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New players and new banking models for Africa

The African banking sector is undergoing radical change as regional and pan-African banking groups develop. Are these players contributing to sustainable development on the continent?

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The African banking sector – largely dominated by the European banks through to the late 1990s – is currently undergoing radical change. Alongside the sector's traditional players, regional operations are emerging – and steadily evolving into genuinely pan-African groups. These banks, whether they are local, regional or continental, are deploying a more aggressive growth strategy, seeking to penetrate new market segments and reach target groups previously excluded from the banking system. They are growing branch networks and introducing innovative, low-cost services better suited to underbanked populations.

Access to banking services is advancing, and retail banking and finance for SMEs are on the increase. Yet while they are targeting higher-risk customers, these banks lack the capital base of the major banking groups. To maintain its growth momentum the African banking sector will need to draw on external expertise and financial resources. The trend towards consolidation which has already begun in some markets will need to continue across the whole continent – driven, in particular, by tougher regulatory standards and banking supervision.

To what extent is the banking sector's development contributing to the development of the African continent as a whole? The new players are undoubtedly adding value – yet might their quest for market share entail a systemic risk for the continent's still-fragile economies? Will their emergence on the African scene boost efficiency in the banking sector? Issue 16 of *Private Sector & Development* seeks to answer these questions, in order to outline the conditions for sustainable development of Africa's banking sector. —

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The renewal of African banking sector

Banking systems in Africa have undergone major changes in recent decades. The emergence of African groups and increased competition have forced the sector to adopt growth strategies based in particular on a more diversified customer base and product range. Despite its vitality, the sector faces new challenges to consolidate, to expand and to support the continent's development.

Paul Derreumaux

Economist and independent consultant, honorary chairman of the Bank of Africa Group

In 2012, Africa's 200 largest banks had total assets of approximately USD 1,110 billion and a net banking income (NBI) of USD 45 billion.[1] The dominant countries were South Africa, Nigeria and North Africa, with shares of 36%, 9% and 40% in assets and 45%, 15% and 32% in NBI respectively. The banking sector in sub-Saharan Africa is nevertheless still extremely diverse, particularly in terms of banking concentration and the banking penetration rate, which ranges from more than 50% in South Africa to less than 10% in Francophone Africa.

Today commercial banks continue to dominate the financial systems of sub-Saharan Africa. After countries in the region gained independence, the sector was essentially composed of state-owned banks and a few major banks of the former colonial powers. Over the past forty years, major changes have gradually overhauled Africa's financial systems. The first private African banks appeared and set up regional networks; meanwhile, the sector was suffering from the withdrawal of large foreign corporations and the difficulties faced by state-owned banks. The creation of regional markets fostered the emergence of regional and in some cases continental African banking groups. These different phases and constant changes have shaped Africa's present financial systems – along with their strengths and weaknesses.

PAUL DERREUMAUX

A graduate of the Paris Institut d'études politiques (Institute of Political Studies) with a master's in economics, Paul Derreumaux began his African career in 1976 in Côte d'Ivoire, where he was advisor to the Ministry of Planning and then to the Ministry of the Economy, Finance and Planning. In 1982 he began developing Bank of Africa. He was the Group's CEO from the time of its founding until leaving his position in January 2011. He remains a director of the holding company.

Positive changes in the banking sector

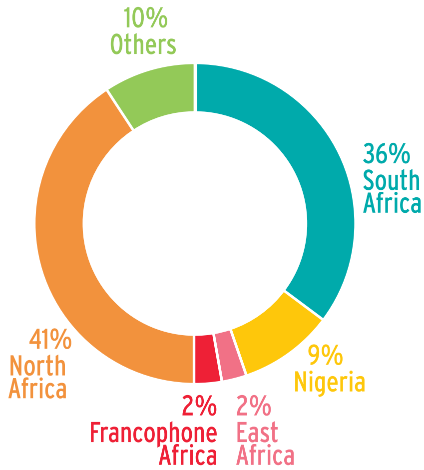
Overall, Africa's banking sector is now regarded as robust. The widespread liquidity and solvency crises of the 1970s and 1980s in Benin, Cameroon and Madagascar, for example, which had impacted commercial banks and their supervisory bodies, are now gone. Practices improved and structural changes were made, such as the creation of regional banking commissions in francophone Africa and improved supervision of counterparty risk at most commercial banks. Today's banking institutions demonstrate greater resilience and higher professional standards – and are therefore posting better results. Spurred on by accelerating economic growth, to which they are contributing, banks are seeing steady improvement in their performance and operating indicators. The annual ranking of the 200 largest African banks highlights these positive changes. Clearly the situation varies considerably from one country to another, depending on the country's economy, environment and financial services regulations. Yet progress is undisputed and noteworthy, regardless of geographical region, country or bank. The shape of banking systems reflects the overall improved health of sub-Saharan Africa, while being consistent with the intrinsic characteristics of the continent's different economic spaces.

"Today's banking institutions demonstrate greater resilience."

Within this spectrum, South Africa remains a world apart. Its four main banks are each three to four times more powerful than those

[1] *For comparison purposes, the NBI of the BNP Paribas Group alone was close to USD 55 billion in 2011.*

FIGURE 1: TOP 100 AFRICAN BANKS GEOGRAPHICAL BREAKDOWN (*)



(*) Data as at December 2011; geographical breakdown based on total assets of the top 100 African banks.
Note: The category 'Others' includes Angola, Mozambique, Mauritius, Zimbabwe, Sudan, Zambia and Eritrea.
Source: Jeune Afrique, 2012

below them in the African bank rankings. These four banks alone account for more than 35% of the total assets of Africa's top 100 banks (Figure 1). Despite this substantial lead – which is narrowing only slowly – South African banks do not have a network on the continent consistent with their size, no doubt due in part to the growth potential in their domestic market and foreign investment restrictions. But South Africa will of necessity have a key role to play in the evolution of African banking systems, as seen in some recent trends: Nedbank has increased its stake in Ecobank, while Barclays and Absa[2] have restructured and merged operations into Barclays Africa Group, and Stanbic[3] has arrived in Nigeria.

"New markets are now being sought throughout sub-Saharan Africa."

Fierce competition and stricter regulations

Foreign bank subsidiaries have gradually lost their dominant position – probably permanently – to African banks. The new leaders, which are few in number, come from several countries. Morocco and Nigeria have the most extensive networks, followed by South Africa and, more recently, Kenya and Gabon. Yet it is an unstable equilibrium, because all of these leaders are powerful and enterprising, particularly because of the size they have reached in their home countries. And all are driven by the same ambition: to expand as much as possible by leveraging their capital resources and know-how. New markets are now being sought throughout sub-Saharan Africa; banks are expanding either by acquiring an existing bank or by creating a new entity, depending on circumstances. Today, the only impediments to this geographical expansion are the financial limitations of some networks or practical difficulties in identifying attractive targets. Rarer still are networks operating across the entire continent, i.e. in at least two linguistic regions, such as Ecobank, Bank of Africa and United Bank for Africa (Table 1). These are likely soon to be joined by several others. With no boundaries to its sphere of action, the banking sector is undoubtedly leading the way and acting as a model; large African companies, which have always thought in regional terms, will thus have to follow suit and go beyond their geographical boundaries, which have become too restrictive. As is often the case, the private sector is providing a model for integration, with banks acting as a crucial catalyst, particularly through the support they offer to their customers.

In this competitive environment, commercial banks are developing similar strategies to attract new customers and diversify their operations. Banks are relying on their branch networks, which are expanding quickly, and as a result banking services' penetration in Africa is increasing. Products and services are multiplying and becoming more innovative based on e-payment, Internet and mobile banking technologies. Commercial banks have the same targets – from individuals to large businesses – as they seek to capture a share of markets that are still narrow and in which players have to work with all types of customers. Today African banks are better organised and more innovative, and are catching ▶▶▶

[2] Absa Group Limited is one of South Africa's top four retail banks. In 2005 Barclays Bank became the majority shareholder in the Absa Group. This stake will rise to 62.3% after the merger with the Absa Group.
[3] Stanbic is a member of the Standard Bank Group.

New players and new banking models for Africa

TABLE 1: MAJOR BANKING GROUPS IN AFRICA

As of 31.12.11	Total Assets (in USD Billions)	Shareholders Equity (in USD millions)	Presence in Africa by number of Countries (*)
Pan-African Banking Groups			
Standard Bank Group	183	3 540	18
Attijariwafa Bank	40	1 844	11
BMCE/BOA	24	949	15
Ecobank	17	1 195	32
UBA	12	458	19
Acces Bank	10	369	9
Groupe BOA	5	333	14
Multi-regional Banking Groups			
Groupe BGFI Bank	4	246	9
Afriland First Group	2	181	9
Oragroup SA	1	55	6
Regional Banking Groups			
Guaranty Trust bank Group	10	963	6
Diamond Bank Group	5	339	5
Kenya Commercial Bank Group	4	454	6
Equity Bank Group	2	187	5
I&M Bank Group	1	92	4

(*) Number of countries in Africa in which each banking group has operations, affiliates or subsidiaries.
Source: Jeune Afrique, 2012

Note: "Regional Banking Groups" are banking groups with operations located within a single economic area. "Multi-regional Banking Groups" are banking groups with operations in at least two separate economic areas. "Pan-African Banking Groups" are banking groups with operations in more than two economic areas – and usually across the whole of the continent.

▸▸▸ up with and even getting ahead of their Northern counterparts when it comes to mobile banking and prepaid credit cards.

Initiatives taken by central banks are another key factor in the sector's evolution, starting with the establishment of independent supervisory authorities using rules based on international banking standards. These bodies were set up in the English-speaking countries of East Africa in the 1970s and in francophone Africa at the end of the 1980s. The massive increase in the minimum capital requirement is a further illustration of these evolutions: Nigeria's sudden requirement in 2005 to set the minimum regulatory capital at USD 200 million reduced the number of banks by 75% within a few years and forced survivors to go beyond their national borders in an attempt to get a return on their new capital. The extent and pace of reforms in francophone Africa are very different; control procedures are often lax and inadequately monitored. Be that as it may, increasingly strict compliance with the rules of international banking supervision is the final step in the sector's overhaul: the Basel II standards, international financial reporting standards (IFRS) and new prudential ratios are being applied slowly but surely throughout sub-Saharan Africa. Francophone Africa has been late to adapt.

"Initiatives taken by central banks are another key factor in the sector's evolution."

Addressing new challenges

As a result of all these changes, African banking systems have improved significantly over the past two decades, and customers have been the first to benefit. This is particularly true for private customers, who are now being offered products better suited to, and even boosting, their needs – educational loans, 'pilgrimage' loans, retirement savings, and savings accounts tailored for young people, all of which are available at an increasing number of branches. Large, well-organised companies are also benefiting, thanks to the now common practice of syndicating among subsidiaries of the same banking group, or among banks in the same region. Also benefiting are the relationships between banks and microfinance organisations, which are multiplying and diversifying as their operations increasingly converge.

Yet despite this, weaknesses remain. Small and medium enterprise (SME) financing remains an issue, even though the most aggressive retail banks today sometimes allocate more than 25% of their direct loan portfolio to this segment. Substantial effort still needs to be made, and it must be supported, sustained and jointly led (Derreumaux, P. 2009). Banks must achieve higher professional standards and be more innovative with risk analysis, guarantees and financing arrangements, while companies need to increase their equity capital and become more organised and transparent in managing their financial flows. Mortgage loans, which have long been the subject of defaults, seem to be benefiting from the recent but rapid involvement of a growing number of banks and from more advantageous refinancing terms for loans granted by institutions.[4] This progress should eventually lead to growth in the supply of quality housing suited to the purchasing power of the population – which would have a ripple effect throughout the sector. By contrast, 'bancassurance', which was introduced almost a decade ago, has barely taken off, even though the insurance sector is undergoing a massive overhaul, much like that experienced by the banking sector.

The story does not end here; most of the current changes are expected to continue, leading to ever more focused and efficient banking systems. But the African financial system needs additional improvements if it is to continue to drive Africa's economic growth. Some are government-dependent; by supporting the banks, governments can pursue their own goals, such as improving the legal system and using tax incentives to obtain, quite fairly, lower credit costs. Yet most of the required improvements depend on the ability of the banks themselves to meet new challenges. Optimal use must be made of new technologies, and more effective procedures need to be implemented to increase staff productivity. Banks must prevent fraud, improve product penetration, capture a substantial number of customers with little or no banking experience, and attract more savers. Lastly, it would be useful if bulk financing at retail banks was facilitated. Dematerialised payment systems are also a major contributor to these developments: mobile banking has already started to 'move the goal posts', as telecommunications companies, which are at the cutting edge of these vehicles, start to emerge as potential rivals. Meanwhile, other systems that rely increasingly on electronic banking are being developed. The winners will be those who can develop and deliver tools that combine simplicity and security and are appropriately tailored to their environment. The emergence of securities markets, corporate venture capital and guarantee funds must also be fostered so that companies have access to a full range of tools that can help them expand. Because of their central position, banks can play a major role in these improvements – if they dare to do so and if they are encouraged by governments.

