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Banking Sector Developments in Emerging Markets: A Review of Recent Developments in Africa

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Abstract
Key to the economic transformation of developing economies is the banking sector developments. The banking sector in Africa has witnessed a steady growth in its core functional areas over the recent decades. This growth has implications on access to finance and stability in the financial system. This study reviews banking sector performance, competition, access to finance and stability in the context of sub-regional and comparator regional analysis with the view to informing and shaping policy directions. The North African economies recorded high levels of financial deepening than the rest of the regions. With the same economic conditions like South Asia, East Asia Pacific and Latin America and Caribbean regions, African's banking sector depth lags behind these regions. Access to financial institutions is high in Southern African region than the rest of the sub-regions. Again, Africa records very low level of banking sector accessibility compared to its comparator regions. Moreover, the banking system in Africa is characterized by high costs, inefficiency and high margins. The banking system also exhibit high concentration and market power and relative stability than comparator regions. The North African economies exhibit low presence of foreign banks than sub-regional groupings.
Keywords: Banking Sector, Efficiency, Performance, Stability, Financial Accessibility, Africa

1.0 Introduction

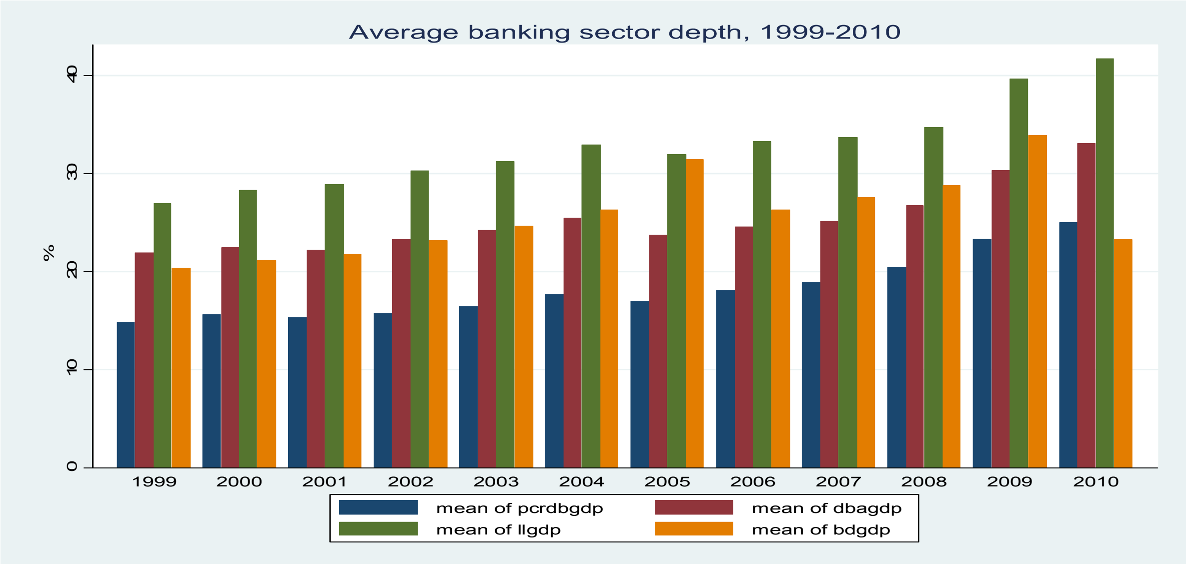
Economic growth in Africa has long been a preoccupation of policy makers. This stems from low level of financial development and its consequential effect on economic growth in Africa. Given the disappointing performance of Africa's economic output, the banking sector becomes the focus and hope of driving the economic growth on the continent. The banking sector in Africa is made up of central banks, deposit taking institutions which include state-owned banks, private domestic banks and subsidiaries of foreign banks. The influence of a banking sector development on economic growth cannot be underestimated, especially, in developing economies where governments have embraced financial sector policies as a centrepiece in policy debates to positively impact growth and reduce poverty. Both theoretical and empirical have established an irrefutable evidence of a positive and robust link between the level of financial deepening and economic growth.
In Africa, like many developing economies, the financial system and the banking sector in particular have witnessed governments' involvement between the 1960s and 1970s where there was high level of state-dominance and ownership of financial institutions. The 1980s and 1990s witnessed financial sector reforms in the form of liberalization and privatization of non-performing state-owned banks. Despite many reforms in the financial sector, Africa's economic and financial developments have been described as a tragedy by some economists (Easterly and Levine, 1997). Recent evidence and data point to an increasing developments in terms of proliferation of foreign and Pan African banks, microfinance companies, insurance and mobile banking services. This paper, based on recent data, exposes new developments and landmark trends in the banking sector developments in Africa in a more comparative and descriptive form in international and regional context to stimulate policy actions from stakeholders. To that end, the rest of the paper is structured as follows: section 2 provides stylised facts on the developments in the banking sector on regional and international bases and sector 2 concludes the review and provides policy recommendations.

2. Stylized Facts about Banking Sector Development in Africa

2.1 Banking Sector Deepening

One of the essential attributes of banks in the financial system is how they allocate resources efficiently. Key indicators of efficient resources allocation and financial deepening (ratio of private credit to gross domestic product, banks assets to gross domestic product and the ratio of liquid liabilities to gross domestic product) show some considerable level of improvement in Africa over the period, 1999-2010. The ratio of liquid liabilities to gross domestic product (GDP) grows faster followed by asset to GDP ratio and finally private credit to GDP ratio. This promising trend may benefit financially dependent industries and small firms (especially large number of small and medium scale firms domiciled in informal sector) to access finance. The private credit to GDP ratio indicates that banks in economies with large banking sector relative to GDP might exploit scale economies and high productivity.

