Why Invest in the Banking and Financial Sector in West Africa

ECOWAS-Japan Business Forum

28-29 October 2015

Tokyo, Japan

Introduction

- A large body of evidence now exists which shows that financial sector development can make an important contribution to economic growth and poverty reduction. This is especially likely to be true in developing countries, whose financial sectors are likely to be particularly underdeveloped, and without which economic development may be constrained, even if other necessary conditions are met
- Financial sector development can stimulate long-run growth through its impact on capital accumulation and on the rate of technological progress.
- Access to financial services can reduce poverty through the same channels that affect overall growth: by increasing investment and productivity resulting in greater income generation, and by facilitating risk management thus reducing vulnerability to shocks.
- However, the poor in developing countries often do not have access to ongoing, formal financial services, and are forced to rely instead on a narrow range of often risky and expensive, informal services. This constrains their ability to participate fully in markets, to increase their incomes and to contribute to economic growth.
- In some countries, semi-formal channels such as microfinance institutions play a role in providing financial services to the poor, as do institutions such as postal banks, development banks and credit unions. But all these institutions are reaching only a minority of the bankable population. So a widening of financial services provision by private sector institutions (particularly commercial banks) in the formal financial sector is necessary to tackle this problem on an adequate scale.

2. Overview of Sub- Saharan Africa’s Banking & Financial Sector

- Financial sectors on the African continent remain to a larger extent underdeveloped, while banking industries continue to dominate the landscape in terms of total assets and services. Nonetheless, financial sector development has been on the agenda of African policymakers for some time. Various policy reforms over the past decade have contributed to an environment more conducive to financial sector development. Governments have made progress in introducing much-needed legal regulatory frameworks, information infrastructure and regulatory institutions. As a result, the depth and coverage of financial systems, when measured by the ratios of broad money volumes of bank deposits and private sector credit to GDP, have improved over the past two decades.

- Nevertheless, Africa’s financial sector continues to be less developed compared to other emerging market regions.
- However, Africa enjoys certain key advantages that will enable the continent to equal or even surpass at least some of its emerging market counterparts in terms of financial sector development in the coming decade and beyond. Most African financial markets are open to new entrant including foreign players compared to other emerging market economies. The growing presence of subsidiaries of major global banks on the continent has undoubtedly improved the quality of financial services in recent years; the focus here has largely, but not exclusively, been on high margin corporate businesses as opposed to retail banking sector. However the largest markets, Nigeria and South Africa are dominated by large local players.

Over cont’d

The continent has also often been at the forefront of new technological advances and other innovative methods to reach new customers and simplify access to banking, especially in more rural locations. However, more than anything else, Africa represents massive financial sector growth potential due to the fact that the market is still largely unsaturated. According to the World Bank, only 34 % of adults in SSA had deposit accounts with commercial banks in 2014. Africa’s flourishing middle class, forecast to triple over the next two decades, further supports the massive potential that lies within Africa’s growing consumer base. Indeed, with real GDP per capita in many African countries having climbed past the critical $1,000-level, a rapid expansion in retail banking is foreseen in coming years. The World Bank projected retail banking in SSA to grow at a compound annual rate of 15% between 2013 and 2020, bringing the sector’s contribution to the continent’s collective GDP to 19% from an estimated 11% in 2009.To do so however, institutions will continually need to embrace innovative strategies so as to shape banking products to fit consumers’ rising financial sophistication needs as well as to tap into the continent’s m

Cont'd

- The banking sectors across sub-Saharan Africa remain highly concentrated. According to the World Bank's Global Financial Development database, the three largest banks held 78.2% of the total banking sector assets on average across sub-Saharan African countries in 2011.This statistic increased to 91.2% when the five largest banks were considered.
- Although the banking sector remains highly concentrated at an aggregate level, there are subtle but significant differences in relation to financial sector development between countries and within regions. Below we briefly consider financial development in Africa from a regional perspective, while also highlighting key banking sector developments in country-level case studies.