Convergence may well be the watchword of these desired changes: convergence of mechanisms with those implemented by other sectors; convergence of banks with other possible financial sector players; convergence of bank and insurance players, who together could examine potential joint action. And other changes are afoot, such as the opening up of countries still off-limits to foreign banks, and the arrival of major new players in the African banking system. In this regard, the large European banks seem to be returning with measured steps, while Chinese and Indian institutions seem to be in no rush. The surprise could come from the Middle East, which understands the challenge and promises that the African continent represents, and appears poised to act quickly.[5] •

Banks must (…) capture a substantial number of customers with little or no banking experience."

[4] Also noteworthy is the recent creation of a mortgage refinancing institution, the Caisse Régionale de Refinancement Hypothécaire (CRRH) as part of the West African Economic and Monetary Union (WAEMU), through which many retail banks now routinely grant 15-year housing loans.

[5] Qatar Bank has just bought the Egyptian subsidiary of Société Générale, while a major fund from Kuwait is considering a stake in Atijari Bank.

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An African banking model

Following the lessons of the pan-African banking groups' expansion, a number of local commercial banks have successfully expanded regionally. They differ from the international banking groups in a number of ways. These include flexibility and leveraging technology to service customers. They focus on retail and on growing SMEs, building loyalty among their customers. But they have limited resources, and need to partner with financial investors.

Sarit S. Raja Shah

Executive Director, I&M Bank

The past two decades have seen the emergence of African banks, characterised by their African ownership, some of which, such as Ecobank, Bank of Africa, United Bank for Africa, and Stanbic have already grown pan-African. This pan-African status is the result of a long, challenging, expensive, yet perfectly orchestrated, expansion strategy. Following the positive pitfalls of these pan-African groups' expansion, a growing number of African commercial banks have started to expand, but with the prime goal of conquering their own regional markets. A growing number of successful regional expansions are becoming flagships of the continent's banking industry.

SARIT S. RAJA SHAH

Mr Sarit S. Raja Shah, a Kenyan national, joined I&M Bank in 1993 as an Executive Director, after completing his master's degree from City University, London. He had previously undergone training at Biashara Bank of Kenya Limited.
He spearheaded the expansion of I&M Bank, which besides having 20 branches in Nairobi, is now also operating in Tanzania, Mauritius and Rwanda. He is the Chairman of I&M Tanzania and is a director on the board of Bank One. He sits on the boards of several companies.

The I&M Goup, a Kenyan-based banking group, which has expanded progressively throughout the East African Community, thus becoming one of the leading regional banks in East Africa, is one case in point (Table 1).

I&M Bank was established in 1974 as a financial institution that grew to be a full-fledged commercial bank, licensed in 1996. It then started to deploy its expansion strategy with the acquisition of a Kenyan bank in 2003. This merger offered the bank an increased market share and some sounder financial grounds for a regional expansion.

Over the last few years, I&M Bank has successfully pursued a regional expansion strategy and established operations in Mauritius through its associate Bank One Limited, and in Tanzania and Rwanda through its subsidiaries I&M Bank Limited (T), and Banque Commerciale du Rwanda Limited.

A fertile ground for expansion

The two main factors that allowed the rise of locally owned regional banks in Africa were the emergence of regional markets, and financial integration across these markets (Beck, T., Fuchs, M., Uy, M. 2009). In East Africa, central banks and governments are creating compatible financial infrastructures, and significant progress has been made in Kenya, Tanzania, and Uganda to integrate real-time gross settlement systems.

This progress has facilitated cross-border commercial transactions and has consequently stimulated regional trade. This natural trend cannot be fully completed without homogeneous regulations applying to the banking sector. The harmonisation of the prudential guidelines and the regulatory framework is thus another significant driver of African banks' regional expansion. Against this background, regulators in the East African Community are harmonising prudential guidelines and supervisory rules to ensure that there is a level playing field and practices that meet global standards. To a certain extent, within the different economic zones across Africa, central banks are looking at similar capital requirements for banks, as well as common shareholding structures and licensing requirements, thereby allowing the single licensing of banks across the continent.

"Competition within the industry is another key driver of African banks' expansion."

The intensifying competition within the industry is another key driver of African banks' expansion. Competition is indeed growing beyond borders. Local markets, despite the low banking sector penetration rates, no longer offer the expected returns. Hence, growing locally instead of regionally is becoming less profitable. Growing regionally is, in the long run, the only

option for African banks to ensure their viability and profitability. Leading banks usually compete for large clients that have needs exceeding local financing capacities. While international banks can rely on their parent companies to finance or syndicate large transactions, African banks have to raise resources locally. Should they develop regionally, with a competitive network of well capitalised subsidiaries, they would be able to syndicate regionally, and thus, compete: hence, the regional expansion of the I&M Group in Mauritius, Tanzania and Rwanda.
Aside from being a key competitive advantage, African banks consider regional expansion to be the key axis of their risk mitigation strategies. A bank will more easily absorb the shock of political and social temporary instabilities in one country if it has a presence in other countries. The post-electoral crisis in Kenya was a good reminder of how quickly a situation can deteriorate and impact the economy. If a bank is too small, and only local, such a crisis can threaten its existence.

"African banks enjoy a decentralised decision-making process."

African banks' salient features

Several medium-sized regional banks have appeared on the map in the past ten years. These new players depart from traditional European banks in several ways, notably in terms of positioning and strategy.
International banks operating in Africa have centralised business lines with a significant focus on trade finance, corporate and consumer banking, and their activities target essentially medium and large corporates, and state entities. On the contrary, although African banks like I&M will target, to a certain extent, large corporates, the bulk of their business is with small and medium enterprises (SMEs) and retail. African banks focus on growing SMEs to corporate size, which builds loyalty among their customers.
African banks tend to be more flexible in the services and products they extend to their customers. They also tend to be swifter in introducing new products that address their customers' concerns. An example is the prepaid Kenya shilling and US dollar–denominated VISA cards introduced by I&M Bank, which have gained popularity amongst a wide range of customers – companies whose employees travel on work, parents whose children are studying abroad, as well as Kenyans travelling abroad – all of whom want to monitor expenses closely.
African banks' focus on SMEs is linked to their flexible internal organisation, which is another of their key characteristics. International banks are characterised by a hub-and-spoke structure, where the hub is based in the head office. African banks enjoy a decentralised decision-making process or an organisation that enables the head office to respond quickly when approached by its regional subsidiaries.
But beyond these differences, their philosophy in approaching their domestic and regional markets might be their most distinctive characteristic. Lending decisions are based not only on financial statements but also on the relationship that has been established over time with the client. Speaking from the I&M perspective, it may be noted that after the post-election violence, in 2007-2008, many businesses suffered and many loans as per regulatory classification were classified as non-performing assets, but the bank was able to work with its customers, and in many cases gave them additional time to repay and reduce their interest rates for a few months. This resulted in most of the non-performing assets becoming performing assets within a year.
African banks tend thus to be more proactive in adapting their strategies to their moving local markets' environments. For instance, they have a far better understanding of non-traditional financing opportunities, such as microfinance and Saving and Credit Co-operatives (SACCOs). African banks are more familiar and comfortable with these banking techniques, which require a good knowledge of the local environment. Equity bank, for instance, has been instrumental in increasing its branch network and financial access and has grown to be one of the leading banks in Africa. Bank One, an associate of I&M Bank, provides another good example. This Mauritius bank introduced a Planters credit card, which allows farmers to access funding to assist them grow their crops and sell them to make a living.
Another key characteristic of African banks is their innovative approach. Indeed, they go out of their way to use technology as much as possible for the convenience of the customers. Some have even gone to the length of using technology to allow users access to both savings and loans. For instance, I&M Bank was the first to introduce a prepaid Kenya shilling card that could be topped up using M-Pesa, a revolutionary mobile-money transfer service offered by Safaricom, the leading mobile operator in Kenya. Similarly, Safaricom has partnered with ▶▶▶

FOCUS

I&M Bank Limited is a privately owned commercial bank headquartered in Kenya, with a growing regional presence, currently extending to Mauritius, Tanzania and Rwanda. With a group staff compliment of over 860, balance sheet size of KES 108 billion (approx. USD 1.27 billion) and profit before tax of KES 4.95 billion (approx. USD 58.3 million), it is one of the strongest banks in Kenya. It has a network of 20 branches in Kenya, serving a customer base of over 25,000. I&M was recently ranked overall 4th best bank in Kenya, by the 2012 Banking Survey.

TABLE 1: KEY FIGURES ON I&M GROUP

The I&M Group					
As of 31/12/11 in million USD	I&M Kenya	Bank One	I&M (T)	BCR	I&M Group (*)
Positionning					
Countries	Kenya	Mauritius	Tanzania	Rwanda	EAC
Financial performance					
Total Assets	761	523	102	166	1,437
As % of Consolided Assets (*)	53%	36%	7%	12%	100%
Shareholders' equity	132	32	12	22	194
As % of Consolided Assets (*)	68%	17%	6%	11%	100%
Net profit	29	6	3	4	44
As % of Consolided Assets (*)	67%	13%	6%	10%	100%
Return on Equity (RoE)	22%	18%	23%	20%	23%
Return on Assets (RoA)	4%	1%	3%	3%	3%

(*) Consolidated data proforma BCR acquisition. Audited Figures as of 31.12.11.

Source: I&M, 2011

▸▸▸ Commercial Bank of Africa to provide M-Shwari- the revolutionary new banking product for Safaricom's M-Pesa customers that allows them to save and borrow money through their mobile-phones while earning interest on money saved.

In the field of mobile banking, African banks have taken advantage of the rise of M-Pesa, which targets mainly middle- and low-income individuals. These banks have understood that technological innovation can be of great assistance in gaining market share. In Kenya, Equity Bank, for instance, has continuously invested in technology and expanded both locally and regionally, offering micro-finance and successfully expanding its customer base in the rural areas.

"The viability of African banks depends on their ability to grow quickly enough to become regional."

The remaining feature that distinguishes African banks is the perception of them by local customers. African banks indeed inspire more trust in their customers. The cultural proximity, as described above, is not the only factor building trust. The fact that African banks cannot leave the country, without bankrupting, also inspires trust. African banks are bound to stay, whereas foreign and international banks can choose to sell their assets and leave the country. Or, less dramatically, they can decide to reduce their activity or change their strategy to address concerns in their home markets.

The critical parameters of size

If African banks bring a lot to the market, being more innovative and certainly less risk-adverse than their international counterparts, they still suffer from a great weakness: their size. Indeed, African markets are expanding and becoming more integrated; trade flows are booming, and this trend is expected to continue.

The African economy will thus require a more efficient, stable and well-performing banking sector, able to take advantage of economies of scale. The minimum size to exist in these markets is increasing. Therefore, African banks will need to become regional players or will be marginalised. Opportunities to grow lie ahead. Capital requirements are increasing to meet international standards, and this may prompt some shareholding reshuffling whereby historical players or under-capitalised shareholders may look at exiting, thereby creating opportunities for African local banks to pursue their expansion throughout the continent, even if this means paying a premium.

Many of the banks in Africa have government and private equity shareholdings, and this too may create opportunities for regional banks to further expand. However, African banks have limited resources and need to partner with financial investors. In this process, Development Finance Institutions (DFIs) have a role to play. In recent years DFIs have been supportive of banks by taking equity and providing senior debt. Both French and German DFIs, Proparco and DEG, have been instrumental in supporting I&M bank in its regional expansion by taking equity in Kenya, Tanzania and Rwanda. The viability of African banks depends on their ability to grow quickly enough to become regional, which implies partnering with the right players. •

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Fostering financial inclusion with mobile banking

Mobile telephony penetration in Africa has increased exponentially over the last decade. On the contrary, banking penetration remains low on the continent. This contrast paves the way for mobile banking's success in Africa. While mobile telephony reduces geographical constraints and transaction costs, it offers commercial banks a costless expansion strategy. Win-win partnerships between banks and ICT operators can foster banking penetration in the continent.

Peter Ondiege

Chief Research Economist, African Development Bank[1]

The annual growth rates of mobile phone penetration in the developing world have ranged between 30% and 50% or higher, and penetration has been rapidly increasing (Hausman, J. 2010). In Africa, mobile phone penetration has exploded during the last ten years. Between 1998 and 2009, Africa witnessed an increase from 0.53 per 100 people to 42.82 per 100 people (Hausman, J. 2010). At the same time, the average price of a 2G handset decreased from USD 150 in 2003 to USD 75 in 2008. Africa is now considered to be the fastest emergent continent for Information and Communications Technology (ICT) sector growth (Figure 1).