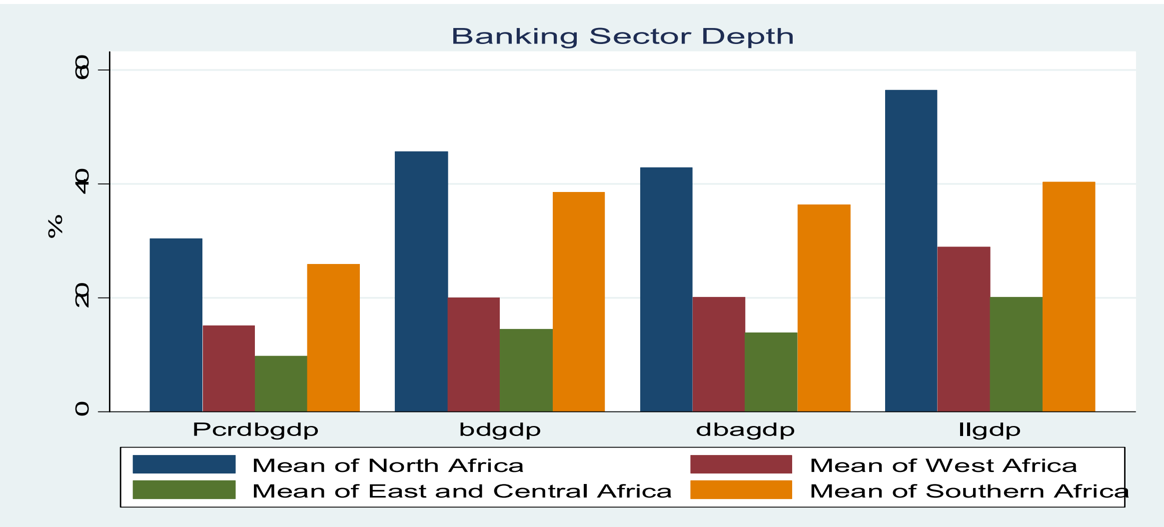
Figure 2.1 Average Banking Sector Depth in Africa, 1999-2010



Source: Source: Global Financial Development Database, WB, 2012 and author's calculations. Pcrdbgdp (private credit scaled by GDP), llgdp(ratio of liquid liabilities to GDP), dbagdp (domestic banks asset to GDP ratio), bdgdp (deposits to GDP ratio).

The growing banking sector performance varies across regional groupings as well (see figure 2.2). Figure 2.2 shows the rise in average financial depth ratios in all the regions: North Africa, West Africa, East and Central Africa and Southern Africa. The growth in financial depth was highest in the North Africa region followed by Southern Africa, West Africa and finally East and Central Africa. The improved performance in the North African region can be attributed to scale economies and high productivity enjoyed by banks in the region due to relatively large size of the banking sector. Notable countries that demonstrate improved performance in the North Africa are Morocco, Algeria, Tunisia, Egypt and Sudan. These countries in the North Africa are generally endowed with oil and agricultural resources and the region has maintained consistent and impressive economic gains over the past years (Allen, Otchere and Senbet, 2011).

Figure 2.2 Average Banking Sector Depth in Africa, 1999-2010 (Sub-Regional Analysis)



Source: Source: Global Financial Development Database, WB, 2012 and author's calculations.

In Algeria, the banking sector is largely controlled by six state-owned banks which controls largest market share (Allen et al. 2011). Although there are foreign and private banks, they account for minority of market share with the main focus on financing the private sector industries, small and medium scale firms and multination firms whereas the state-owned banks primarily focus on financing large state infrastructure. Similarly, the banking system in Egypt is dominated by state-owned banks which focus on providing funds for agriculture, long term finance for real estate and related developments (Allen et al., 2011). The state-owned banks together with three biggest private banks control about fifty percent of the banking market share in deposits and assets (HSBC Global Research, 2009)[1]. Consolidation efforts in the Egyptian banking sector by the Central of Egypt led to a reduction in the total number from 60 in 2005 to 39 2010[2].

In Tunisia, the banking sector dominates the financial system contributing about 115% of the GDP in 2011 (IMF FSAP, 2012)[3]. The state-owned banks that dominate the financial market share are Societe Tunisienne de Banque, Banque Nationale Agricole and Banque de I'Habitat, accounting for the about 37% of the banking assets (IMF FSAP, 2012). Both private domestic and foreign banks equally compete for the remaining share of total banking assets (IMF FSAP, 2012). In Libya, one of the oil-rich economies in the region, state owned banks (Jamahiriya Bank, Wahda Bank, Sahara Bank, Umma Bank and the National Commercial Bank) dominated the banking system in terms of market share in assets (Allen et al., 2011).

Unlike the other North African countries, the Moroccan's banking sector is dominated by privately owned banks which account for about 50.6% of assets, 66% of branches, 60.3% of deposits and 51% of loans, majority foreign owned banks controlled 21.1% of assets, 21.2% of deposits, 23.3% of loans and 16.7% of branches. Majority state-owned banks also controlled 17.3 % of branches, 28.3% of assets, 25.7% of loans and 18.5% of deposits as at 2010 (BAM annual financial report, 2010)[4].

The East and Central Africa's banking sector seems to lag behind in terms of financial depth. All the countries in this region established their independent central bank except economies the Banque des Etats del'Afrique Centrale (BEAC), namely Central Africa Republic, Congo, Cameroon, Chad, Gabon and Equatorial Guinea (Allen et al., 2011). Similar to North Africa, this region is endowed with natural resources, particularly agriculture and oil.

Also, most of the banks in this region are either foreign or locally owned or a mix of the two, with exception of Ethiopia and Eritrea that maintain their full local ownership of banks. Notable country in this region is Kenya, whose economy has the largest and the most diversified financial institutions. Domestic privately owned commercial banks dominate the financial system with state-owned banks forming the minority. The banking sector in Kenya has maintained consistent and impressive performance in its financial depth and development. In Tanzania, the banking sector is controlled by nearly 50% of the foreign-owned banks while state control is largely limited to the minority banks whereas the banking system in Uganda equally indicates foreign-owned banks' dominance (Allen et al., 2011).

With regards to the Southern African economies, the highest performing banking sector is the Republic of South Africa which contains the highest and largest number of banks in the region followed by Botswana and Namibia. The largest local banks in the banking sector in South Africa are Standard Bank, Absa, First National Bank and Nedbank. The banking sector has shown strong resilience and improved performance in private credit to GDP ratio over the years.

Except for the North African economies, the banking sector performance in the Southern African economies is on the average, relatively better than West, East and Central African economies. However, compared to the East and Central African region, the West African banking sector equally exhibits better performance in financial depth. This region covers English and French speaking countries. The French speaking economies are dominated by 90 credit institutions, 70 banks with Cote d'Ivoire and Senegal being the major drivers of the banking sector development (Allen et al., 2011) with a formation of common central bank, known as Central Bank of West African States (BCEAO). The structure of the banking system in the region is shared between foreign and domestic owners but foreign owned banks seem to have dominated the banking landscape.

