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**Sector Report**

# Banking in Sub-Saharan Africa

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## Introduction

The banking sectors of a number of sub-Saharan Africa (SSA) countries have exhibited significant growth in recent years. The key contributing factors have been increased economic activity and improved regulatory oversight. However, the rapid rise of pan-African banks has also been a contributing factor. The growing presence of major pan-African and global banks on the continent has undoubtedly improved the availability and quality of financial services in recent years. That said, large banks from well-developed financial markets on the African continent have made the biggest impact. As a result, financial sectors across the SSA region stand to benefit from gains in efficiency, innovation and financial deepening. On the other hand, the rise of pan-African banks raises the possibility of financial sector contagion across borders. As such, banking sector oversight may need to be improved and the regulatory frameworks strengthened as financial markets become more integrated.

Despite strong banking sector growth, a large proportion of the African populace still does not make use of formal financial services. Banking penetration still remains as low as 36% in some of the larger economies. The fact that commercial banks' reach – in terms of branches and ATMs as a proportion of the population – remains well below global averages certainly does not prove helpful in this regard. That said, commercial bank branches and ATMs are costly and most efficient in areas with high population density and are thus not really suited to serve the large unbanked populations which are widely dispersed over large areas. To bridge this gap, banks have started to explore alternative operating models, including mobile banking, mobile branches and using third-party agents. This report intends to explore the above-mentioned topics in more detail.

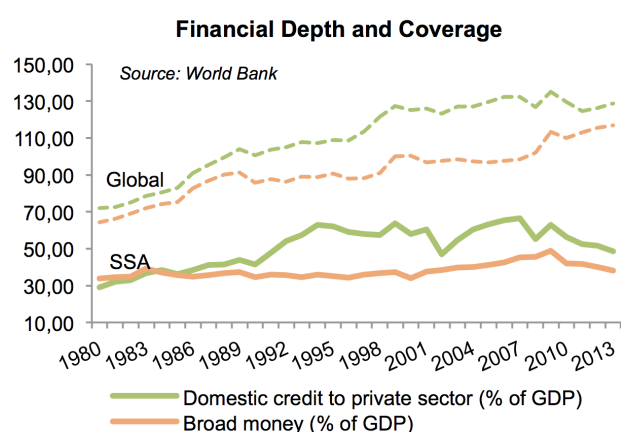


## Current State of Banking

Financial sectors across SSA are still largely underdeveloped – the financial sectors of South Africa and Mauritius represent the most notable exceptions in this regard – while banking industries continue to dominate the landscape in terms of total assets and services. Nonetheless, financial sector development has been on the agenda of African policymakers for some time. Various policy reforms over the past decade have contributed to an environment more conducive to financial sector development. Governments have made progress in introducing much needed legal/ regulatory frameworks, information systems and regulatory institutions.

As a result, the depth and coverage of financial systems, when measured by the ratios of broad money and private sector credit to GDP, have improved over the past three decades. That said, the levels of financial sector depth and coverage remain well below global averages. Even more concerning is the fact that the gap between SSA and the rest of the world seems to have widened in the last few years.

Furthermore, SSA's financial sector continues to be less developed even when compared to other emerging market regions. Findings from a benchmarking study commissioned by the World Bank during 2012 support this assessment. Examining various indicators in relation to financial system access, depth, efficiency and stability, the findings suggest that SSA performed weakest on average.



According to a report published in 2013, the International Monetary Fund (IMF) highlights that most banking systems across the SSA region remain relatively small when measured by the size of industry assets. Furthermore, most banks are characterised by low loan-to-deposit ratios. Instead, large amounts of assets are held in the form of government securities

