looking at the depth of SSA banking markets, there is little doubt that financial intermediation has a long way to go in practically all SSA countries (as discussed in section 1). It is therefore no surprise that major actors such as PABs have been scaling up significantly in recent years (as discussed in section 2). The general trend is that of continued expansion of cross-border activity on the back of growing loan books financed primarily by deposit collection (as discussed in section 3). Overall, the rising scale of PABs is expected to improve competition across SSA banking sectors. This improved competition is resulting in the deepening of the banking markets of SSA and in the “importation” of world class / African class new products sets. PABs are reported to be driving innovation in the markets they are entering. Improving cost-to-income ratios and rising profitability also set the stage for PABs to become key actors for spreading the benefits of financial intermediation to a broader spectrum of firms and individuals, with the support of international financial institutions where needed. Indeed, a large proportion of PABs surveyed for this study report SMEs as a primary target for expansion.

PABs are also having great success in collecting an increasing amount of deposits, so much so that they have become systemically important banks in many of the markets in which they operate. This has led national regulators, the IMF and other observers to worry about the increasing possibility of a banking crisis in one SSA country being transmitted to another. An additional risk is that under-supervised PABs could be raising the level of systemic risk across the continent. PABs often span multiple regulators and currency areas. This creates room for regulatory arbitrage and oversight gaps. Most African regulators outside South Africa are still relying on variants of the Basel I bank regulation framework and implementation is poor. Pan-African banking group structures are often complex and opaque, which makes supervision by understaffed African regulators even more challenging. Furthermore, in many SSA banking sectors, some of the depositors’ experience of bank accounts is only very recent. It is difficult to predict how such recent depositors would react in the event of a large-scale banking sector upheaval with low resolution capacity.

The keys to increasing the resilience and transparency of pan-African banking groups are to improve the exchange of information between regulators and cross-border banks and to ensure that regional regulators oversee effectively large trade blocks such the SADC, the EAC and ECOWAS. Wherever possible, a certain degree of regulatory harmonisation would make it easier for PABs to operate cost-effectively across borders. Proposed solutions include memorandums of understanding (MOUs) between national supervisors and ad hoc colleges of supervisors (CoS) to monitor each large PAB. In practice, some progress has already been made towards consolidated monitoring but much remains to be done. For instance, when Banque Marocaine du Commerce Extérieur (BMCE) took a controlling stake in Bank of Africa (BoA), Bank Al-Maghrib, the Moroccan central bank, became the de facto supervisor of BoA’s operations on a consolidated basis. Similarly, United Bank for Africa (UBA) is supervised by the Nigerian regulator on a consolidated basis, and likewise Kenyan Commerce Bank (KCB) by the Kenyan regulator. The International Monetary Fund has been providing significant technical assistance and pushing for a multilateral supervisory

committee to be set up. The European Investment Bank is, along with the EU, a sponsor of the IMF's Afritac technical assistance centres.

As a response to this risk of transmission and information asymmetries, local regulators often prod or force PABs to set up their cross-border activities as subsidiaries rather than branches. While this provides a modicum of firewalling between SSA banking markets, it prevents the full mutualisation of central activities and therefore prevents PABs from reaping economies of scale and thus reducing their operating costs as much as they could otherwise. In turn, short of this centralisation, lowering the price of banking services to a level that is affordable to a broad spectrum of African retail clients and SMEs will remain a challenge.

A switch from pan-African networks of subsidiaries to pan-African networks of branches would require more effective and more credible supervision on a consolidated basis for it to be permitted by home and host country regulators. PABs themselves stand to gain from increased credibility of their reporting and governance structures. This would enable them to raise longer-term resources on more favourable terms and in turn to offer their clients much needed longer-term credit. Indeed, suppliers of long-term liquidity, including the European Investment Bank, clearly have a deep-rooted interest in enhanced oversight and transparency. We hope that our survey will contribute to the publicly available knowledge about PABs and we value feedback about how to make this more effective. The fact that PABs report plans to rely more systematically on longer-term resources is a reflection of the progress that has already been made in terms of enhanced credibility and transparency. Ultimately, the prize should be the establishment of regional capital markets where PABs would be in a position to raise funds for regional activities.