Like the French speaking countries, the English speaking countries in West Africa form the economic block known as the Economic Community of West African States (ECOWAS) but without a common central bank like the French speaking countries. Three economies seem to have dominated the banking system in the English speaking West Africa region, namely Nigeria, Ghana and Sierra Leone. Similar to the French speaking countries, the banking sector in the English speaking countries are controlled by foreign owned banks (except Nigeria) reducing the state and private domestic banks' market share. Following North and Southern Africa, West African's banking sector private credit to GDP ratio experienced significant growth in liquid liabilities to GDP as well as growth in deposit money banks assets to GDP ratio. Despite a significant and dramatic growth in the banking sector depth in Africa, the continent still lags behind compared to comparator regions of similar socio-economic conditions as shown in figure 2.3.

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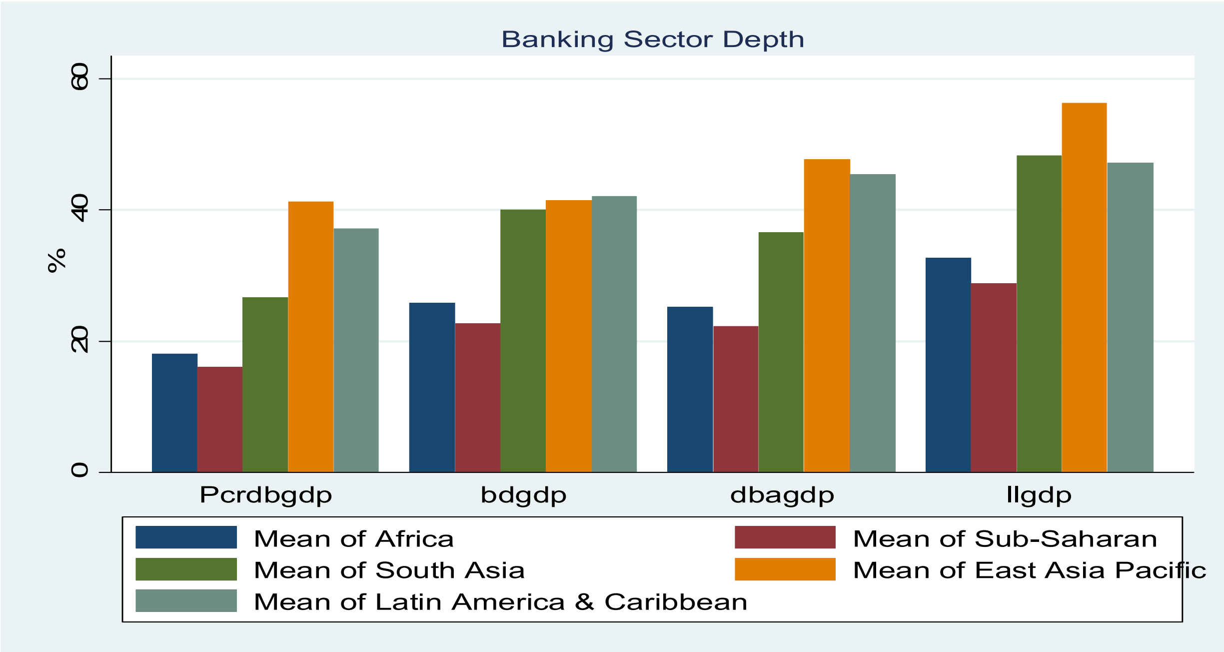
[1] HSBC, 2009,GlobalResearch, March.
[2] Central Bank of Egypt
[3] (IMF, Financial System Stability Assessment, 2012)
[4] Central Bank of Morocco, Annual Report, 2010

Figure 2.3 Average Banking Sector Depth: Africa & Comparator Regions, 1999-2010



Source: Global Financial Development Database, WB, 2012 and author's calculations.

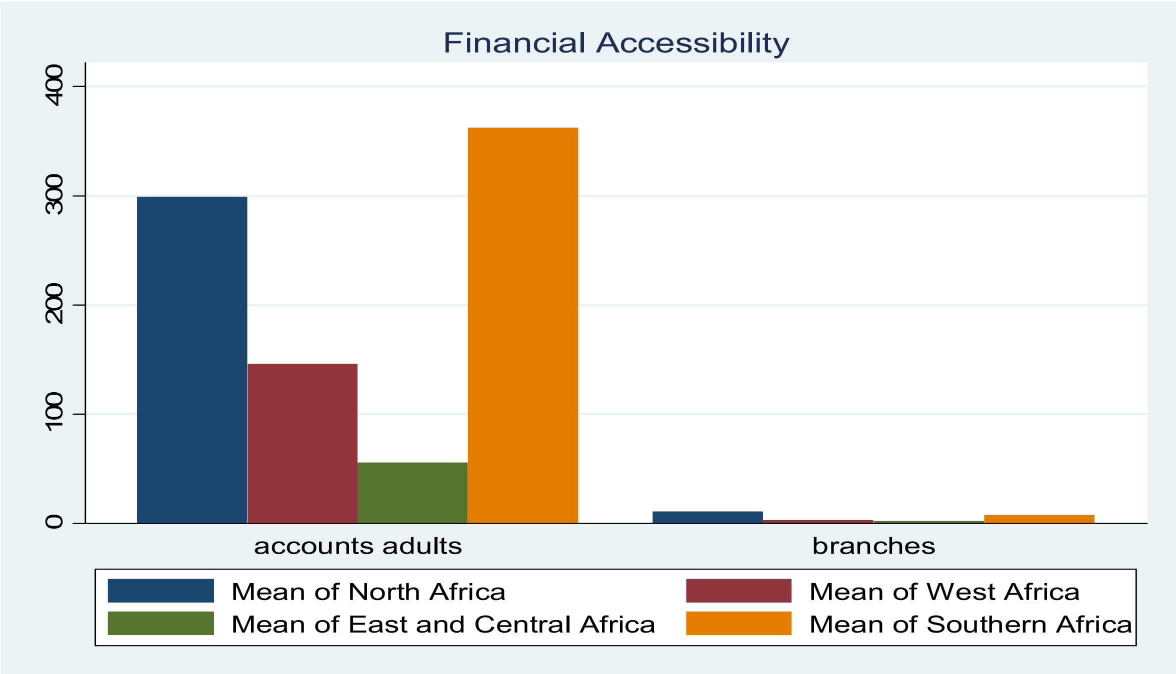
2.2 Banks and Financial Services Accessibility

Accessibility to financial institutions and markets by savers and borrowers is important for enhancing competition and economic growth. After decades of experimenting waves of financial sector reforms and more recently the quest to meet the Millennium Development Goals of halving poverty by 2015, the significance of financial inclusion for African governments cannot be overemphasized. Indeed, empirical evidence demonstrate unequivocally that access to financial services enhances economic growth, promotes healthy competition and ensures equality of income distribution to the poor (Beck, Demirgüç-Kunt, and Levine 2007; Beck, Levine and Levkov, 2010).