PETER ONDIEGE

Professor Peter Ondiege is Chief Research Economist at the Development Research Department of the African Development Bank where he is responsible for Investment Climate Assessment, African Competitiveness Reports and ICT innovations studies. Previously, he was a Director of the Housing and Building Research Institute and an Associate Professor at the University of Nairobi, Kenya. He holds a Master and a PhD degree in Economics from the University of Tsukuba, Japan.

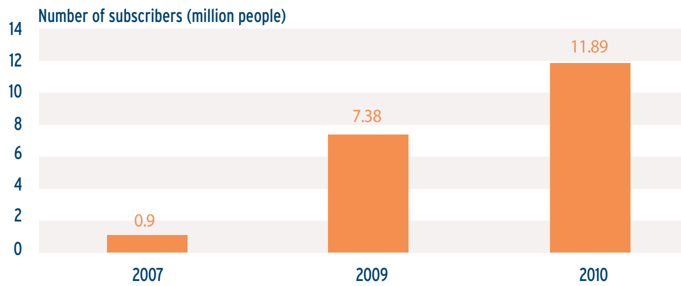
The low financial services penetration compared to the exponential growth of mobile telephony in sub-Saharan Africa is creating a unique niche for mobile phone banking to develop on the continent. In Africa, the majority of the population has no access to banking services, with only 20% of African families having bank accounts. Sub-Saharan Africa has the lowest deposit institution penetration in the world, standing at an average of 16.6% compared with 63.5% in developing countries (Financial Access, 2010). In rural areas, which account for 60% of Africa's total population, the commercial bank branch network is particularly underdeveloped. The limited access to financial services in Africa stems from physical-geographical isolation or inaccessibility, but also deficient infrastructure and financial illiteracy, all of which have culminated in an exceedingly high cost of providing banking services. In some countries, the minimum deposit can be as high as 50% of gross domestic product (GDP) per capita. Transaction costs are usually quite high.

Taking the Bank to the client

Financial institutions and mobile phone service providers are introducing resourceful methods of bringing these unserved populations into the formal economy using mobile phones. For commercial banks, the main advantages of the mobile phone technology lie in its capabilities to reach everywhere and be reached from everywhere. Mobile banking is a powerful way to deliver savings services to the billions of people worldwide who have a cell phone but no bank account. It has a number of advantages over traditional banking methods because it breaks down geographical constraints. It also offers other advantages such as immediacy, security and efficiency. Its power is in transforming the economics of service delivery, especially by reducing the costs of financial transactions. ▸▸▸

"Mobile banking is a powerful way to deliver savings services."

FIGURE 1: INCREASING TREND OF MOBILE BANKING IN AFRICA



Source: AfDB, 2010

[1] This note draws from the earlier paper of the author 'Mobile Banking in Africa: Taking the Bank to the People', 2010.

New players and new banking models for Africa

▸▸▸ The mobile phone can serve as a virtual bank card where customer and institution information can be securely stored, thereby avoiding the cost of distributing cards to customers. In fact, the SIM[2] card inside most, GSM[3] phones is in itself a smartcard (similar to the virtual bank card). Thus, the bank customer's PIN[4] and account number can be stored on this SIM card to perform the same functions as the bank virtual card.

The mobile phone may also serve as a point of sale terminal. As such, a mobile phone may be used to transact and communicate with the appropriate financial institution to solicit transaction authorisation. This has the same functions of a point of sale terminal at malls, retail, or other stores. A mobile phone can duplicate this functionality with ease.

The mobile phone can also be used as an ATM[5]. A point of sale is used to pay for goods or services at the store. If we consider cash and access to savings as 'goods and services', which customers buy at the store, then this point of sale will also serve as a cash collection and distribution point, which basically is the function of an ATM.

The mobile phone may also be used as an Internet banking terminal. This provides two fundamental customer services: instant access to any account, and the ability to make payments and transfers remotely. Consequently, the mobile phone device and wireless connectivity bring the Internet terminal into the hands of otherwise unbanked customers.

Kenya and South Africa, at the forefront of Mobile Banking

Only 19% of the adult population in Kenya has access to a formal bank account, and banking services in Kenya are largely restricted to urban populations (Mas, I., Radcliffe, D. 2010). Cellular operators have designed an ingenious way to provide financial services to rural populations in remote areas. In 2007, Safaricom, a national mobile telephony operator, at the time a subsidiary of Vodafone, introduced M-Pesa: 'M' standing for Mobile and 'Pesa' for money in Swahili. This revolutionary service enables money transfers between mobile phones *via* SMS, from the most rudimentary mobile phone.

The overwhelming presence of Safaricom in the Kenyan market and the high penetration rate of mobile telephony in the country, especially in remote and rural areas, paved the way for M-Pesa's great success. By the end of 2008, payment and money transfers via mobile phones were used by 5 million people, and in 2009, by 10 million people. In 2010, the number of M-Pesa clients grew by 61% in one year, a third of which were held by people who were otherwise unbanked. M-Pesa financial services have low value and high volume and generate significant returns. Additionally, the services carry a minimum cost of about USD 0.46 per transaction, less than transaction costs of bank services in Kenya, which range from USD 1 to USD 3. Another interesting initiative, the M-Kesho account, has been developed in Kenya through the partnership between Equity Bank and Safaricom. It is a bank account linked to the M-Pesa account that enables money transfers from one Mobile-account to another and encourages savings, the M-Kesho account being remunerated. M-Kesho accounts, like the M-Pesa, have no opening fees, and minimum balances or monthly charges. M-Kesho clients can open accounts at either Equity Bank branches or at a subset of some 5000 M-Pesa agents, at which Equity Bank will place a bank representative and transact at any of the 17,000 M-Pesa retail outlets. The venture into mobile banking and the subsequent partnerships with mobile operators enabled the bank to grow its deposit base at an average compounded growth rate of 40% from 2007 to 2012[6], without incurring any significant branch network expansion costs and deteriorating its cost to income ratio. This new initiative is the perfect showcase of convergence between the mobile phone and banking. This tool is a powerful lever to increase the banking penetration rate, going beyond what M-Pesa was able to. M-Pesa could ease and increase access to financial services in the formal sector, but it could not directly foster any increase in deposits. M-Kesho, in itself, has the potential of bringing over 18 million Kenyans into formal banking services. It shows that mobile banking has to be driven by the banking sector itself, and adapt to local customers' needs and expectations.

"Mobile banking has to be driven by the banking sector itself."

In 2010, the Central Bank of Kenya issued new agent banking regulations, which for the first time allowed banks to engage a wide range of retail outlets for transaction handling and

[2] *Subscriber Identity Module*
[3] *Global System to Mobile*
[4] *Personal Identification Number*
[5] *Automatic teller machine*
[6] *Equity Bank Q2 Investor Presentation*

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The African Development Bank (AfDB) Group is the premier development finance institution in Africa, with a mandate to spur sustainable economic development and social progress on the continent, thereby contributing to poverty reduction. It achieves this objective by mobilising and allocating resources for investment on the continent, and providing policy advice and technical assistance to support development efforts. The AfDB's authorised capital of around USD 100 billion is subscribed to by 77 member countries, made up of 54 African countries and 24 non-African countries.

product promotion. This paved the way for banks to begin utilising the M-Pesa platform and the associated network of M-Pesa outlets as a channel. It prompted a growing number of banks into mobile banking partnerships with local mobile operators. In October 2010, Safaricom and Barclays Bank of Kenya signed a partnership that allows Barclays account holders to deposit and withdraw to and from their M-Pesa accounts. The M-Pesa agents who bank with Barclays Bank will also be able to purchase an e-float for their daily operations. This constitutes the eighth bank, after Family Bank and Kenya Commercial Bank among others, to partner with M-Pesa, either as an agent or a super agent, denoting the growing opportunities offered by the synergies between mobile telephony and banking activities. The agency banking model is thus becoming a key axis of Kenyan-based commercial banks' expansion. Indeed, as it enables commercial banks to offer services through third party agents, such as telecoms operators, it is a powerful tool to increase their retail network and presence, without incurring the operational costs related to the opening of new branches. As of September 2011, there were 70,000 agents in Kenya, licensed by only 10 banks.

South Africa provides some further examples of mobile banking success stories. With a high mobile penetration rate, South Africa is by far the country where mobile banking is most widely used on the continent and the most important emerging market in terms of mobile banking potential. An illustrative example of this potential can be provided by Multinational telecommunications Group (MTN)[7] and its Mobile Money Account. This account provides access to a client account from anywhere in the world, and at any time, through a secure connection using an MTN mobile phone. South Africa's MTN in 2010 announced plans for a fully-fledged bank account on mobile phones, with an optional credit card. The service will be extended to the 20 countries where MTN operates, including Uganda, Nigeria, Cameroon and Cote d'Ivoire, which combined have over 90 million mobile phone users.

"The mobile phone revolution continues to leave large parts of the continent behind."

Extending the M-Banking frontier

The cases of Kenya and South Africa clearly demonstrate that there are colossal opportunities in Africa to increase affordable and cost effective means of bringing on board the large number of the population who has been excluded from formal financial services for decades. The development of mobile banking will contribute to boosting domestic savings. It will also participate to increase money transfers from the diaspora at low costs. It will reduce financial transactions costs, leading to lowering the cost of doing business, which will benefit small and medium enterprises and overall private sector development. Hence, the mobile phone is becoming much more than a phone to the poor and the unbanked populations of Africa. It is transforming people's handsets into banks in their hands or pockets.

To go further, the next challenges will be, in some cases, to lower costs and to deepen mobile telephony penetration on the continent. Penetration rates vary a lot, from under 10% in Ethiopia to nearly 100% in Gabon, with an average of about 33% for the whole continent. The mobile phone revolution continues to leave large parts of the continent behind. Low incomes, illiteracy and large signal black spots are key obstacles to the acquisition and use of mobile phones. These obstacles are further aggravated by high taxes, which in some countries such as Tanzania and Uganda can be as high as 30% of overall charges. These challenges can be addressed by the authorities through policy reforms and scaling up investment in the ICT sector.

Furthermore, partnerships between banks, financial institutions, microfinance institutions (MFIs) and the mobile industry players should be sought out and encouraged. In order to sustain the growth of these mobile banking success stories, there is a need to support a single integrated framework (between financial institutions and the mobile industry) to cut costs, in order to provide consumers with the convenience of banking from home, the farm or other remove areas. MFIs should also upgrade their technology to be able to adopt the new mobile banking emerging technology and should seek solutions that are user-friendly and easy to implement. The increased access to cell phones by the unbanked Africans would be the most cost-effective and economically efficient method of providing financial services to a wide segment of the African populations in the very near future.

[7] Launched in 1994, the MTN Group is a multinational telecommunications group, operating in 21 countries in Africa and the Middle East.

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Supporting the emergence of a sustainable financial sector in Africa

The last ten years have seen a local banking sector emerge in Africa, alongside the European banks that have traditionally been present. While a development model based on these local resources seems more sustainable, the foreign banks must continue to play a role, particularly in helping to connect Africa's economies to the rest of the world. In this changing environment, DFIs are adapting their strategies in order to contribute to the development of a durable and strong financial sector.

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Manager of Proparco's West Africa regional office[1]

Sub-Saharan Africa has the world's least developed financial sector. Excluding South Africa, its banking sector is around one tenth of the size of China's leading bank and is comparable in size to Germany's tenth-largest bank. Even taking gross domestic product (GDP) differences into account, Africa's financial sector remains very underdeveloped, with a penetration rate[2] of around 30% - less than half the average for other developing nations. For this reason, development finance institutions (DFIs) have made strengthening Africa's financial systems their priority. In volume terms this sector represents more than half of their commitments in sub-Saharan Africa, i.e. around €3 billion in 2011. Recent radical changes in the banking landscape are prompting DFIs to rethink their strategy, in relation both to local banking groups - which are set to play an increasingly important role - and to the international banking players who are still reluctant to invest in the continent.

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Julien Lefilleur joined Proparco in 2004. After having occupied several positions - mainly in the Banks and Financial Markets department - he opened Proparco's regional office in 2010 for West Africa in Abidjan. Julien Lefilleur is also the founder and editor-in-chief of the Proparco magazine *Private Sector & Development*. He is a graduate of École Centrale de Paris with a PhD in Economics from the Sorbonne University.

Complementarities of local banks and foreign banks

Compared with the world's other developing regions, Africa has a high proportion of foreign banks operating in its territory - 45%, compared with a 30% average for developing countries (World Bank, 2006). Yet this proportion is declining. While the European banking groups, who have dominated the market since independence, have remained in their natural territories - French-speaking Africa for the French banks, English-speaking Africa for the UK banks - where they have in fact lost market share, local banking groups have developed rapidly since the late 1990s. The continent currently has a number of pan-African banks - Ecobank, Bank of Africa Group (BOA), Standard Bank, United Bank for Africa (UBA) - which are present in 10 or more countries, and a good number of fast-growing regional banks. These new players, pursuing more ambitious goals than the traditional

"Sub-Saharan Africa has the world's least developed financial sector."