References

- AfDB-OECD-UNDP (2011), "Africa and its Emerging Partners" in *African Economic Outlook*, Paris.
- Allen, Franklin, Elena Carletti, Robert Cull, Jun Qian, Lemma Senbet and Patricio Valenzuela (2012). "Resolving the African Financial Development Gap: Cross-Country Comparisons and a Within-Country Study of Kenya", *NBER Working Paper*, No. 18013, April.
- Bykere, Arpitha, Tomás Conde, Felix Huefner and Dongyoon Kim, "Financial Inclusion at a Glance", presentation, June, Institute of International Finance, Washington D.C.
- Beck, Thorsten, Samuel Munzele Maimbo, Issa Faye and Thouraya Triki (2011). "Financing Africa: Through the Crisis and Beyond", edited by the World Bank, Washington D.C.
- Beck, Thorsten (2015). "Cross-Border Banking and Financial Deepening: The African Experience". *Journal of African Economies*, 2015, Vol. 24, AERC Supplement 1, pp. i32–i45.
- Beck, Thorsten, Michael Fuchs, Dorothe Singer and Makaio Witte (2014), "Making Cross-Border Banking Work for Africa". World Bank/GIZ GmbH: Eschborn, Germany.
- Beck, Thorsten and Robert Cull (2013). "Banking in Africa". *CSAE Working Paper*, WPS/2013-16, August.
- Beck, Thorsten (2013). "SMEs Finance in Africa: Challenges and Opportunities" in *Banking in sub-Saharan Africa: Challenges and Opportunities*. Edited by the European Investment Bank, Luxembourg.
- European Investment Bank. *CESEE Bank Lending Survey*. Various issues: H2-2014, H1-2014, H2-2013.
- Gulde, Anne-Marie, Catherine Pattillo, Jakob Christensen, Kevin Carey and Smita Wagh (2006). "Financial Sectors: Issues, Challenges and Reform Strategies." Technical Chapter in *Regional Economic Outlook: Sub-Saharan Africa* (Washington: International Monetary Fund, May).
- International Monetary Fund (2014). "Pan-African Banks – Opportunities and Challenges for Cross-Border Oversight", Staff report, December.
- Léon, Florian (2015). "Has Competition in African banking sectors improved?" Mimeo. CERDI, Université d'Auvergne.

Appendix 1: The Pilot Survey Questionnaire

Q1 | What is your bank's positioning in each country?²²

	... current positioning	... perceived market potential	... strategic positioning
1 Angola			
2 Benin			
...			
49 Zimbabwe			

In Q1, for current positioning, the following answers are possible: a. active with subsidiary or branch – with significant market share (among top three market players); b. active with subsidiary or branch – with medium market share; c. active with subsidiary or branch – with niche market presence; d. active with representative office; e. inactive.

For perceived market potential, the following answers are possible: a. low; b. medium; c. high.

For strategic positioning, the following answers are possible: a. increase presence with new acquisition; b. increase presence with new capital provided by parent company/reinvested earnings; c. increase presence with new funding from parent company; d. increase presence via cross-border lending activity; e. remain stable; f. decrease presence via reduced cross-border lending activities; g. decrease presence with lower funding from parent company; h. decrease presence by selling assets/subsidiaries.

Q2 | Key indicators have been/are expected to be ...

	LAST 12 months	NEXT 12 months
Assets		
Loans market share		
Deposits market share		
Loans/deposits ratio		
Return on assets		
Cost-to-income ratio		
Net profit margin		
Raising capital on the market		

²² The full list of countries covered by the survey is: Angola, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Côte d'Ivoire, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria, Republic of the Congo, Rwanda, São Tomé and Príncipe, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Swaziland, Tanzania, Togo, Uganda, Zambia and Zimbabwe.

Q3 | Group funding: group's access to funding...

	...How has it changed over the LAST twelve	...How do you expect it to change
Total		
Deposits		
Interbank market		
IFIs		
Wholesale debt securities		
Loans or credit lines		
Short-term funding		
Long-term funding		

For each variable in Q2 and Q3, the following answers are possible: a. rising; b. stable; c. decreasing.

Q4 | Longer-term strategic approach (beyond 12 months): Looking at operations in sub-Saharan Africa, your group intends to...

Overall	
Market segment focus	
New product/services focus	

For Q4, overall, the following answers are possible: a. expand operations overall; b. maintain the same level of operations overall; c. scale down operations overall.