Recently two standard measures about access to finance in Africa have been estimated with the help of Gallup Survey data. The two standard measures of financial inclusion are: *accounts adults*, which measures the number of commercial banks' account per 1000 adults and *branches,* number of commercial banks' branches per 100,000 adults. The mean *accounts adults* and *branches* in the financial system in Africa show some level of variations in the financial accessibility. In terms of *accounts adults,* Southern Africa economies show more accessible banking sector followed by North Africa and West Africa with East and Central Africa being the least in that order (see figure 2.4).

The low level of financial accessibility in the region reflects high cost of banking for customers. For instance, in the Central Africa region, bank account holders are less than one percent of the total population (IMF, 2009). The limitedness of access to financial services was also attributed to weak legal and judicial system that would enforce contractual obligations and weak macroeconomic environment following decades of political instability. Beck, Demirgüc-Kunt and Martinez Peria (2008) show that about 54% of the total population in Cameroon, 94% in Malawi, 93% in Uganda and 81% in Kenya cannot afford the fees demanded by banks for maintaining checking account given their level of their annual income. Additionally, huge stock of documents (passport, local address, utility bills, pay slips and recommendation letters) expected from prospective account holding customers also hinder effective access to financial services in the region (Beck et al., 2008). Beck et al. (2008) further noted that in Uganda and Cameroon not less than three documents are required for opening an account while customers in Uganda can apply for loans only at a bank's headquarters and branches not through mobile phones or internet.

Figure 2.4 Mean Financial Accessibility Indicators, 1999-2010

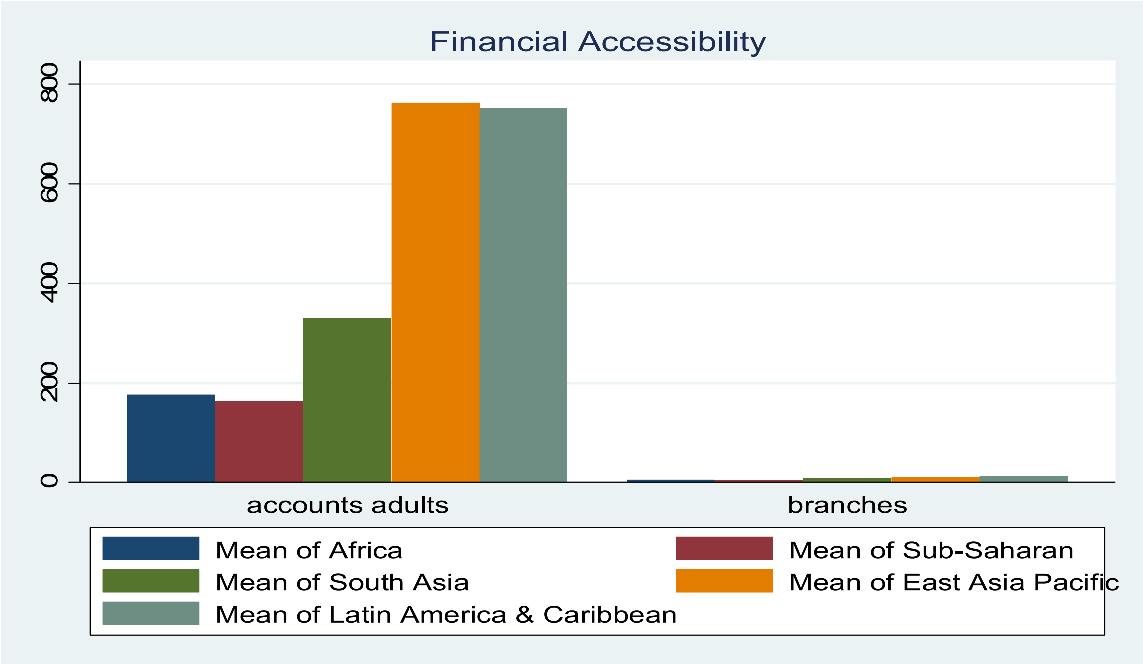


Source: Global Financial Development Database, WB, 2012 and author's calculations.

With respect to the Southern African's financial system, *accounts adults* –majority of the adults possess commercial bank accounts than the rest of the regions. This shows more accessibility to commercial banks. Demirgüç-Kunt and Klapper (2012) indicate that whereas only 11% of adults in Central Africa possess commercial bank accounts, 51% in Southern Africa do while more than 95% in the economies of the Democratic Republic of Congo and Central African Republic are 'unbanked'. They further noted that, though less than Southern Africa but higher than East and Central Africa region, more (20%) adults have an account at commercial banks with 10% and 39% in Morocco and Egypt respectively. One possible factor that could explain this variation is the low level of income (in addition to documentation, cost and proximity of financial firms). According to Demirgüç-Kunt and Klapper (2012), this has been the most often touted reason for the inability to possess bank account in both North Africa and Sub-Saharan Africa. In terms of proximity or access point, *branches,* Southern Africa remains marginally below North Africa but higher than both West Africa and East and Central Africa. Improvement in telecommunication, less restrictions on branch banking and geographical expansion could further enhance access to banking facilities and expand the frontiers of financial accessibility.

In terms of international comparison, financial inclusion in Africa is below comparator regions (South Asia, Latin America and Caribbean and East Asia Pacific) (see figure 2.5). Rather than variations in national income (GDP per capita), Demirgüç-Kunt and Klapper (2012) observed that absolute household income accounts for the variations in financial inclusiveness. They find that, whereas about 27% of households who live on less than $2 a day in South Asia and East Asia and Pacific have an account with formal financial institution, only 6% of households who live in Middle East and North Africa have an account. Other possible reasons ascribed to this low level of accessibility to financial institutions are the financial institution's proximity, lack of the necessary documentation, lack of trust in banks, and religious reasons, gender, cost of documentation and low level of income (Demirgüç-Kunt and Klapper, 2012).