[1] *Except where a specific source is cited, the data in this article are based on calculations by the authors, drawing on the Bankscope (2011) and World Bank (http://data.worldbank.org/) databases.*
[2] *The penetration rate is defined as the ratio of total banking assets to national GDP.*

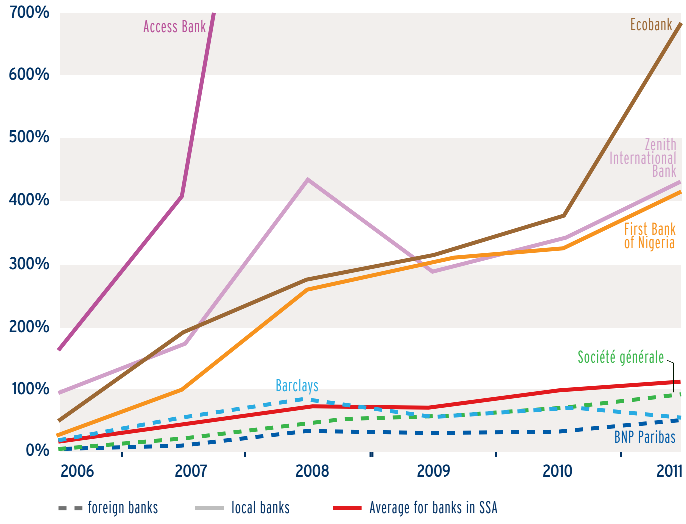
banks, have helped to stimulate competition and have boosted banking activity levels observed in Africa over the last decade. Throughout the 1990s, loans to the private sector remained steady at around 10% of GDP; now they are in excess of 20%. This growth has mainly been driven by local banks (Figure 1).

The local banking sector, with its in-depth knowledge of the market environment, is driving the expansion of specific market segments - small and medium enterprises (SMEs), rural clients, low-income clients, etc. - which are, to a certain extent, overlooked by the foreign banks. In order to expand, the local banks need to penetrate these higher-risk markets, which constitute their primary growth drivers, given that the foreign banks dominate more easily accessible segments (large corporates, etc.). Moreover, the local banks have longer-term plans concerning their national markets than the foreign banks, as a result of which they naturally become more deeply involved in developing and structuring these markets. Unlike the foreign banks, local banks have no alternative but to grow within their national and regional markets first, since they lack the requisite scale to penetrate other markets beyond the continent.[3] The development of a banking sector based on local capital therefore seems more sustainable and certainly more favourable to the penetration of new markets than development driven by the international groups. Such a pattern should therefore be encouraged.

"Unlike the foreign banks, local banks have no alternative but to grow within their national or regional markets first."

Yet exclusively endogenous growth is not the most desirable solution either. The sector needs external resources in order to grow at sufficient speed and to make up ground – and foreign banks generally have more resources at their disposal than local banks. Most of them are backed by large groups, with expertise, easier access to highly experienced human resources, and a greater training and innovation capability, which enables them to play a key role in structuring the local financial sector. They also have greater intervention capacity – they can syndicate financing from within their group – as well as access to low-cost refinancing. Moreover, the African markets will naturally become increasingly integrated in the global economy, implying an increase in financial transactions between Africa and the rest of the world. This can only happen if there are connections between the African financial sector and the outside world – and the foreign banks are better positioned to connect African economies to the rest of the world. So although the development of Africa's banking sector will probably continue to be driven by local players, it is essential that the continent remains open to the external financial sector too. DFIs definitely have a role to play in encouraging the expansion of both types of players.

FIGURE 1: GROWTH OF THE MAIN BANKS IN SUB-SAHARAN AFRICA (OUTSIDE SOUTH AFRICA)



Source: Figures were calculated by the authors, based on the Bankscope, 2011 database and annual reports of the banks.

Supporting the emergence of pan-African champions

The first stage in developing an effective local banking sector involves promoting the emergence of pan-African champions large enough to generate economies of scale. DFIs can assist the process through targeted initiatives designed to support specific banking groups that are well positioned to fulfil this role. In addition to groups that are already well established (Ecobank, BOA, UBA) - which have received substantial support from the DFIs - two types of players might prove to be suitable candidates here: regional ▶▶▶

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As a DFI, Proparco sees supporting banks and financial institutions as a key element of its intervention strategy. In Africa, Proparco deploys a broad range of financial instruments including, in particular, equity investments, credit lines and guarantees.
Proparco's financial sector portfolio stood at EUR 1.6 billion at 31 December 2012 – with Africa accounting for nearly 45% of this.

[3] *"We do not have a strategy for Africa, our strategy is Africa" (Thierry Tanoh, CEO of Ecobank, Investors Club, November 2012, Paris).*

▶▶▶ groups that have already achieved a critical size and the major banks of Africa's main financial centres. The former category includes banks such as Orabank and BGFI Bank in Central and West Africa; I&M, Equity Bank and Kenya Commercial Bank in Eastern Africa; and BancABC in Southern Africa. These banks have a thorough knowledge of the markets in which they operate, but are limited by the resources at their disposal. They can therefore usefully be supported by capital injections provided by DFIs - as did FMO (Netherlands) with Afriland First Bank, Proparco with I&M and Orabank, and the International Finance Corporation (IFC) with Equity Bank. Regarding Africa's main financial centres, three countries might function as engines driving regional growth: Nigeria, Morocco and South Africa. Although the latter two countries do not belong, strictly speaking, to sub-Saharan Africa, this region is their natural expansion zone. Banks in these countries remained within their national borders for many years and have only recently embarked on pan-African expansions: Moroccan banks (BMCE, AttijariWafa Bank, BCP) have acquired existing banking groups; Nigerian banks have opted to create banking networks from scratch (UBA, GT Bank, Zenith Bank, Access Bank); South African banks have prioritised developing an existing network (Stanbic). This expansion into relatively unfamiliar markets remains tentative, however. The largest banks in South Africa (FirstRand Bank, Nedbank, Absa Group) and Nigeria (First Bank of Nigeria) still remain focused on their national markets. DFIs therefore have a role to play in encouraging and supporting these banks' ventures beyond their national borders. Proparco and FMO, for example, have supported BMCE's regional expansion by contributing to its merger with BOA Group, and IFC invested in BCP Maroc to finance the acquisition of the Banque Atlantique group in West Africa.

In this way, DFIs have contributed substantially to the emergence of a local banking sector with pan-African ambitions. However, to date their support has involved mainly relatively traditional forms of financing, in order to provide these groups with the long-term resources they lacked. Other, more innovative forms of support might be considered today. It may, for instance, be appropriate to help them access the international capital markets, where they currently lack visibility - by guaranteeing their first bond issues. Similarly, DFIs could assist in the organisation of the syndication market, as a way of encouraging local banks to work together in order to overcome the constraints imposed by their size. Another possibility would be to improve cross-border cooperation, which is very underdeveloped among banks belonging to different groups. Most Ghanaian banks, for example, do not have any partner banks within the West African Economic and Monetary Union (WAEMU), despite Ghana's position at its heart, which limits the range of operations they can undertake with their clients active in this region. Just as they promote trade between Africa and other continents, by guaranteeing trade finance transactions, DFIs could also facilitate intra-African trade.

In general terms, therefore, while the local banks have faith in Africa's markets and want to grow in them, they lack the necessary resources and they need the DFIs' support. The situation is exactly the opposite for the foreign banks - whose sensitivity to Africa's risk factors outstrips their awareness of the profitability levels achieved on the continent.

Overestimation of risk by foreign banks

Africa's banking sector is the most profitable one in the world; yet, to date international investors have shown little interest in this market. Except for the traditional European banks - whose market share is eroding - and a few isolated banks from emerging markets, the only players driving the development of Africa's banking sector are African. International investors still see these markets as too risky. In other words Africa suffers from a moral hazard problem, while the profitability levels of Africa's various banking sectors confirm the gap between reality and perception with respect to the risk levels involved. Average return on equity (ROE) in Africa was 19% for 2007-2010, compared with just 11% in Europe, despite the higher capitalisation levels of African banks.[4] Even so, the "country risk" deters investors. Yet it is rare that social and political instability reaches the extremes of Liberia or Sierra Leone. Even though numerous countries experienced major disturbances between 2007 and 2010, it is interesting to note that their banking sectors remained highly profitable during the same period (Table 1). The African financial sectors' ability to bounce back shows that African economies are highly resilient to this

"Three countries might function as engines driving regional growth: Nigeria, Morocco and South Africa."

[4] *Moreover, these figures understate the real profitability levels of foreign banks operating in Africa, since they are influenced by the performance of Africa's large state banks, which can have important market shares and very poor profitability.*

TABLE 1: SOCIO-POLITICAL CRISES AND BANKING SECTOR PROFITABILITY, 2007-2010

Country	Events	Average ROE of the national banking sector, 2007-2010
Central African Republic	Central African Republic Bush War, 2004-2007	21%
Chad	Civil war in Chad, 2005-2010	24%
Djibouti	Djiboutian-Eritrean border conflict, 2008	41%
Eritrea	Djiboutian-Eritrean border conflict, 2008	10%
Guinea	Putsch, 2008	22%
Kenya	Mount Elgon insurgency, 2005-2008 ; 2007-2008 Kenyan crisis	20%
Madagascar	Putsch, 2009	25%
Mali	Tuareg rebellion, 2007-2009	14%
Mauritania	Coup d'Etat, 2008	3%
Niger	Tuareg rebellion, 2007-2009 ; Putsch, 2010	15%
Nigeria	2009 Boko Haram insurgency; 2010 Jos riots; Nigerian Sharia conflict, 1953-present; Conflict in the Niger Delta, 2004-present	2%
Sudan	Darfur conflict, 2003-2010	13%
Average for countries which experienced major disturbances between 2007 and 2010		18%
Average for sub-Saharan banks		19%

Note: although disturbances occurred in the Comoros, the Democratic Republic of the Congo and Somalia, they were not included in this table as ROE data for their banking sectors was not available.
Source: Figures were calculated by the authors based on Bankscope, 2011 data.

type of crisis: profits are volatile, but the rebound effects compensate for periods of poor performance. This guarantees record returns on investments in Africa for investors who take a long-term view and are able to diversify their assets geographically.

A recent Ernst & Young survey highlights the anti-selection phenomenon from which Africa suffers (Ernst & Young, 2011). It shows that Africa is the continent that appears the riskiest to investors, but that there is a significant difference between investors who have already invested in Africa and those who have not. The former are satisfied with their investments and are planning further commitments; the latter view the continent as overly risky and generally do not have plans to invest there. An overview of Africa's financial sector illustrates these findings: the main international banking groups present in sub-Saharan Africa are indeed either French banks (Société générale, BNP) or UK banks (Barclays, Standard Chartered), i.e. those originally from the former colonial powers. These banks entered the African market at the time of independence and have since stayed there. Their continuous presence over 50 years has shown that risks are manageable and rewarded by adequate profits. By contrast, very few foreign banks have sought to establish a presence on the continent during the last 30 years. In particular, practically no banks from emerging and developing markets -China and India, for example, even though these countries are the continent's main trading partners - have shown any inclination to move into sub-Saharan Africa (outside South Africa) in recent years.