The following answers are possible with respect to market segment focus: a. by focusing on large multinationals; b. by focusing on large local companies; c. by focusing on SMEs; d. by focusing on retail clients.

As for new product and services focus, the following answers are possible: a. by rolling out mobile banking; b. by rolling out mortgage financing; c. by rolling out consumer credit/credit cards; d. by rolling out leasing products; e. by rolling out e-banking services; f. none of the above/other.

Q5 | Group total medium-term exposure to sub-Saharan Africa: Concerning cross-border operations to SSA countries, your group has/intends to...

	LAST 12 months	NEXT 12 months
Total exposure		
Exposure to subsidiaries – intra-group debt funding		
Exposure to subsidiaries – capital		
Direct cross-border lending booked in the balance sheet of the parent company		
Funding to banks and other financial institutions (e.g. MFIs) not part of the group, booked in the BS of the parent		

For Q5, the following answers are possible: a. expand(ed) exposure; b. maintain(ed) the same level of exposure; c. reduce(d) exposure.

Q6 | Profitability of operations in SAA region: contribution of activities in SSA in total ROA of the Group has/is expected to...

	LAST 12 months	NEXT 12 months

For Q6, the following answers are possible: a. increase(d); b. be(en) stable; c. decrease(d).

Q7 | Compared to the overall group and corrected for the cost of risk, profitability of operations in SSA region: ROA of your SSA operations has been/is expected to be ...

	LAST 12 months	NEXT 12 months

For Q7, the following answers were possible: a. lower; b. equal; c. higher.

Q8 | What has been/is expected to be the most relevant form of funding for your subsidiaries?

	LAST 12 months	NEXT 12 months

For Q8, the following answers are possible: a. deposits; b. credit from the parent bank; c. interbank market; d. IFIs; e. wholesale debt securities; f. loans or credit lines from the central bank; g. other short-term funding; h. other long-term funding.

Q9 | Funding conditions in your own subsidiaries in sub-Saharan Africa have been/are expected to be...

	LAST 12 months	NEXT 12 months
Overall		
Pricing		
Maturity		

For Q9, the following answers were possible: a. improving; b. deteriorating; c. stable.

Q10 | What share of your operations in SSA lie outside your base country?

	...assets	...revenues

For Q10, the following answers are possible: a. below 10%; b. 10 - 25 %; c. 25 - 50 %; d. 50 - 75 %; e. above 75 %.

The EIB in sub-Saharan Africa

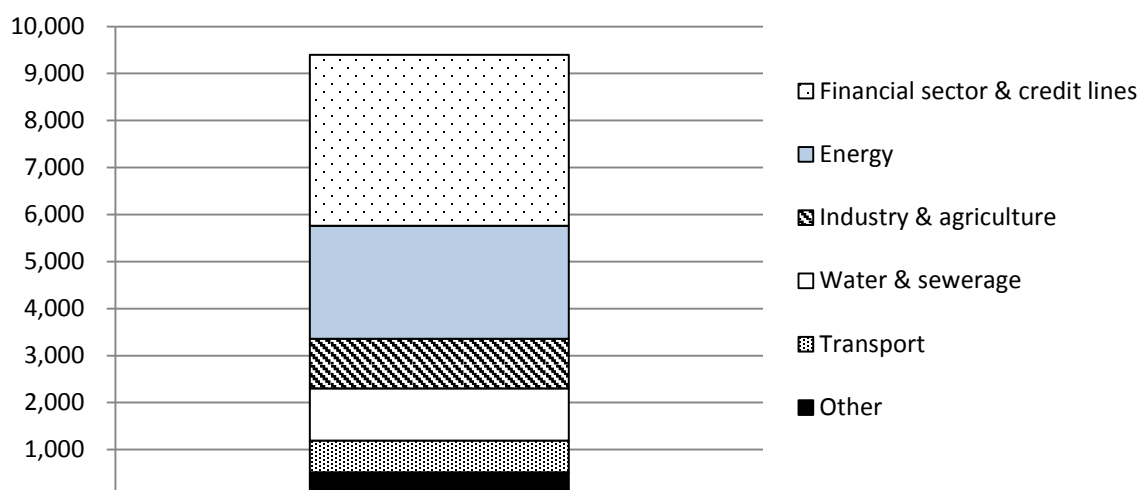
OSKAR NELVIN AND TIM BENDING

The EIB is the European Union's bank. As the world's largest multilateral borrower and lender, the EIB provides finance and expertise for sound and sustainable investment projects in the EU and more than 130 other countries. The Bank is owned by the EU's 28 Member States and the projects it supports help to further EU policy objectives. Outside the EU, the EIB supports projects that contribute to economic development in countries that have agreements with the EU or its Member States. In 2014, it provided loans totalling over EUR 1 100m in sub-Saharan Africa.