Figure 2.5 Mean Financial Accessibility Indicators: Africa & Comparator Regions, 1999-2010



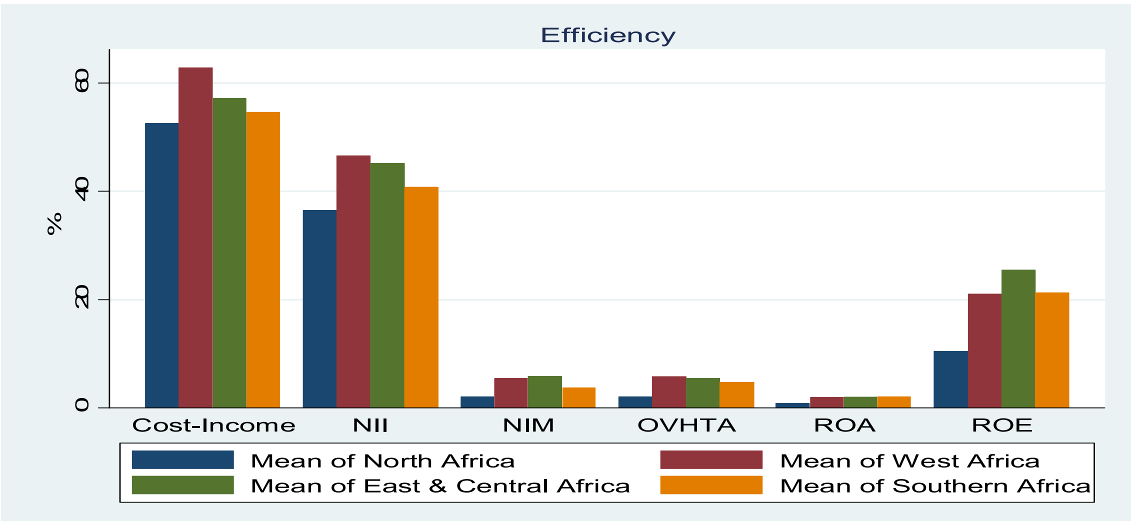
Source: Global Financial Development Database, WB, 2012 and author's calculations.

2.3 Banking Sector Efficiency

Another key attribute of a financial system is its ability to allocate resources efficiently at affordable cost. Thus, an efficient banking sector is expected to function in a least-cost manner so as not to transfer high cost unto economic agents. Financial institutions' efficiency levels are usually measured using such indicated as *overhead costs to total assets(OVHTA)*, *net interest margin(NIM)*, *spread (lending-deposits), non-interest income to total income(NII), cost to income ratio(cost-income), return on assets (ROA) and return on equity (ROE)*.

On one hand, efficiency and profitability could be correlated while on the other hand, it is also possible inefficient financial institution could post high profitability. Figure 2.6 shows that banking sector inefficiency (in particular cost-income and overhead costs divided by total assets and non-interest income) is highest within banking sectors in West Africa economies, but lowest with respect to return on assets. In an environment of weak institutional qualities, less competition and contractual obligations, banks would not efficiently allocate resources and this might further explain the high non-interest and net interest income being earned by banks in West Africa sub-region.

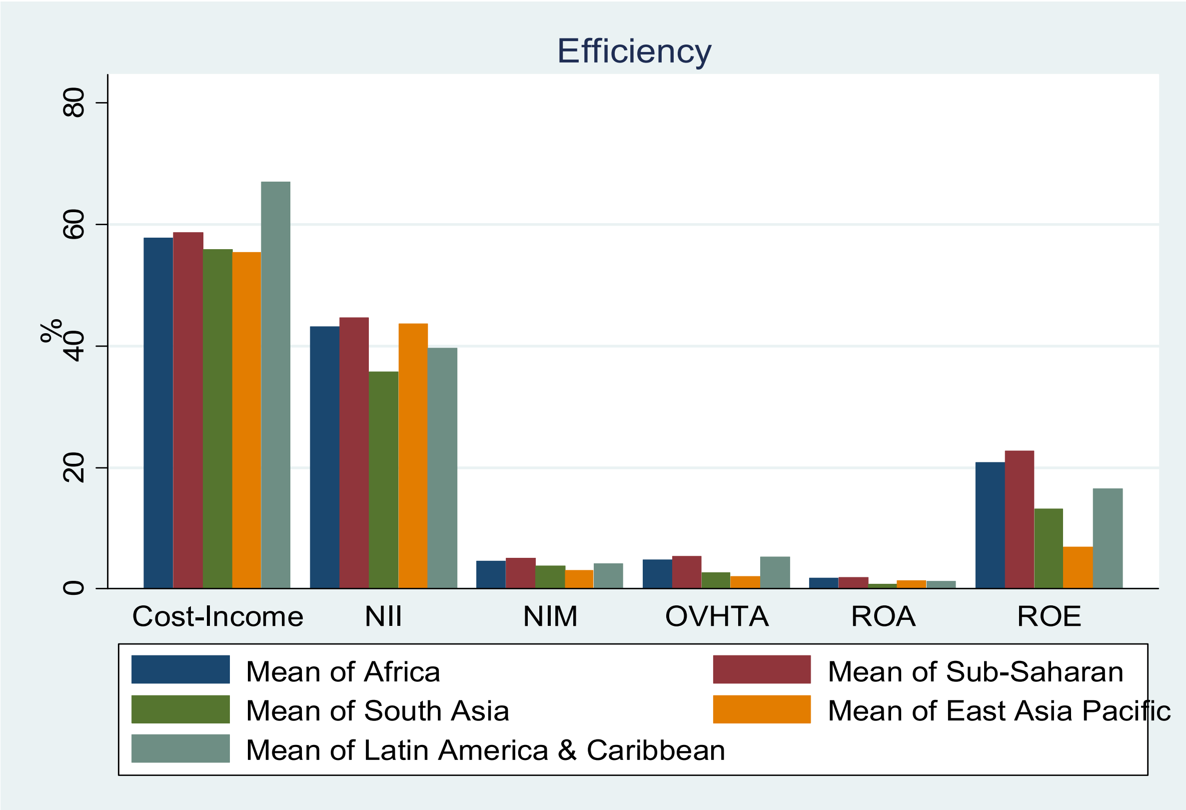
Figure 2.6 Mean Efficiency Indicators (Sub-regional 1999-2010)



Source: Global Financial Development Database, WB, 2012 and author's calculations.

In the light of international comparisons, banking sectors in Africa and Latin America and the Caribbean possess high average net interest margin with equally high average cost-income ratio (see figure 2.7). Beck, Maimbo, Faye and Triki (2011) noted that banks in Africa earn high margins due to the small size that limit scale economies and production as well as high risk of intermediation in the region. Thus, in spite of the high operating cost in the African banking sectors, banks are more profitable compared to the comparator regions.