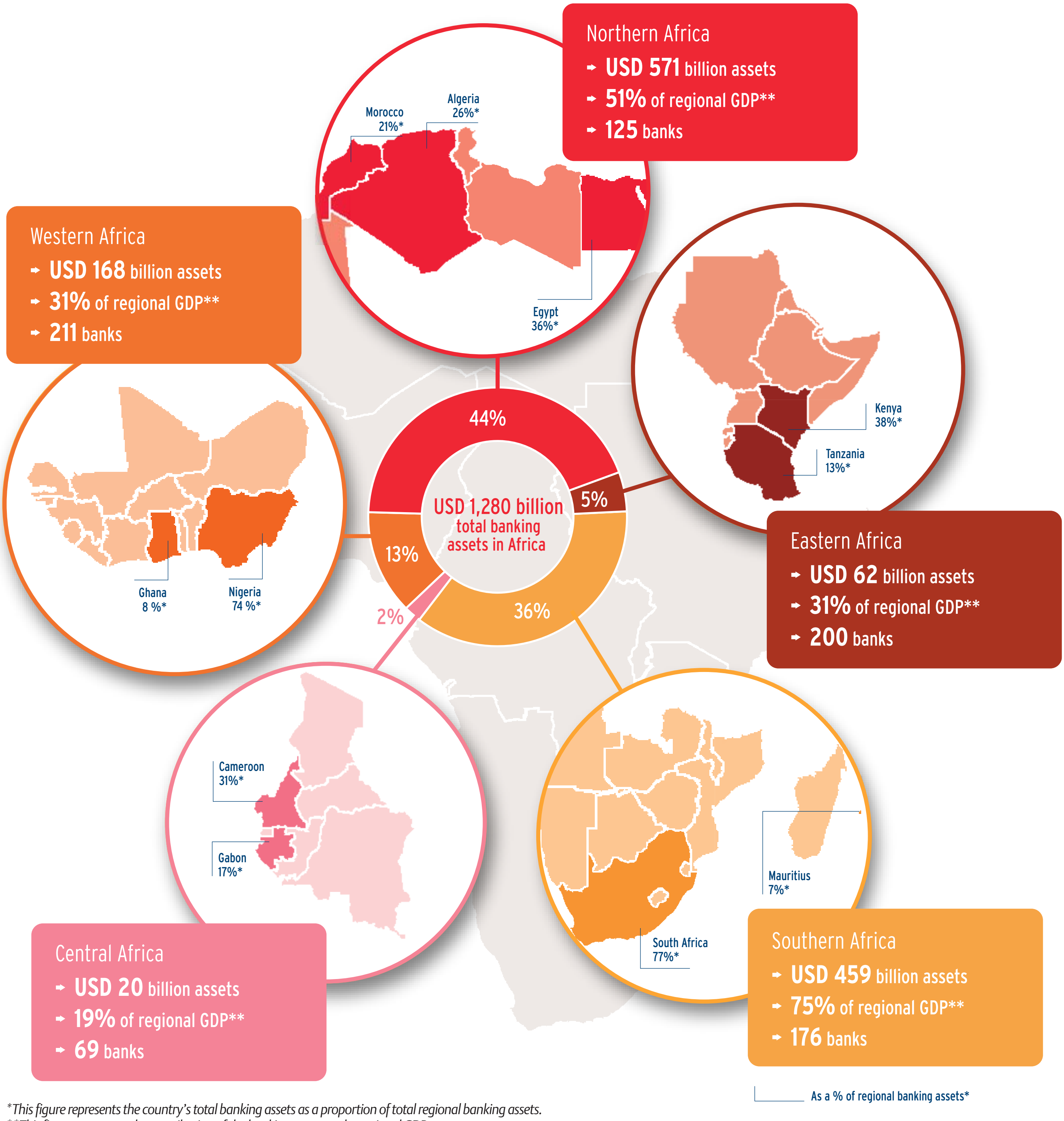
"Very few foreign banks have sought to establish a presence on the continent during the last 30 years."

In order to ensure that the African banking sector does not remain isolated, it is vital to mitigate the level of risk it inspires in the outside world. DFIs enjoy a special position, originating as they do in the Northern hemisphere but with a long-standing presence in the Southern hemisphere, and this gives them access to a broad spectrum of investors to whom they can promote Africa. Using this position to build a bridge between Africa and other markets would appear to be one of the main levers available to DFIs to channel private international investments towards the African banking sector. •

RÉFÉRENCES / **Bankscope, 2011.** *Database.* / **Ernst & Young, 2011.** It's time for Africa. Ernst & Young's 2011 Africa attractiveness survey. / **World Bank, 2006.** Making Finance Work for Africa. The International Bank for Reconstruction and Development / The World Bank, Washington, DC.

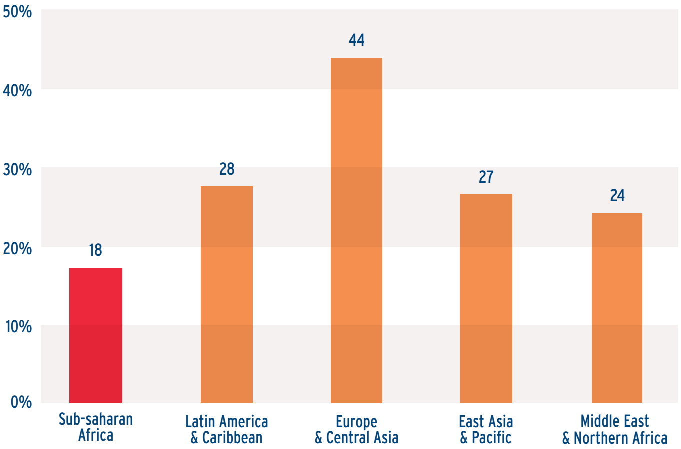
The African banking sector is booming. For many years low penetration rates were its defining feature; now this sector is enjoying a strong momentum. Its landscape may still be dominated by regional leaders - South Africa, Nigeria and Kenya - yet the strong asset growth trend is both widespread and unmistakable. The continent's economic growth is boosting the banking sector, and profitability levels are high.

Overview of the African banking sector



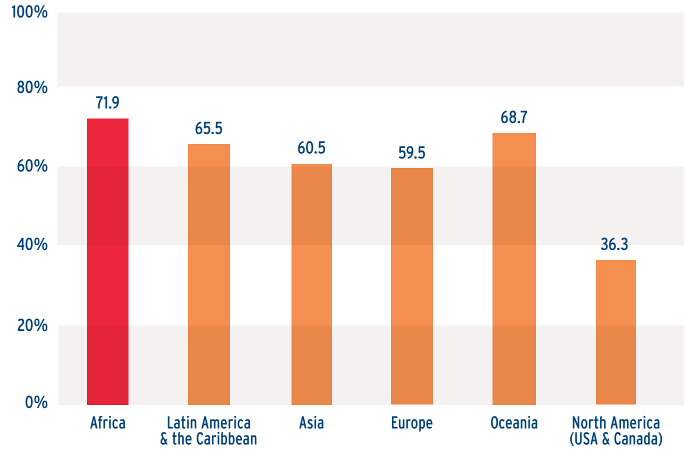
**This figure represents the country's total banking assets as a proportion of total regional banking assets.*
***This figure represents the contribution of the banking sector to the regional GDP.*
Source: Figures are based on calculation made by Private Sector & Development on the basis of data collected from EIB, the CIA and central banks of represented countries, 2010

Banking penetration rate per region



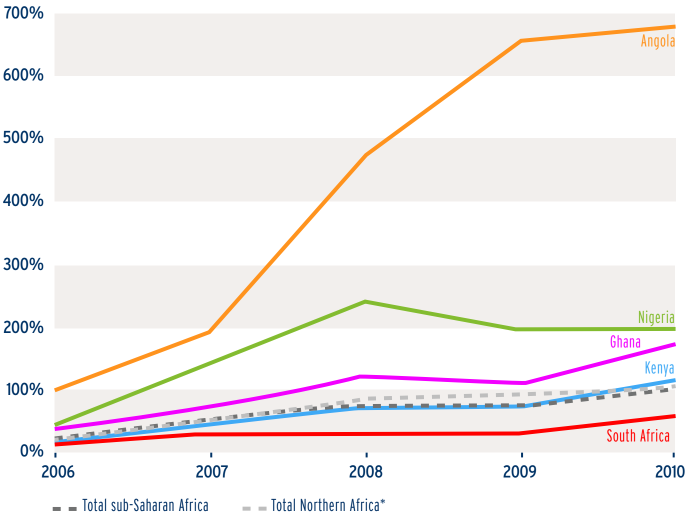
Note: These figures represent the percentage of total adults with an account opened at a Formal Financial Institution
Source: EIB, 2013

Average banking concentration per region



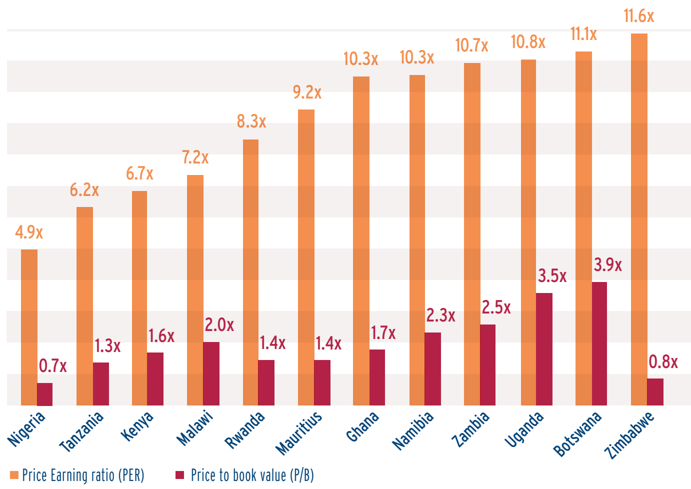
Note: For each underlying country of the aforementioned regions, these figures represent the top 3 banks' total assets in comparison to the banking sector's total assets size
Source: World Bank, 2010

Main banking centers' cumulative growth



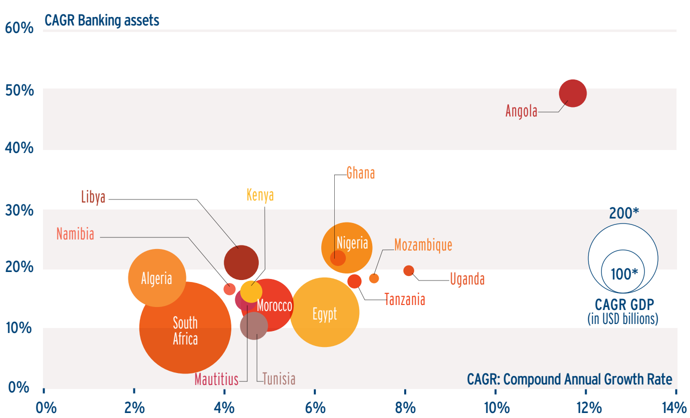
**Northern Africa comprises Algeria, Egypt, Libya, Morocco and Tunisia.*
Source: Figures are based on calculation made by Private Sector & Development on the basis of The World Bank, IMF, 2010

Selected Sub-Saharan Africa's banking sectors valuation



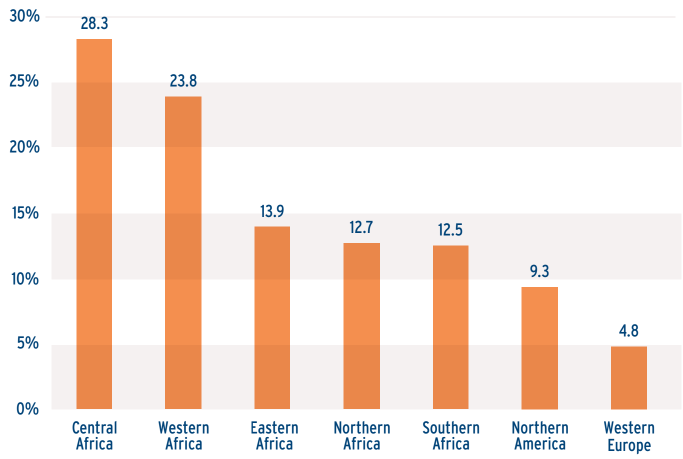
Note: These figures are based on the median trading multiples of a sample 54 banks listed on the main sock exchanges of Sub-Saharan Africa. Share price as of 30.11.12
Source: Hartland Peel, 2012

Correlation between banking assets and GDP growth



Note: This graph represents the sixteen African countries which record the highest banking Assets' compound annual growth rates in comparison to GDP's compound annual growth rate
CAGR: Compound Annual Growth Rate
Source: Figures are based on calculation made by Private Sector & Development on the basis of the World Bank, Africa Development Indicators, 2010

Average return on equity by region



Note: These figures measure the average return on equity of commercial banks in the aforementioned regions
Source: Figures are based on calculation made by Private Sector & Development on the basis of Bankscope, data as of 31.12.10

Renewing the rules for an efficient financial system

Africa's financial systems have developed and stabilised – a process driven, among other factors, by the emergence of local banks and their capacity for innovation. Although banks are becoming more regional and regional integration is increasing, real weaknesses remain: the problem of attaining critical mass or weak governance. To address these issues it is vital to encourage competition and improve regulation in the sector.

Thorsten Beck

Professor of Economics at Tilburg University and Chairman of th European Banking Center

In spite of the global financial crisis of 2007/2008 denting some of the progress African finance has made, there are clear signs of continuous financial deepening and broadening across Africa, with more financial services, especially credit, provided to more enterprises and households. New players and new products, often enabled by new technologies, have helped broaden access to financial services, especially savings and payment products. Across the continent, financial innovation has taken place. This includes mobile banking, access to basic payment services through mobile phones, including without having to have a bank account. Other innovations have been psychometric assessments as a viable low-cost, automated screening tool for identifying high-potential entrepreneurs, and agricultural insurance based on easily verifiable rainfall data. New players and ways of doing business have also emerged in the financial systems, such as micro-deposit taking institutions, and co-operation between formal and informal financial institutions. For the first time in several decades, there is an air of hope about Africa's financial systems.