3. The Structure of West Africa's Banking & Finance Sector

- The West African banking and financial sectors are mainly concentrated in Nigeria, Ghana and the West African Economic and Monetary Union (UEMOA), which compromises mainly former French colonies and one Portuguese Speaking countries (Benin, Burkina Faso, Cote d'Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo).

- In general, the Central and West African (CWA) region is characterised as having the lowest median in relation to private sector credit as a percentage of GDP. A potential opportunity for investors!

Cont'd

Nigeria

The banking sector in the region's largest economy, Nigeria, has undergone substantial transformations over the last ten (10) years. Following the 2005-06 consolidation, Nigeria's banking sector experienced rapid credit growth, as banks expanded their service offering and started entering the untapped retail sector. However, a large share of the credit originated from high risk investment activities, such as margin traders focusing on equities and oil importers not hedging their positions. This meant that, in contrast to most of its African peers, the Nigerian banking sector proved especially susceptible to the impact of the global financial crises. The Central Bank of Nigeria took various steps in an attempt to rectify the situation. Firstly was to address corporate governance and removal of boards and CEO's. The CBN also fixed and ensured adherence to tenure limits for the board and Chief Executive, which resulted in changes at UBA, Zenith Bank etc. This included a guarantee on all interbank transactions and pension deposits as well as setting up the Asset Management Company (AMC) to swap all NPLs with tradable zero-coupon-

The West African Monetary & Economic Union (UEMOA)

- The financial system in the West African Economic and Monetary Union (UEMOA) remains primarily bank-based. The banking sector comprises 106 banks and 13 financial institutions, which together hold more than 90 percent of the financial system's assets (about 54 percent of GDP end-2011). Five banks account for 50 percent of banking assets (see Figure 1). The ownership structure of the sector is changing fast with the rapid rise of foreign- owned (pan-African) banks.
- This contributes to higher competition but also rising heterogeneity in the banking system, with large and profitable cross- country groups competing with often weaker country-based (and sometime government-owned) banks. Nonbank financial institutions are developing quickly, notably insurance companies, but remain overall small. More detailed analysis on the banking system is presented in the section entitled "The Banking Sector."
- Microfinance institutions (MFIs) represent a small but rising share of the financial system and contribute strongly to improving access to finance2 by lower-income households and small and medium-sized enterprises. The UEMOA has 759 registered MFIs. Sixty-one entities are classified as large institutions with assets or deposits above CFAF 2 billion and are supervised by the Banking Commission. These account for 90 percent of the MFI sector's assets. Although significantly smaller than the banking system—MFIs' total loans amount to about 8 percent of total bank credit—more people, particularly in rural areas, have accounts at MFIs than at banks, which helps raise overall access to the financial system from 5 to about 15 percent of the population.

UEMOA cont’d

- As the banking hub of francophone West Africa, Cote d' Ivoire accounted for 27.6% of total banking sector assets within the West African Economic and Monetary Union (UEMOA) region in 2012. The banking sector consists mainly of French and Nigerian subsidiaries in addition to state-owned banks. Although relatively well capitalised, the Ivorian banking sector also suffers from credit risk in the form of comparatively high NPL ratios, partly a consequence of the post-election conflict during 2010, when banks temporarily seized operations. Authorities in the WAEMU region are considering the establishment of a financial stability fund to support the financial system during times of crises, such as experienced in Ivory Coast recently.

Ghana

- The Ghanaian banking sector is fairly well developed in an African context. The sector comprises 28 ‘Class 1’ commercial banks. Of these, 12 are domestic-owned while the remaining 15 are foreign- owned. ARB Apex Bank functions as a ‘central bank’ for the Rural and Community Banks (RCBs), and is financed by the Rural Financial Services Project (RFSP) of the Ghanaian government.
- Total commercial bank assets increased by 32.8% y-o-y to reach GH¢36.2bn by end-2013. One year later, commercial bank assets had increased by 42.2% y-o-y to GH¢51.4bn, partly driven by a 41.6% y-o-y increase in gross advances.