Figure 2.7 Mean Efficiency Indicators (Regional 1999-2010)

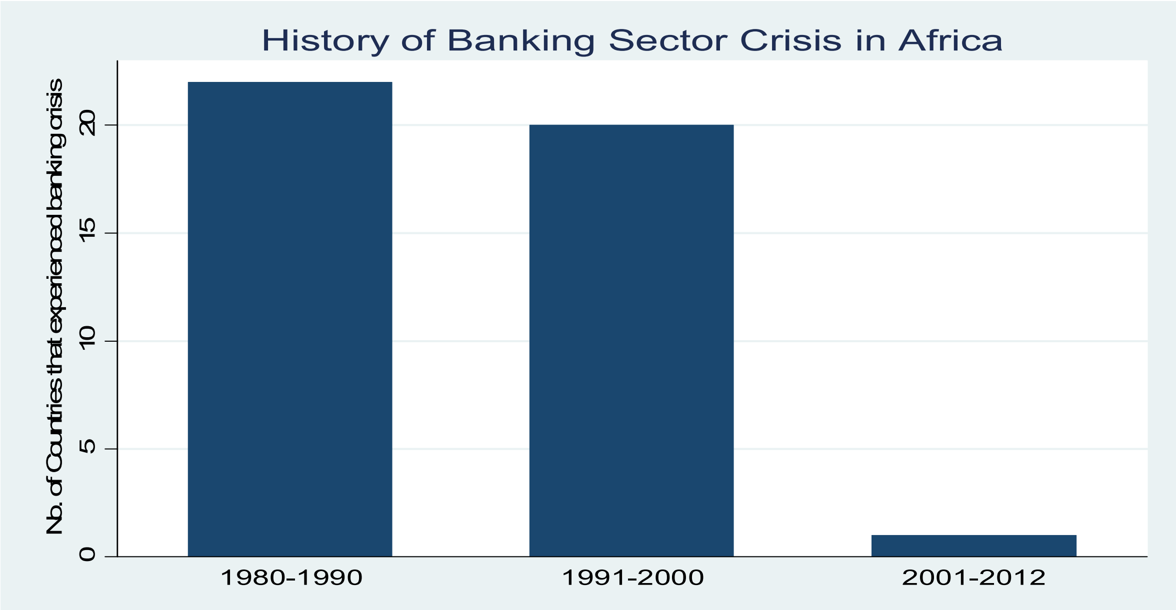


Source: Global Financial Development Database, WB, 2012 and author's calculations.

2.4 Banking Sector Soundness and Competitiveness

One of the most challenging issues facing financial market regulators in recent times is how to ensure overall financial system soundness while maintaining competitiveness of the system. Banking system instability affects efficient allocation of financial resources and consequently hinders economic growth. Also, financial system stability affects macroeconomic performance and hence financial deepening. In spite of being not adversely directly affected by the global financial crisis, banking system crisis is not new to African economies. A cursory observation of figure 2.8 shows that a number of banking systems in Africa suffered widespread crisis between 1980 and 1990. The period between1991-2000 witnessed a reduction of the banking crisis in a number of countries until 2009 when Nigeria was the only country that experienced a major banking sector crisis where the Central Bank of Nigeria (CBN) provided significant liquidity support and guarantees on bank liabilities.

Figure 2.8 Episode of Banking System Crisis in Africa

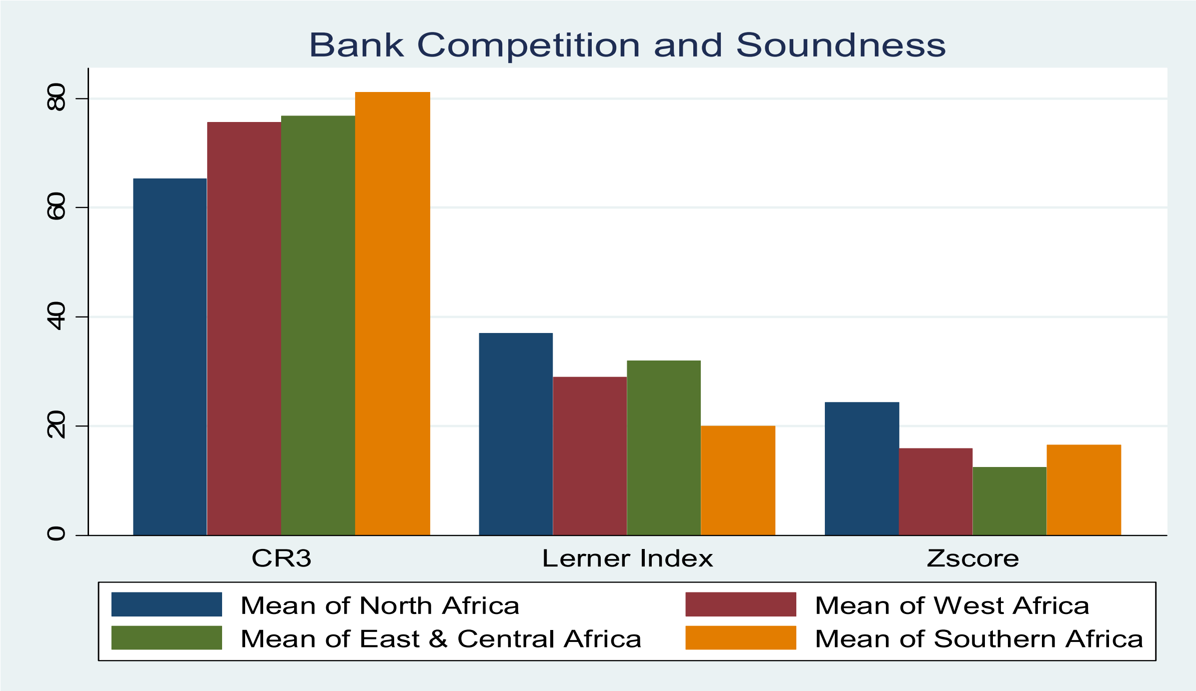


Source: Laeven and Valencia (2012) and author's computation

Although banking system crisis may vary in terms of its devastating impact and causative factors, the banking literature generally attributes high risk taking in banking to country specific factors, bank specific factors and governance problems. For instance, Honohan and Beck (2007) noted that the banking system crisis in African in the 20th century was mainly caused by governance problems at the bank level (bad banking practices) and at the regulatory level (weak regulatory and supervisory framework). Also, bad bank lending practices (loose standards) that enhance loan growth as a positive sign of financial deepening and profitability may likely affect bank stability when loans turn bad. However, the complex nature of modern banking does not permit assessment of banking sector soundness using one indicator; several indicators have been used in the literature.