THORSTEN BECK

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African regional banks, engines of progress

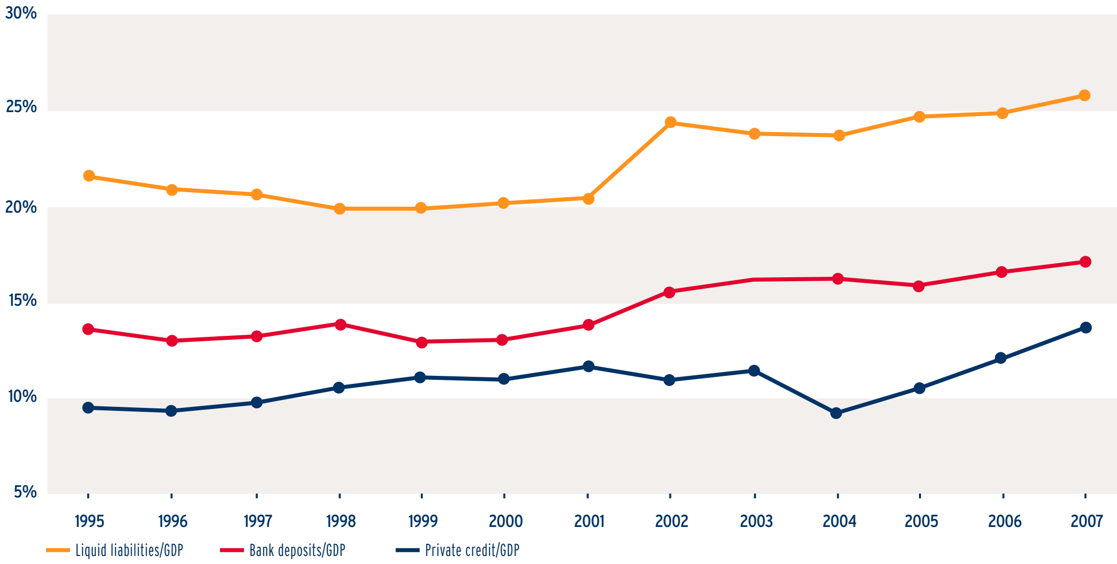
Recent changes in the structure of African banking, coupled with new opportunities offered by technology, contributed to financial deepening and broadening across Africa (Figure 1). Within a few decades, many African economies have gone from a post-colonial banking system, which was mostly state-owned, to a predominantly privately owned system. The privatisation process of the 1980s saw the return of many state-owned African banks to the private sector, often to the same European banks that had been proprietors previously. Over the past twenty years, however, a new trend has dominated African banking – the expansion of African banks across the continent. After the end of apartheid, several South African banks, most notably Absa and Standard Bank, started expanding across the continent. More recently, two West African banks – Bank of Africa and Ecobank – have started establishing subsidiaries across the region. Moroccan banks have also started to expand South, and both Nigerian and Kenyan banks have set up subsidiaries in their respective sub-regions and beyond (Box). This expansion has been driven by excess capital – such as in the case of Nigeria after the consolidation wave – but also by growth opportunities. While cross-border bank expansion is often a result of cross-border real sector expansion, financial integration through cross-border banking can also be a driver for real sector integration across borders. The result of these trends has been that by 2009 almost half of cross-border banks in Africa were either from within the region or other emerging countries. African banking has changed its face, with important repercussions for competition and innovation.

"There are clear signs of continuous financial deepening and broadening across Africa."

The recent entry of regional banks, however, has changed the narrative on the role of for-

[1] *The collection cost is USD 16 per ton and the disposal cost is USD 5 per ton.*

FIGURE 1: FINANCIAL DEEPENING IN SUB-SAHARAN AFRICA (1995 - 2007)



Source: Beck, T, Demirgüç-Kunt, A., Levine, R., 2009
Note: This graph shows the median of liquid liabilities to GDP, bank deposits to GDP, and private credit to GDP across sub-Saharan Africa for each year.

eign banks. Foreign bank ownership in Africa has been, for long, controversial. On the one hand, foreign bank participation seems to bring critical advantages to African financial systems. International banks can help foster governance; they can bring in much-needed technology that should translate into increased efficiency in financial intermediation; and they can help exploit scale economies in small host countries. Nonetheless, especially in Africa, with its many small enterprises, with a riskier and more opaque profile, the dark side of foreign bank entry can become obvious, even more so in countries in which foreign banks have captured almost 100% of the banking market. Specifically, the greater reliance of foreign banks on hard information about borrowers, as opposed to soft information, can have negative repercussions for these small enterprises, if foreign banks crowd out domestic banks.

Banks from neighbouring countries are more likely to bring with them specific knowledge about African private sectors and how to overcome challenges specific to the region. They are more likely to rely on leap-frogging technologies as standard channels of financial service provision, such as brick-and-mortar branch networks, as standard lending techniques are too costly for Africa. While innovation in the form of new products and services often comes from unexpected quarters, one can make the argument that African financial service providers are uniquely positioned to innovate, given their experience. Two examples suffice to illustrate this. In Uganda, the market-dominating state-owned Uganda Commercial Bank was privatised to the South African Standard Bank, with the condition of maintaining its branch network. Standard Bank not only maintained the branch network, but even opened new branches, introduced new products and increased agricultural lending. The recent expansion of Equity Bank from Kenya across the East Africa region has helped export the successful business model of going downmarket and reaching out to previously unbanked population segments.

"Finance in Africa still faces problems of scale and volatility."

The remaining fragility of banking systems

African financial systems have not only deepened over the past years, but have also come a long way in terms of financial stability. While in 1995 a third of all countries on the continent were suffering a systemic banking crisis, fragility has subsided across the continent. Today, most African banking systems are stable, well-capitalised and highly, if not over-liquid to a degree that undermines their ability to intermediate efficiently. However, finance in Africa still faces problems of scale ▶▶▶

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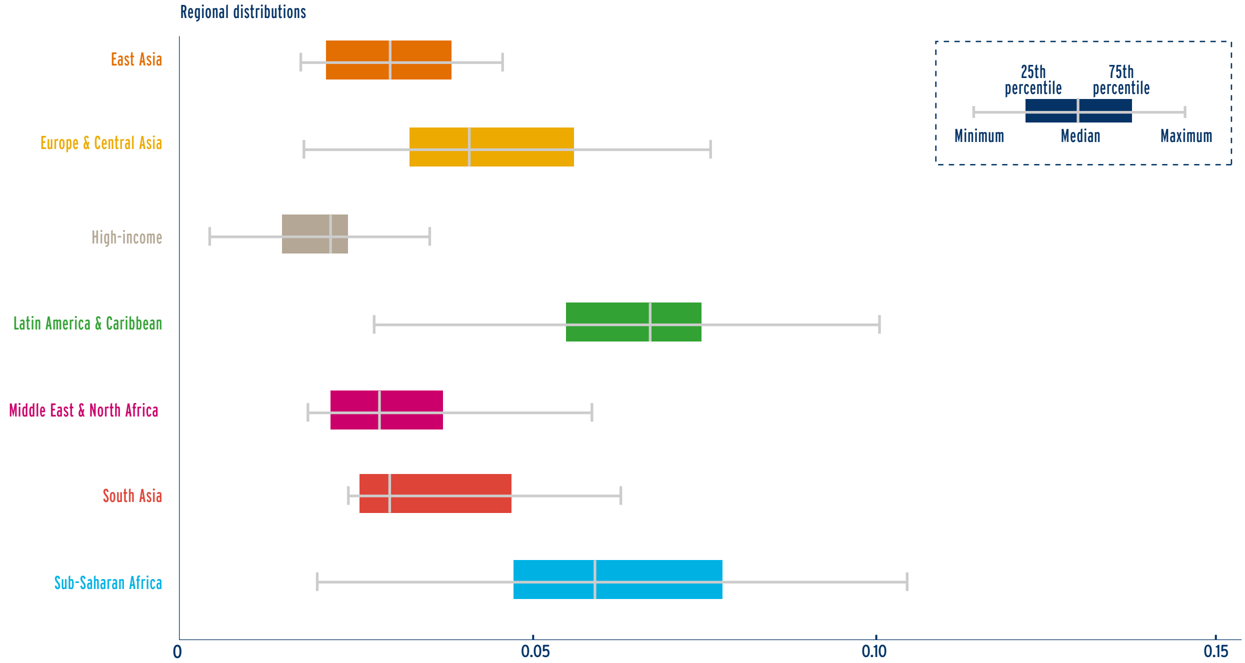
Tilburg University is a university of the Netherlands, providing high-quality education and research for more than eighty years. It has a student population of about 13,700 students. Enjoying the reputation as Europe's best in Business, Economics, and Law, it also specializes in Humanities, Theology and Social Sciences. A feature of the research carried out at Tilburg University is the innovative multi-disciplinary approach. There are more than twenty centers in which scientists from a wide range of fields work together.

New players and new banking models for Africa

FIGURE 2: NET INTEREST MARGINS ACROSS REGIONS



Source: Beck, T., Demirgüç-Kunt, A., Levine, R., 2009
Note: Sample size is 133 countries; data are for 2007. Net interest margins are calculated as net interest revenue divided by total earning assets.

▸▸▸ and volatility. There is still hidden or silent fragility in several countries, especially in Central and West Africa. Among the smaller financial systems, Togo has several banks with a high level of non-performing loans and insufficient capital-asset ratios, with effectively 50% of its banking system in distress, the result of governance deficiencies as well as political and economic turmoil over the past two decades. In Cote d'Ivoire, a large number of banks, mostly local or regional, were facing difficulties in 2008, mostly related to the accumulation of public sector arrears, lending to risky sectors, and governance problems, with the government taking control of three banks and recapitalising them.

"Competition is critical to achieving the financial interest innovation that Africa assets requires."

Among the several fundamental challenges that African banking systems still face, are the small size of host economies, which does not allow the reaping of scale economies; the high degree of informality, which increases the costs and risks for financial institutions and excludes large segments of the population from formal financial services; volatility on the individual and aggregate levels, which increases costs and undermines risk management; and governance problems that continue to plague many private and government institutions throughout the continent and undermine not only the market-based provision of financial services but also reform attempts and government interventions aimed at fixing market failures. These rather adverse circumstances explain why banking systems in Africa are still mostly concentrated and uncompetitive, why financial services are still very costly and interest spreads high, why banks focus mostly on government bonds and less on private sector lending, and why most of the lending is short-term (Figure 2). For most of the past 50 years, African finance has not supported real economic growth.

Renewing rules in the banking sector

To overcome those challenges, a completely African-dominated banking system does not appear as solution. Instead, it is an open and competitive financial system which is required. Banks with different ownership structures will continue to play an important role, be they domestic, regional or international. Competition is critical to achieving the financial innovation that Africa requires to deepen and broaden financial systems. Competition in this context is broadly defined and encompasses an array of policies and actions. In its broadest sense, it implies a financial system that is open to new types of financial service providers, even if they are non-financial corporations, such as cell phone companies. Within the banking system, competition implies low-entry barriers for new entrants, but also the necessary infrastructure to foster competition, such as credit registries that allow new entrants to draw on existing information. However, this might also mean more active government involvement by, for example, forcing banks to join a shared payment platform or contributing negative and positive information to credit registries.

Progress in expanding access and lengthening contracts – the ultimate objectives of financial development – also requires further regulatory and supervisory upgrades and a smart, rather than holistic, adoption of regulatory reforms in developed economies. A critical element in this upgrade refers to the regulation and supervision of cross-border banks. The relationship between home and host country supervisors, information exchange and allocation of responsibilities and obligations in times of fragility is critical, not only to prevent banking distress or reduce its impact but also to set incentives ex-ante to avoid aggressive risk-taking. Recent reforms of the international supervisory architecture following the global financial crisis have focused on the creation of colleges of supervisors for all internationally operating banks. The representation of African supervisors in these supervisory colleges remains a weak point given the current asymmetry in terms of the size of the operations of large international banks between developed markets and most African markets. For example, the activities of an international banking group in Africa may make up a very small part of its total balance sheet, but that bank may be of disproportionate systemic importance for certain African countries.

"Financial integration has to be accompanied by a proper regulatory."

Closer to home, the emergence of regional banks headquartered in African jurisdictions requires closer cooperation of banking supervisors across the region. African home supervisors need to champion regional college agreements and bilateral memorandums of understanding, to facilitate cooperation processes. The recent European experience, however, suggests that colleges of supervisors and memorandums of understanding are necessary but not sufficient tools for coordination in cases of idiosyncratic or systemic fragility. In the end, memorandums of understanding are legally non-binding documents, and even within a college of supervisors, it is the home country supervisor who takes the final decision. Planning for the worst-case scenario with resolution and recovery plans that include ex-ante burden sharing agreements is critical. Closer integration on the sub-regional level might even lead to the establishment of integrated bank supervisors, as already exist in West and Central Africa.