Celebrating 50 years of operations in sub-Saharan Africa

Since the beginning of its activities on the African continent in 1963, the Bank has supported over 1 000 development projects in 47 countries with over EUR 16bn of funding. The EIB backs projects that deliver sustainable economic, social and environmental benefits. A key focus lies in the fostering of private sector-led initiatives with the aim of supporting sustainable private sector-led growth and job creation. Support for the development of stronger and more professional financial institutions lies at the heart of that effort. In addition, the Bank backs public infrastructure projects, involving water and sanitation, roads and power plants, which are critical for competitiveness and development. Since 2003, the Bank's activities in sub-Saharan Africa have been governed by the Cotonou Agreement, which is the main framework for the EU's relations with the partner countries in the African, Pacific and Caribbean (ACP) regions. The principal goal is to support poverty reduction, sustainable development, climate action and the progressive integration of the region into the world economy.¹

Figure 1: EIB funding in sub-Saharan Africa by sector in EUR m, 2003-2014



Source: EIB/ECON

¹ The Africa, Caribbean and Pacific (ACP)-EU Partnership Agreement ("Cotonou Agreement") does not cover activities in the Republic of South Africa (RSA), which are instead governed by the EU-South Africa Trade, Cooperation and Development Agreement. The EIB has been active in RSA since 1994. Priorities for RSA are similar to those for the ACP countries.

The EIB adds value for partners and clients

The Bank builds on more than 50 years of experience. Active in the EU and beyond, the EIB actively contributes to knowledge transfer and thereby to improved project design. It offers a wide range of financial products at favourable interest rates. In addition, it offers technical assistance to support project preparation and implementation, especially in countries outside the EU.

Over the last 10 years, the EIB has provided over EUR 8bn of finance in over 36 sub-Saharan African countries, making the Bank one of the biggest multilateral lenders in the region. This effort would not have been possible without close cooperation with leading private and public sector business partners, including domestic and regional banks.

A range of flexible risk-bearing instruments

Alongside its standard senior loan product, the EIB invests via credit guarantees, equity, junior loans and subordinated loans.² The Bank has, for example, launched an ACP-wide credit guarantee facility aimed at improving access to local currency loans for small and medium-sized enterprises (SMEs). It also backs regional private equity funds – including funds investing in microfinance and local mid-cap enterprises – and can provide subordinated bank capital to banks in the region. Funding in local currency is also available in a variety of African currencies. Technical assistance is another important product area for the Bank in the region.

Investing in the African financial sector

The EIB invests in financial sector development and actively supports access to finance for private companies and households in sub-Saharan Africa. Poor access to financial services and credit is a severe bottleneck to growth in many African countries. The situation is especially troublesome for SMEs and micro-enterprises. Ten of the 20 lowest-ranked countries in terms of availability of financial services are located in sub-Saharan Africa, according to the World Economic Forum's latest Global Competitiveness Report. Domestic credit to the private sector amounts to less than 20% of GDP in sub-Saharan Africa³ compared to close to 50% in South Asia and Latin America.

The EIB supports financial sector development and access to finance both through intermediated credit lines targeted to specific sectors and through direct financial sector projects. Local intermediaries are used to provide funding to clients that are too small to benefit from direct lending. Most such credit lines are designed to reach SMEs, but the Bank has also used intermediaries in the region to reach smaller-scale projects in sectors such as infrastructure, climate mitigation and social housing. Direct financial sector projects are operations that are directly linked to extending the availability and quality of financial services in the region. Such projects include, for example, financing of branch network extensions or investments in new technology. They also include technical assistance within

² In South Africa the Bank's product offering is limited to senior loans.

³ Based on World Bank data from 2013. Excludes South Africa. In South Africa, domestic credit to the private sector amounts to around 150% of GDP.

specialised areas such as microfinance. Funding can be provided through equity and subordinated debt, as well as through senior loans. Over the last 10 years, EIB credit lines and funding for regional or domestic banks and other financial institutions in sub-Saharan Africa have amounted to more than EUR 3bn.