One of the standard metrics used in assessing banking system stability is the Z-score, defined as the sum of bank capital to assets and return on assets, divided by the standard deviation of return on assets. Compared to other metrics of measuring banking sector soundness, the Z-score appears more robust and reliable since it compares a financial institution's buffers (capitalization and returns) against its risk (volatility of returns). In terms of competitiveness of financial system, two approaches have been used in the existing literature to assess the banking sector competitiveness: the three-bank asset concentration ratio (CR3)-measured as the sum square of the market share of assets of three largest banks to the total banking assets and the Lerner Index which examines the extent of market power (less competition) enjoyed by banks. High value of Lerner Index and CR3 show high market power while high value for Z-score indicates high stability and vice versa. Figure 2.9 shows stability and competitiveness of the banking system in Africa.

Figure 2.9 Mean Sub-regional Bank Competitiveness and Stability in Africa, 1999-2010

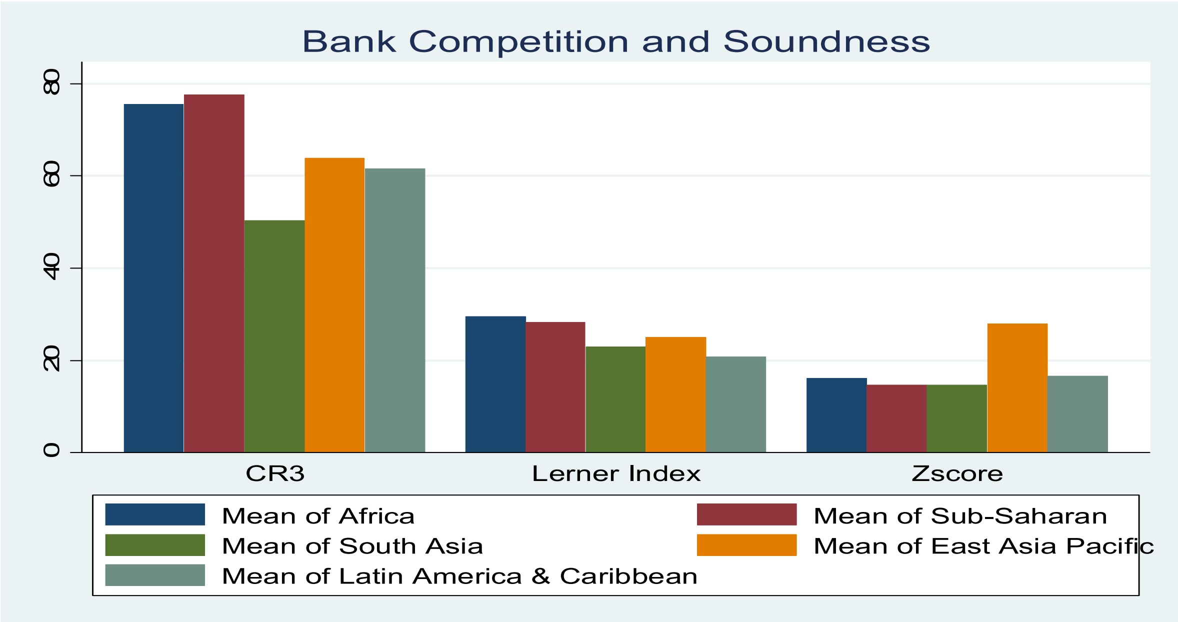


Source: Global Financial Development Database, WB, 2012 and author's calculations.

With respect to the banking sector concentration (CR3), Southern Africa banking sector posts the highest value followed by East and Central Africa with North Africa being the lowest. The market power measure however indicates that banks in North Africa exhibit the highest degree of market power while those in Southern Africa command the lowest degree of market power. Given that the Lerner Index is considered more superior in assessing banking sector competitiveness than CR3 (a crude measure of competition based on the structure conduct performance), it implies that the banking systems in Southern Africa appears more competitive than West, East and Central Africa and North African banking systems. In terms of banking system's soundness, East and Central African banking systems post high instability with North Africa being relatively more stable followed by Southern and West African banking systems. Thus, one stylised feature observed is that banks that exploit relatively high level of market power in North Africa appear more stable than their counterparts in the other regions.

In terms of regional comparative analysis (see figure 2.10), banking systems in Africa are more concentrated and exhibit high market power among banks than comparator regions. With respect to systemic stability, except East Asia Pacific and Latin American and Caribbean regions, the banking systems in Africa are more stable than that of South Asia banking systems.

Figure 2.10 Mean Regional Bank Competitiveness and Soundness, 1999-2010



Source: Global Financial Development Database, WB, 2012 and author's calculations.

2.5 Bank Ownership Distribution in Africa

The banking system in most of the African economies went through two levels of systemic changes: the pre-independent and post-independent changes. In the first level, the pre-independent stage, the banking system was dominated by large branches of colonial (foreign) banks whose major focus of operation was to serve the colonial and multinational businesses while local businesses were not attractive customers. The post independence stage, especially in the 1970s, was characterised by nationalization and emergence of state-owned banks and enterprises motivated by overly ambitious agenda of governments to accelerate the pace of economic transformation of their economies using the banking sector as the key.

However, following counts of unimpressive performance of state-owned banks, the financial system was liberalised and that permitted large influx of foreign-owned banks and restructuring and privatization of state-owned firms in the 1980s and 1990s. The domestic banking system was thereafter opened for international competition and entry of foreign banks, except for a few countries in Africa like Eritrea and Ethiopia (See table 2.1) where state-ownership of banks dominated the banking system. The influx of foreign banks in Africa and that of regional banks (Ecobank, Bank of Africa, Stanbic Bank and Access Bank) into the domestic banking system brought about essential banking benefits such as enhancing financial outreach, improving competition, fostering good governance as well as the introduction of modern technology and efficiency. Although the foreign bank entry in Africa provides positive spill-over effects on the domestic banking system, there are concerns that foreign entry is not sufficient to improve intermediation efficiency, competition, access to finance and stability in the financial system. For instance, the presence of weak contractual and institutional quality (lack of credit registries, weak creditor rights and weak legal system for contract enforcement) and state dominance in the banking system still represent huge hindrance to efficiency, competition and stability. Additionally, experience from Uganda, Tanzania and Mozambique (where national authorities had to renationalize previously privatized banks due to insufficient fund and lack of managerial expertise (Beck, Fuchs and Uy, 2009) demonstrates that in some cases foreign bank entry may not yield the much expected dividend to the national economy.