Conclusion

- The countries of the ECOWAS zone offer very attractive opportunities for investors who are considering investing in the banking and financial services industry within the sub-region. The region is endowed with huge oil and gas deposits and a host of other natural resources.
- Apart from the natural resources, the sub-region has experienced sustained and robust economic growth in the past decade, averaging over 6 %.
- The below listed, not exhaustive by any means presents an excellent opportunity for investors:
- Large proportion of population that is unbanked
- A large proportion of the adult population does not have access to banking services in Africa (only 34 % of the adult population have a bank account 2014 World Bank estimates
- Use of mobile phone technology:
-
- The emergence of mobile technology as an alternative to more traditional banking has allowed for services to be provided to lower income households often residing at distant rural locations. This was made possible by the rapid diffusion of affordable cellular technology on the African continent.
- The rate of cellular phone penetration in West Africa is reported at 80 %. This could massively be unleashed if the Nigerian market reaches its full potential.
- The presence of Pan African Banks
- The presence of subsidiaries of major global banks on the continent has undoubtedly improved the availability and quality of financial services in recent years. However, large banks from well- developed financial markets on the African continent have made the biggest impact in this regard. As noted above, these banks mostly have their origins in South Africa and Nigeria. According to the EIB: *“at least nine SSA-domiciled financial groups operate banks in seven or more other SSA countries.”*

Cont’d

Standard Bank, Africa’s top bank by assets, has a comprehensive Africa presence with the company operating in around 17 SSA countries. The company remains focused on its African strategy, and has indicated that it no longer has ambitions to buy or build commercial operations outside of Africa. Standard Bank’s affiliation with the Industrial Commercial Bank of China (ICBC), following ICBC’s purchase of a 20% stake in Standard Bank in early 2008, remains a strategic advantage in terms of tapping into Asia’s growing presence in Africa. Similarly, in July 2009, FirstRand Group formed a strategic partnership with China Construction Bank (CCB), with the intention to align two leading banks on two strategic continents to facilitate banking opportunities in the China-Africa corridor.

Cont'd

- The banking sector in West Africa continues to witness increased growth.
- The growth of West African banks remain solid in 2014, with an expansion in the balance sheets of the first 50 banking institutions in the zone by 10 % against 6.8 % in 2013 and 15.1 % in 2012. The growth of Ecobank, which retook the first place regionally reflects its regain of form: last year, the Group's profit exploded by 167 %, after a 2013 marked by massive provisions, without doubt occasioned by the acquisition of the Nigerian bank, Oceanic Bank. The combined balance sheet of the first 50 banks in West Africa is USD 252. 5 billion.
-
- West Africa……………………………. USD 252.5 billion
-
- East Africa………………………………USD 84.5 billion
-
- Southern Africa………………………..USD 730.8 billion
-
- Central Africa……………………………USD 36.1 billion
-
- Apart from the solid performance of the banking sector in the sub-region, there are a number of other reasons why a financial investor should consider investing in the sub-region:
- A market of nearly 330 million people and a rising middle class
- A sub-region that has witnessed solid economic growth over the past decade (The ECOWAS region made up of oil exporters, oil importers, landlocked and coastal countries has a market of about 332.7 million consumers and recorded a strong growth of 6.3% in 2014, as against 5.7% in the previous year despite falling global commodity prices and the public health crisis. The region had a combined GDP of more than USD 650 billion in 2014. Regional GDP is expected to grow by 7.1% in 2015: higher than the global growth rate (3.1%) for the same period and above that of advanced economies (2.0%).
-

Cont’d

- An improving business climate (For 2015, ECOWAS boasts of 4 countries (Benin, Cote d’Ivoire, Senegal and Togo) among the top 10 improvers globally, who are making the biggest improvement in business regulation over the past year. Several regulatory reforms that apply to an economy’s business during their life cycle, including start-up and operations, trading across borders, and paying taxes, continue to be implemented by Member States to in order to make their countries, and the sub-region by extension, investor-friendly. Ghana continues to be a top performer in the sub-region.)
-
- Sustained efforts have been undertaken by ECOWAS Member States to harmonize legislation to facilitate investment
- Regional efforts in ensuring cross-border banking supervisory oversight have proven crucial in ensuring financial and banking stability