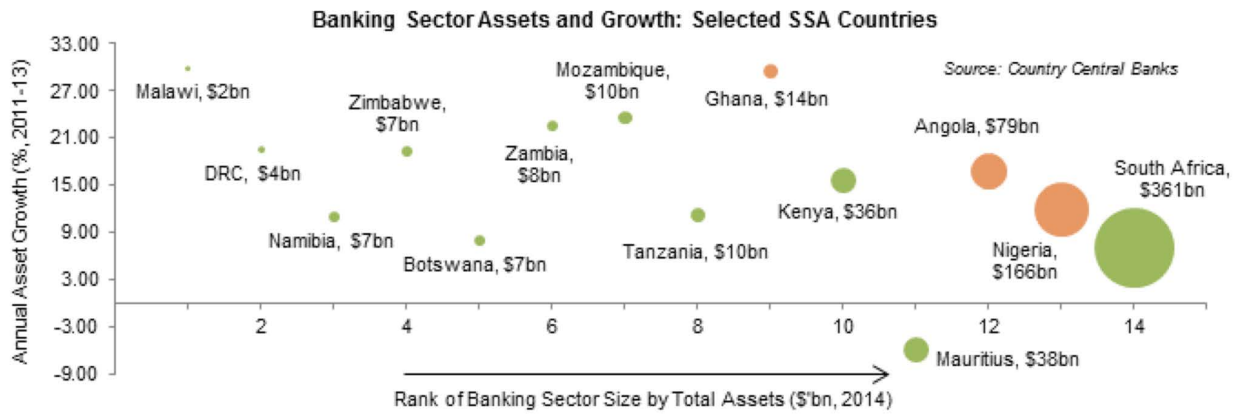
and other liquid assets. According to the IMF, lending is mainly short term in nature, “with about 60% of loans having a maturity of less than one year.” Banking industries across SSA are also highly concentrated, with the top four banks usually accounting for the majority of total banking sector assets within a particular country.

Despite the fact that branches are usually concentrated only in a small number of the main urban areas, the European Investment Bank (EIB) notes that SSA banks are typically high-cost operations. To compensate, interest rate spreads are often fairly wide – prevailing macro conditions and country-specific consumer risk profiles also play a role here – and service fees high. Foreign banks also play a significant role in the SSA banking landscape, “having recovered market share as banking systems were restructured and state banks privatised under reform programs in the 1980s and 1990s,” according to the IMF. Most African financial markets are unusually open to foreign banks and microfinance firms compared to other emerging market economies. The growing presence of subsidiaries of pan-African and major global banks on the continent has undoubtedly improved the availability and quality of financial services in recent years; the focus here has largely, but not exclusively, been on high margin corporate businesses as opposed to retail banking that improves financial inclusion and focuses on the ‘unbanked’ sectors of economies.

On a country level, South Africa still leads the SSA pack in relation to the size of the banking industry when measured by total assets. According to data retrieved from the South African Reserve Bank (SARB), total banking sector assets reached US\$361bn by December 2014. South Africa's banking sector also expanded by a healthy margin in the last few years, with banking sector assets recording an average annual growth rate of 7.1% during 2011-14. The graph below captures similar metrics for a select number of SSA countries – the choice regarding which countries to include was predominantly influenced by data-related considerations. The data was mainly retrieved from central bank publications. The size of each country's banking sector is approximated by the value of total assets in 2014 (latest available data in that year) expressed in US dollars to allow for comparability – annual average exchange rates were used for the calculation. The average annual growth rate was calculated for the 2011-13 period – due to the 2014 data only being available at different dates for a number of countries – using local currencies.

Nigeria boasts the second largest banking sector in the SSA region, with total assets reaching roughly US\$156bn in 2014, followed by Angola with total banking sector assets in the region of US\$79bn. Turning to the growth performance, banking sector

assets expanded at an impressive pace in countries like Ghana, Mozambique, Zambia and Malawi, although for the latter, growth occurred from a very small base.



Although the stylised facts highlighted above provide useful insight on an aggregate level, there are subtle but significant differences in relation to banking sector development between countries. Thus, it might be useful to consider the banking

sectors of certain countries in more detail. For the purpose of this report, we will discuss the banking sectors of Nigeria, Kenya and Ghana in more detail below.