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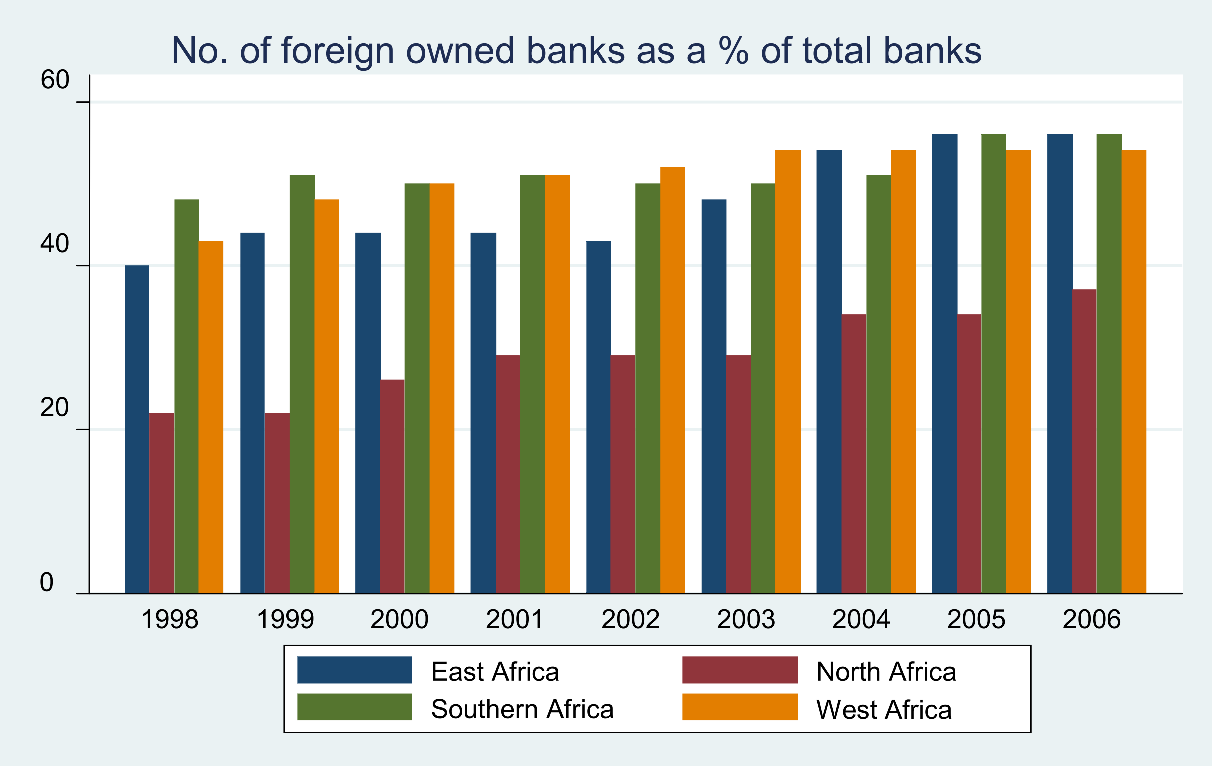
Table 2.1 Bank Ownership Structure Distribution in Africa

Mainly Government	Mainly Foreign	Mainly Domestic Private	Foreign and Government	Equally Shared
Algeria	Botswana	Benin	Angola	Burkina Faso
Eritrea	Cape Verde	Mali	Burundi	Congo, Dem. Rep of
Ethiopia	Central Africa Republic	Mauritania	Egypt	Sierra Leone
Togo	Chad	Mauritius	Gabon	
	Cote d'Ivoire	Morocco	Ghana	
	The Gambia	Nigeria	Kenya	
	Equitorial Guinea	Rwanda	Rwanda	
	Guinea Bissau	Somalia	Senegal	
	Guinea	South Africa	Tunisia	
	Lesotho	Sudan	Cameroon	
	Liberia	Zimbabwe	Congo, Rep	
	Madagascar			
	Malawi			
	Mozambique			
	Namibia			
	Niger			
	Seychelles			
	Swaziland			
	Tanzania			
	Uganda			
	Zambia			

Source: Beck et al., (2011). Financing Africa: Through the Crisis and Beyond. Note: Mainly government, mainly foreign, and mainly local private sector mean more than 60 percent of total assets are held by banks majority owned by government, majority owned by foreign shareholders, or majority owned by the local private sector, respectively; foreign plus government means these two categories together hold more than 70 percent. Equally shared is a residual category. (In Senegal foreign plus private local adds to more than 70 percent).

In terms of regional presence and distribution, foreign banks dominate West Africa, East Africa and Southern Africa more than North Africa countries (see figure 2.11)

Figure 2.11 Foreign Banks Presence in Africa



Source: Author's calculation with Data from Claessens and van Horen (2011): Foreign Banks: Trends, Impact and Financial Stability

3.0 Conclusion and Policy Recommendations

This paper summarises stylized facts about the banking sector performance and provides several policy options for banking sector regulators and policy analysts in developing economies. The banking sector in Africa has witnessed steady growth in its core functional areas of private credit to GDP ratio, liquid liability to GDP ratio; deposit money banks assets to GDP and bank deposit to GDP but lags behind similar economies like South Asia, East Asia Pacific and Latin America and Caribbean regions. Also, regions with better and improved institutional quality and contractual enforcement accounts for higher financial accessibility. Furthermore, compared to similar regions, banking systems in Africa report higher levels of overhead costs, high level of profitability, high net interest margin and non-interest income over total income ratio. In regards to the competitiveness of the banking system, Africa banking system is relatively less competitive (high concentration) and possesses market power but relatively stable banking system than comparator regions. Banking sector regulators must institute measures such as enhancing regulatory and supervisory capacity of the banking sector, improvement in the contractual environment by means of establishing and enforcing the legal frameworks and commercial court systems, improves upon protection of property rights, minimize economic and political instability. All these would enhance the institutional quality and regulatory framework needed to reduce high banking transaction costs, improve access to finance and promote competition while ensuring some level of stability in the banking sector.

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