Recent changes in Africa's banking system reflect the new frontier spirit in African banking. Beyond statistics showing a deepening and broadening of financial systems, there are new products and providers across the continent, and new enterprises and households gaining access to financial services. Cross-border banking is an important part of this new scenario. Regional banks have brought innovation and competition to African financial systems. Going forward, however, there will be important challenges that require regulatory and supervisory responses. The European experience has taught us that there is no development without challenges and that cross-border financial integration has to be accompanied by a proper regulatory and especially resolution framework in order for there not to be failures and expensive bailouts. •

BOX: FINANCIAL INTEGRATION IN EAST AFRICA, A SUCCESS STORY

All five members of the East African Community (EAC) have seen financial deepening in the past years and rising levels of financial inclusion, though coming from very low levels. Especially Kenya has experienced how financial innovation in the form of new players (Equity Bank, M-Pesa), new products (cell phone-based banking), regulatory easing (agency banking) and an active dialogue among stakeholders can lead to deepening and broadening of the financial system to the benefit of the real economy. The Central Bank of Kenya (CBK) has played a significant role in this process, by allowing a non-financial sector player – Safaricom – to offer financial services, by looking beyond the brick-and-mortar branching model of financial service provision, and by encouraging competition. By adopting an open– try and see –regulatory mindset, rather than following the traditional path of legislation-regulation-innovation, CBK has enabled private-sector-driven financial innovation. More recently, Kenyan banks have started to expand throughout the sub-region, encouraged by an explicit commitment to financial integration and high capital levels. Financial integration across the five members of the EAC will provide additional opportunities for increasing competition and innovation, while overcoming the challenge of low scale, ultimately contributing to economic growth and poverty alleviation. It is critical, however, that the regulatory framework keeps up to date with a more vibrant and thriving financial sector. Especially, increasing financial integration will pose new challenges for central banks across the EAC to adapt the cross-border regulatory and resolution framework. Financial stability is a moving target and a sound regulatory framework is always a work-in-progress.

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The rise of local privately owned banks

Local banks in sub-Saharan Africa have real advantages over their foreign competitors. Their growth is leading to greater access to banking services and the emergence of leading companies. As demonstrated by the example of Nigeria, local banks' recapitalisation will be key to strengthening the banking sector and to them playing their part in the regionalisation and democratisation of banking activities in Africa.

Cyrille Nkontchou

Managing Partner, Enko Capital Management LPP

The past twenty years have seen sweeping changes in the African banking landscape. During the 1970s, state banks were established alongside the traditionally dominant large banks of the former colonial powers. These mostly failed, either through bankruptcy or liquidation as part of the structural adjustment programmes of the early 1980s.

In many countries, this collapse led to the emergence of the first privately owned African banks. Some of them, notably in East Africa, belonged to families already running businesses; their main role was to facilitate financial and banking operations for the companies within these family groups. Other banks arose from local private stakeholders' purchases of the shares held by foreign banks withdrawing from the African market. Some banking establishments were completely new, thanks to the greater flexibility granted by the central banks, which had initially been very reluctant to award new licenses to local private capital. This trend was further boosted by states keen for the African continent to have its own leading banks, in a competitive environment dominated by branches of European banks.

CYRILLE NKONTCHOU

Cyrille Nkontchou is the founder of both Enko and Liquid Africa, an African private investment bank, where he is now the executive chairman. He began his career in France, as a consultant with Andersen Consulting, before joining Merrill Lynch in London. He holds a degree in economics from the Paris Institut d'études politiques (Institute of Political Studies) and an MBA from Harvard Business School.

Increased penetration of local banks

Traditionally, local privately owned banks focused on local customers. With their limited geographical coverage and capital, and their narrow range of financial services, they were not very competitive compared with the foreign banks, which also tended to manage the relationships with their major industrial customers remotely from their home countries. The foreign banks began losing interest in their African customer base – both personal customers and small and medium enterprises (SMEs). The development of microfinance institutions went some way to meeting the needs of personal customers; despite the high interest rates they applied to credit facilities, they were the only ones offering financing to them. The privately owned local banks soon took over the microfinance sector. More broadly, in many countries they contributed greatly to opening up access to banking services. In Kenya, it took Equity Bank less than ten years to reach the top rung of the Kenyan banking ladder. It is followed by Barclays Bank and Standard Chartered, which has been established in the country for almost a century. In Cameroon, Afriland First Bank became the country's number one bank, both in terms of customer numbers and its depositor base.

"Traditionally, local privately owned banks focused on local customers."

The presence of more local privately owned banks has led to a significant increase in the number of bank branches and in the deepening of their networks. Consequently, it is easier to access banking services, and the traditionally very high minimum amounts required to open an account have been lowered. More recently, the rapid penetration

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Enko Capital founded in 2008, is an asset management company specialising in investment in Africa. Based in London, it manages funds, investing in listed companies as well as high-growth African companies looking to enter the stock market. Enko also advises both central banks and sovereign funds on their investment strategies.

of mobile telephony in Africa[1] has further improved access to banking services. Local mobile telephone operators as well as some start-ups providing mobile banking have been agents of change, making an effective contribution to the increase in banking penetration. For example, it has been estimated that in Kenya a third of the country's bank deposits are processed by the M-Pesa mobile telephone payment system.

Local privately owned banks have clear comparative advantages. The first advantage is a better knowledge of local banking habits. The success of Afriland First Bank, for example, is largely linked to its detailed knowledge of the tontines system, which forms a parallel banking network in Cameroon. The bank has developed specific products for making this system secure and supporting its deposits, through a conventional banking infrastructure. The second key advantage of local privately owned banks is their flexibility. Historically, foreign operators have tended to transpose the operating modes of their home countries, without always knowing how to adapt to the local situation (lack of infrastructure, prevalence of the informal sector, illiteracy). Local privately owned banks have often succeeded in coming up with innovative solutions, with low-cost agencies located in remote, densely populated areas and banking standards better suited to the situation on the ground.

"Many African groups (...) owe their success to the support of local privately owned banks."

Improved access to finance for local large businesses

Lack of access to banking services has in many cases been a serious obstacle to the development of locally owned industrial groups. Many of these groups have long mistrusted foreign banks, suspecting them of favouring companies from their home countries. The locally owned banking groups naturally focus on local business customers. Their credit risk assessment differs fundamentally from that of foreign banks, whose decision-making processes regarding credit generally require consultation with their head office. They take into account, among other factors, country-wide risk, which is an alien notion for a bank operating only locally. Many African groups that have become local or regional leaders owe their success to the support of their local privately owned banks.

Through internationalisation, local banking groups have sought to support and grow with their customers who have become regional players, as have the foreign banks. This internationalisation has allowed them to increase their credit limit to any counter-party within regional monetary zones, such as the Economic and Monetary Community of Central Africa (CEMAC) or the West African Economic and Monetary Union (WAEMU). This in turn has enabled them to use resources gathered in countries with excess deposits to grant credit in countries with asset needs that are in the same monetary zone. Last year, for example, the Ecobank group syndicated a loan of over USD 300 million to the OLAM group,[2] drawing on the resources of its sub-regional branches plus those of several local privately owned and multilateral development banks. This example illustrates the dynamic expansion of local banks and shows how far the banking sector has evolved in recent times. Previously, a transaction of this size could only have been handled by a foreign bank, supported by its parent company.

The need for recapitalisation in the banking sector

Currently, local privately owned banks are restricted by their low equity levels. Here, lessons can be learned from the recapitalisation of the banking sector in Nigeria, which is mainly dominated by local privately owned banks (Box). African banking groups' growth, as well as their ability to finance major infrastructure projects and leading local businesses requires increased levels of capitalisation. This strategy is well understood and underway in English-speaking countries (Nigeria, Ghana, Zambia), but has been slow to spread to the Francophone countries. This could hinder these banks' ability to tap into the opportunities afforded by vigorous economic growth in Africa. It also leaves the door open for the banking system in Francophone Africa to be dominated by the better capitalised banks from the Anglophone countries.

Recapitalising the banking sector also has indirect spinoffs, such as promoting the regionalisation of banking activities. For example, since the recapitalisation of the banking sector, the number of Nigerian banks in the CFA franc zone has risen slightly. In 2005, only the Ecobank group had a presence in Nigeria and in at least one CFA franc zone ▶▶▶

[1] *The penetration level for mobile telephony in sub-Saharan Africa (excluding South Africa) averages 33%. This is much higher than the average level of access to bank accounts, which in some regions, is still only 10%.*
[2] *Olam International is a leading global supply chain manager and processor of agricultural products and food ingredients. It operates in 65 countries, through 16 distribution hubs.*

country. From 2008, almost half of the 25 Nigerian banks had at least one branch in a country in the CFA franc zone. Faced with this Nigerian offensive, the local privately owned banks have also been forced to react by increasing their equity and gaining a foothold in neighbouring countries. Locally owned banking groups such as BGFI, Atlantic Bank Group, Financial Bank (now Orabank) and Afriland First Bank have opened branches in neighbouring countries. In East Africa, banking groups such as Kenya Commercial Bank and Equity Bank have opened branches in countries within the Community of East African States. At the same time, the large banking groups in North Africa and South Africa have revealed a growing determination to break into the sub-Saharan banking sector, encouraged by the withdrawal of some foreign banking groups (Attijariwafa Bank's takeover of the former Crédit Lyonnais' branches in Africa), acquisitions (BMCE group's increased stake in Bank of Africa, Attijariwafa's acquisition of CBAO in Senegal) and privatisations. South African banking groups have shown themselves to be cautious, preferring to consolidate their regional expansion within the Southern African Development Community (SADC) zone. Only Standard Bank took advantage of the recapitalisation of the banking sector in Nigeria to gain a foothold there.

"The democratisation of banking services remains both a major challenge and a tremendous prospect for local privately owned banks."

The future looks bright for the banking sector in Africa. With pan-African economic growth forecast to average over 5%, the banking sector should see double-digit growth fuelled by the emergence of a growing middle class.[3] But with levels of banking penetration still low, the democratisation of banking services remains both a major challenge and a tremendous prospect for local privately owned banks. For these banks, the real opportunity lies in providing personal banking services. This applies, for example, to mortgage loans, which comprise the main banking service in more advanced countries but are largely non-existent in Africa, apart from South Africa and North Africa. It is offering these types of services, solidly based on local privately owned banks' in-depth knowledge of the local situation that gives them an undeniable competitive advantage. Unfortunately, the development of these services, which are still vital for financing access to housing, is currently thwarted by the lack of long-term resources for the banks in sub-Saharan Africa, other than South Africa, as well as by banking regulations that are frequently inadequate. Despite the difficulties, the banks in some countries are gradually introducing these types of services into their markets (Kenya, and Ghana and Nigeria to some extent). Meanwhile, those in Francophone countries are lagging behind.

[3] According to McKinsey, the African middle class will number more than 200 million by 2020.

BOX: THE FORCED RECAPITALISATION OF NIGERIAN BANKS

In 2004, the Governor of the Nigerian Central Bank raised the minimum level of capital required to be an authorised bank, from USD 25 million to USD 250 million within one year, affecting more than 90 establishments. The objective was twofold: to get the sector in order and consolidate it, making it easier to monitor, and to expand the local banking sector's capacity to provide finance, the lack of which was hampering the development of the Nigerian economy. Despite the excesses of the early years, this bold gamble contributed to the radical transformation of the Nigerian banking system. It stimulated competition, significantly increased the banking network's coverage and service provision, and helped local banks become international. Nigerian banks are now in a position to finance most large local infrastructure projects without resorting to outside help. They have also been behind the emergence of African industrial leaders such as the Dangote cement group.

A French bank's vision of the African banking sector's evolution

Far from adopting a wait-and-see approach, Société Générale is pursuing a growth strategy in Africa. While consolidating its offer for underbanked populations, it continues to build working relationships not just with big business but with SMEs too. The group intends to opt for controlled growth rather than frantically seeking to capture market share, and argues for a revolution in regulatory standards and for tougher banking supervision – changes that are crucial for the stability of the African banking sector as a whole.

Jean-Louis Mattei

Former head of Société Générale's International Retail Banking, chairman of AFD Audit Committee[1]

With six operations in North Africa, eight in West Africa and three in Central Africa, the Société Générale Group is one of the biggest banking networks on the African continent. Starting from a core historical nucleus in Senegal, Cameroon, Côte d'Ivoire and Guinea, over the last decade, its network has expanded via acquisitions to include seven new locations in French-speaking Africa. The Group is a banking sector leader in numerous markets, holding market shares in excess of 20% in Cameroon, Côte d'Ivoire, Guinea, Equatorial Guinea, Madagascar, Senegal and Chad, for example. Despite the ongoing international crisis and the emergence of new players in the African market, the Société Générale Group continues to expand on the continent. With a total of 15,000 employees and a network of 1,000 branches, its African subsidiaries had 3.5 million customers at the end of 2012, including 1.2 million in sub-Saharan Africa. The group's African network continues to generate growing revenues and sustained profitability.