Focus on financial sector projects

Supporting agricultural diversification in Malawi. The Malawi Credit Line for Exporting Industries, launched by the EIB in 2013, is a EUR 15m facility, which is to be matched by local bank funding. It is expected to provide long-term finance to about 1 400 SMEs and 20 mid-caps operating in the export sector, extending the average loan maturity of the local banks' lending portfolio from 1 to 3.5 years and providing a hedge against foreign exchange risk for exporting businesses. With a focus on labour-intensive agri-businesses, among other sectors, it aims to sustain 14 800 jobs and develop the value chain in the agricultural sector, which forms the basis of the Malawian economy. Against the backdrop of Malawi's foreign exchange crisis, the credit line has also had an important macroeconomic dimension: by promoting export-led growth it supports Malawi's efforts to improve economic and export performance under the country's Growth and Development Plan and National Export Strategy.

Equity finance for African firms. In 2008, the EIB invested EUR 20m in the private equity fund AfricInvest II. Based in Tunis, AfricInvest II targets African firms with a good local market position and high growth potential, enabling these firms to seize opportunities to expand. With a hands-on approach to monitoring investments, it adds value by strengthening management teams, by improving corporate governance, reporting and transparency, and by capitalising on AfricInvest's extensive network throughout Africa. Leveraging the EIB's EUR 20m with EUR 123m from other sources, AfricInvest II has invested in 15 companies across northern, western and eastern Africa, in insurance, pharmaceuticals, oil and gas services, telecoms and agribusiness. According to the latest results, these businesses have been able to expand successfully, with turnover increasing 37%, on aggregate, to EUR 803m, and with employment increasing, on aggregate, 42% to reach 6 678 jobs. AfricInvest has also contributed to significant improvements in ESG standards, including in terms of working conditions and environmental aspects.

22 600 jobs supported in East and Central Africa. A new study of EIB credit lines for SMEs in East and Central Africa over the last five years estimates that micro, small and medium-sized enterprises (MSME) employing 22 600 people benefited from these EIB operations. According to loan application data reported to the EIB, MSME investment projects were expected to create some 16 613 jobs. Supported businesses benefited from a long average tenor period of 66 months, with data suggesting that the tenor received was typically longer than that previously enjoyed by these businesses. The vast majority of supported businesses received local currency financing, and these loans were much smaller on average than the loans provided by intermediary banks in foreign currency, pointing to the importance of local currency financing for reaching the smaller firms that are more likely to face access to finance constraints.

Financing infrastructure in Africa

The Bank is also a major provider of infrastructure finance in the region and provides direct funding for larger African corporates. Nine out of the 20 lowest-rated countries in the world in terms of quality of infrastructure are located in sub-Saharan Africa according to the latest Global Competitiveness Report. Poor roads and insufficient or unreliable electricity supply constitute significant bottlenecks to growth in large parts of the continent. Since 2003, the Bank has committed over EUR 4.6bn to funding infrastructure projects in sub-Saharan Africa. The energy sector accounts for the largest share of this effort (above 50%) – reflecting the poor state of electricity generation and distribution in many African countries. A special emphasis has been placed on renewable energy sources, as a means of both reducing dependence on expensive imported fossil fuels and contributing to the mitigation of climate change. The Bank commits significant funds every year in direct lending to African corporates. In this way it finances larger-scale projects in a wide range of sectors, ranging from manufacturing to agriculture.



The European Investment Bank (EIB) is the European Union's financing institution

Under its external mandates, the EIB helps to implement the financial pillar of the EU's foreign policy. It is active mainly in the pre-accession countries of South-East Europe, as well as in the neighbouring countries to the South and East. The Bank also operates in the African, Caribbean and Pacific countries and Asia and Latin America. Its financing activities are aimed at supporting local private sector development, improving social and economic infrastructure and climate change mitigation and adaptation.

Contacts

Economics Department

☎ +352 4379-22000

☎ +352 4379-62000

✉ economics@eib.org

www.eib.org/economics

European Investment Bank

98-100, boulevard Konrad Adenauer

L-2950 Luxembourg

☎ +352 4379-1

☎ +352 437704

✉ info@eib.org

www.eib.org