JEAN-LOUIS MATTEI

Jean-Louis Mattei, a graduate of the Institut d'études politiques de Paris (Paris Institute of Political Studies) and the Centre d'Études Supérieures de Banque (Centre for Advanced Banking Studies), joined Société Générale in 1973. He became the chief executive officer of Société Générale de Banques en Côte d'Ivoire in 1988. Ten years later he took charge of Société Générale's international retail banking operations, building the group's international network, while strengthening its traditional positions – especially in Africa.
In 2012 he became an advisor to the chairman and chief executive officer.

An ambitious African strategy

Although the 2008 financial crisis and the emergence of new international financial standards have limited European banks' African subsidiaries to a more selective and prudential investment strategy, Société Générale's commitment to Africa remains unchanged. Far from adopting a wait-and-see approach, the group is pursuing an ambitious, dynamic, long-term growth strategy on the continent, with the goal of consolidating its market share and remaining alert to growth opportunities. This is because Africa - in addition to being a traditional field of operations for the group - remains a profitable market that fulfils its selection criteria for expansion. Despite economic and political conditions that are at times unsteady, growth on the continent has been sustained over several years. There is no doubt at all that this zone offers numerous advantages, connected with its dynamic population growth and the presence of significant natural resources. These three parameters - economic growth, an expanding population, and low banking penetration rates - represent significant growth drivers for the group. Political stability, a healthy business environment, and security for people and property will ▶▶▶

"Société Générale's commitment to Africa remains unchanged."

[1] *This article is a personal contribution by the author – the views expressed in it are not necessarily those of Société Générale or its directors.*

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Based on a diversified universal banking model, Société Générale is one of the leading European financial services groups, with more than 154,000 employees, based in 76 countries, and serving 32 million clients throughout the world. Société Générale's teams offer advice and services to individual, corporate and institutional customers. The group has a long-standing presence in Africa, where its subsidiaries operate a network of more than 1,000 branches.

FIGURE 1: SOCIÉTÉ GÉNÉRALE'S PRESENCE IN AFRICA

1 **MAURITANIA**
Société Générale Mauritanie
Customers: 27,300

2 **SENEGAL**
SGBS
Customers: 158,000
No. 1 bank in Senegal for total loans (end 2011)

3 **GUINEA**
SGBG
Customers: 74,000

4 **CÔTE D'IVOIRE**
SGBCI
Customers: 250,000
No. 1 bank in Cote d'Ivoire for total assets (end 2011)

5 **GHANA**
SG-SSB
Customers: 243,000

6 **BURKINA FASO**
Société Générale Burkina Faso
Customers: 39,000

7 **BENIN**
Société Générale Benin
Customers: 22,000

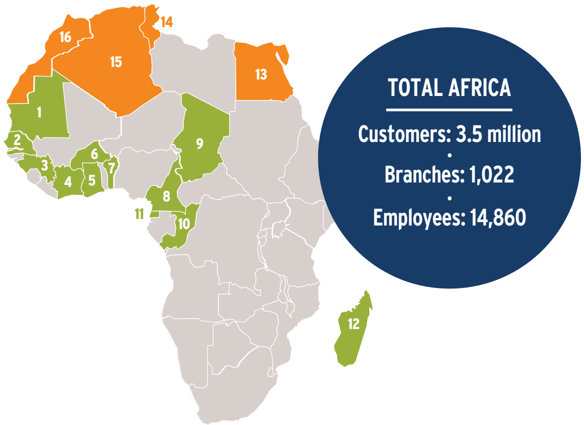
8 **CAMEROON**
SGBC
Customers: 147,000
No. 1 bank in Cameroon for total loans (end 2011)
Bank of the year (EMEA Finance, 2012)

9 **CHAD**
Société Générale Tchad
Customers: 38,000

10 **CONGO**
Société Générale Congo
Customers: 165

11 **EQUATORIAL GUINEA**
SGBGE
Customers: 28,000

12 **MADAGASCAR**
BFV-SG
Customers: 165,000



13 **EGYPT**
NSGB
Customers: 728,000

14 **TUNISIA**
UIB
Customers: 605,000

15 **ALGERIA**
Société Générale Algérie
Customers: 322,000

16 **MOROCCO**
Société Générale Maroc
Customers: 725,000
Established in this market for more than 100 years
No. 3 private bank in Morocco
Bank of the year in Morocco
(Euromoney Awards for Excellence, 2012)

Source: Société Générale, 2012

▶▶▶ be the key criteria in selecting future areas for geographic expansion. The group's goal, therefore, is to continue its selective expansion in the region.

In order to consolidate its leadership in the market, and in a climate of increased competition, Société Générale is strengthening its presence in markets where it already has an operational base, implementing an ambitious expansion plan for its branch networks and its customer base, with the goal of having 1.7 million personal customers in sub-Saharan Africa by 2015. In Côte d'Ivoire and Senegal, the bank is already opening new branches at a rate of 10 to 15 per year. In other markets its expansion is proceeding at a rate of two to three new branches per year.

A universal banking model

Société Générale's African strategy is based on consolidating its universal banking model. The group plans to expand across all customer segments - individuals, small businesses, and corporations - offering a wide range of products and making use of all available distribution channels. A key strategic challenge is to support the democratisation of banking services. The group is offering new, simple, low-cost solutions for serving the unbanked population - the majority of the sub-Saharan population, and a market that offers significant potential for growth in the region. New mobile and Internet banking products have been developed to meet their needs. A low-cost banking experiment is also due to be launched in Senegal, targeting potential customers in the gap between traditional banking networks and the microfinance market. This new bank will be based on a network of low-cost branches, featuring a limited range of low-cost products and services and the use of mobile phones - linking in with the new Yoban'tel mobile payment service launched in 2010.[2] Sharing the group's back office operations has helped to reduce costs and to improve reactivity in terms of products offered.

"Société Générale's ambition is to grow in Africa from a sound, solid, sustainable base."

With respect to business clients, Société Générale works with most of the major corporations operating in the countries where it is present, as well as being highly involved in the small and medium-sized enterprises (SMEs) sector. These segments play a vital role in delivering balanced economic growth. Most of the group's subsidiaries have adapted their commercial and loan approval systems to meet these companies' needs and to assess the risk levels involved more effectively.

Prudent risk management

Société Générale's ambition is to grow in Africa from a sound, solid, sustainable base, maintaining the quality of its assets at all costs. Its African subsidiaries have surplus liquidity, capitalisation levels substantially higher than the regulatory requirements - and compliant with the Basel II and Basel III Accords (Box) too – and very low risk-related costs, due to the excellent quality of their assets. When investment opportunities are scarce, these subsidiaries prefer to conserve their excess liquidity rather than frantically seeking to capture market share. The group intends to encourage controlled growth and prudent risk management.

Some more recent entrants into the banking

[2] *Société Générale's new mobile phone payment service is designed as a universal payment method open to the largest possible number of people, in particular those who do not use traditional banking services.*

market seem less inclined to update their prudential arrangements and their investment strategies in order to meet Basel II and Basel III standards. Not all of these players are scrupulously supervised by the regulators in their national markets. Their strategy of capturing market share, combined with a lack of supervision and sanctions when they do not comply with prudential guidelines, could lead them to take excessive risks, and their strong growth could entail a systemic risk for the entire sector. This is not to question the value of the competition these players represent - which has helped to improve the banking sector's efficiency - but rather to plead for a level playing field, and for rules observed by all.

The conditions for healthy and sustainable growth in the sector

The banking sector in Africa is undoubtedly attractive, and yet it needs to undergo substantial changes in order to offer its players the necessary preconditions for healthy growth. African banking groups can only emerge if there is a genuine revolution in regulatory standards and a move towards tougher bank supervision. Above all, everyone needs to be playing by the same rules, avoiding aggressive growth strategies that might endanger the sustainability of the entire system. Central banks must play their role fully, keeping the sector on a sound footing, particularly by raising regulatory capital requirements and tightening the regulation of the credit supply. At stake is nothing less than the stability of the African banking sector as a whole.

Although central banks are adequately structured, their effectiveness is impaired at times by dysfunctional state apparatus (police, justice system, government, customs, etc.); sometimes the rules are not applied as strictly as they should be. And so strengthening the banking sector will inevitably also involve upgrading governmental systems in the various countries of the region.

Moreover, in many countries, problems of governance obstruct the creation of a healthy, attractive environment for doing business. Political stability and security for people and property are far from being the norm everywhere. Only political stability, an untroubled business environment, and effectively functioning state apparatus that guarantee the security of people and property will remove these impediments and encourage the emergence of investment projects the African economy needs in order to thrive. A bank can certainly promote a country to developers and investors, but it cannot create investment projects, or create a context favourable to their existence. Governments have a vital role to play here.

Through its role as a leader in some African countries, Société Générale has undoubtedly played a structuring role in its banking sectors. Its presence helps to maintain and disseminate good practice, raising ethical standards in the sector. Africa needs to attract responsible investors, with a long-term vision and strategy. Succeeding in the banking sector in Africa is largely dependent on a good knowledge of the local market. Yet it is also necessary to show patience in terms of the results expected - and to appreciate the true value of the continent's potential and dynamism. Société Générale's strategy in this region is a long-term one. In all the countries where it is present, the group is looking to play a significant role in developing the local economy. As a responsible player and a patient investor, the Société Générale Group's mission will stay in sub-Saharan Africa and will continue to write the next chapters in its African history. •

"Africa needs to attract responsible investors, with a long-term vision and strategy."

BOX : FROM BASEL II TO BASEL III

The Basel Committee on Banking Supervision was founded in 1974 by the governors of central banks and banking regulatory/supervisory bodies from the leading industrialised nations. It is housed in the Bank for International Settlements in Basel. The committee publishes recommendations on regulatory capitalisation requirements, and sets standards for the management and supervision of banks' liquidity, to improve risk management, to increase transparency and to promote cross-border cooperation. Its recommendations led to the adoption of the Second Basel Accord (Basel II) by the European authorities.

In response to the financial crisis, an international process of financial regulation was instigated in 2010, as part of which the Basel Committee produced its Third Accord, or Basel III.
The measures adopted aim to strengthen prudential supervision, while preserving a financial system and a banking industry capable of supporting a robust, sustainable recovery.

Lessons learned from this issue

BY JULIEN LEFILLEUR *EDITOR IN CHIEF*

The African banking sector has been one of the most dynamic in the world during the past decade. It has posted record growth rates while at the same time undergoing radical restructuring and stabilisation – in contrast with the situation that led to the recurrent systemic crises of the early 1990s. In a less visible but equally material pattern, the sector's players have changed too. While the banking landscape was once dominated by foreign institutions, the local operators who appeared on the scene in the 1980s have made rapid advances and have now moved centre stage. These local banks, which fuelled their growth by developing customer segments disregarded by the foreign banks (small and medium entreprises (SMEs) and retail banking in particular), have now reached the critical size that allows them to compete with the international banks in their markets, especially in the large corporates segment. Local banks have thus rapidly grown their market share and they have been the main drivers of the continent's banking sector growth over the past decade.

This is a natural evolution since, in order to survive, local banks have no other option than to grow in local markets, which are their sole potential growth drivers. Apart from the need to develop economies of scale in order to be competitive, they have to attain critical mass so that they can diversify their risks, both sectorally – by reducing concentration in their portfolios –, and geographically – by opening subsidiaries outside their country of origin. For international banks, the situation is different, as growth in local markets remains an option, rather than a necessity. Although these markets are very profitable, the foreign banks are more sensitive to the risks involved and to the quality of the business environment, the latter being increasingly at odds with their operating standards and the constraints imposed by regulators in their country of origin. Moreover, it is becoming difficult for them to grow in Africa, as they would need to move into more risky markets such as SMEs and retail markets, whereas the main growth driver for local banks is the more accessible corporate segment.

This reconfiguration of the various forces operating in the market is impacting banking activity in Africa. First and foremost, the rise of local banks has helped to increase banking penetration levels, a phenomenon clearly observed the last 10 years. Indeed, these institutions have a better understanding of the needs of local economic players, and a greater capacity for innovation, adapting their offer to penetrate new market segments. At the same time, the restraint exhibited by the international banks exposes the African banking sector to the risk of becoming isolated. Apart from the expertise and resources they bring, international banks remain vital for financing major investments and international trade transactions, and, more generally, for building a bridge between Africa and other continents.

The African banking sector should continue to offer significant potential. Banking penetration rates remain very low, profit levels are among the highest in the world and competition overall remains low. Prospects for growth are numerous: entire market segments have yet to be explored (mortgage finance, agricultural finance, electronic banking services, etc.); most major transactions are still too large for local banks (infrastructure, mining and oil, international trade, etc.); synergies with other market players are under-utilised (stock markets, private equity funds, guarantee funds, insurance, microfinance, etc.); and English-speaking and French-speaking Africa remain largely disconnected. So the capacity for growth is far from being exhausted. Nonetheless, in order to exploit this potential, the local banks will need more resources – and the international banks will need to have more confidence in Africa.

In our next issue

Does the private sector help improve healthcare systems in developing countries?

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