# Nigeria

Nigeria consolidated its banking system in 2005 from 89 banks to 24. This was followed by rapid growth in banking assets in a high oil price environment, which led to a stock market bubble and a sharp increase in non-performing loans (NPLs). Higher oil prices led to increased liquidity in the banking system, which facilitated an increase in bank lending. During 2004-09, banking assets expanded by an average annual rate of 76%. By 2009, eight of the country's 24 banks had to be rescued after weak risk management and poor corporate governance caused NPLs to rise to more than a third of total loans across the banking system. The Central Bank of Nigeria (CBN) responded strongly to the crisis, removing executive teams from failed banks, fully guaranteeing the interbank market, and setting up the Asset Management Company of Nigeria (AMCON) to purchase a large proportion of the NPLs from Nigerian banks in exchange for tradable three-year zero coupon bonds to bring five of the eight insolvent banks to zero equity. Merger/acquisition agreements were reached with private investors to inject sufficient capital for these banks to meet prudential requirements. The other three (smaller) banks were temporarily nationalised and fully recapitalised by AMCON. Some N3.6trn in bonds was issued to finance these operations, with AMCON later requesting an increase in its borrowing limit to N4.5trn.

In terms of the banking sector's structure, there are currently 21 commercial banks operative in the country, as well as two merchant banks. Banking sector assets increased to N24.3trn by end-2013, up 14.2% from the level recorded a year earlier. By December 2014, banking sector assets had increased further by 13.1% y-o-y to N27.5trn. According to the CBN's most recent Financial Stability Report, the banking sector remains highly concentrated. In December 2014, the market share of the five largest banks amounted to 52.4% and 50.9% for deposits and assets, respectively.

Net domestic credit reached N14.5trn by December 2013, an increase of 14.5% y-o-y. Hereafter, net domestic credit increased by 11% to N16.1trn by December 2014, as the increase in claims on the private sector more than offset the decline in claims on the government. According to the CBN, the latter reflects a decline of the banking system's holdings of government securities. Excess liquidity in the banking sector is a perennial problem for Nigeria due to the large amount of oil revenue relative to the non-oil economy. Banks tend to use excess funds to invest in government securities, thereby crowding out credit to the private sector. The central bank has attempted to address the problem of excess liquidity by increasing the cash reserve requirement (CRR) on

public sector deposits, first from 12% to 50% in July 2013, and then further to 75% in January 2014. This seems to have curbed investment in government debt. Private sector credit growth also slowed during 2014 H1, but rebounded strongly during 2014 H2. According to the CBN, "credit to the private sector increased by 12.08% [during H2], compared with the growth of 4.88% recorded at the end of the first half of 2014." The central bank ascribes the increase in private sector credit growth during 2014 H2 to "the impact of various policies of the Bank [CBN] to enhance the lending capacity of banks."

Turning to capital adequacy, the regulatory capital to risk weighted assets ratio increased to 17.2% by end-2014, up from 17.1% at the end of 2013. The ratio remains above the required minimum of 15% for Systemically Important Banks (SIB) and well above the 10% for domestic banks. Meanwhile, according to the CBN, the aggregate liquidity ratio reached 45.8% by December 2014, easily exceeding the regulatory minimum of 30%. Banks therefore remain well capitalised and liquid. Also, asset quality improved slightly, with the NPL ratio declining to 2.9% by end-2014, down from 3.2% at the end of 2013. As such, the NPL ratio remained well below the regulatory limit of 5%. Seeing that international oil prices have trended markedly lower, the NPL ratio could very well move higher going forward. This is partly ascribed to the fact the oil and gas industry continues to be the main recipient of credit in Nigeria. The oil and gas industry accounted for roughly 25.7% of total bank loans and advances at the end of 2014. The manufacturing sector followed with a 13.2% share. Looking ahead, the fact that monetary policy could be tightened further – in order to ward off the inflationary effects stemming from the depreciating naira – also does not bode well for NPLs.

The increase in the CRR on public and private sector deposits in 2014, in addition to the AMCON levies banks have to pay, may continue to pressurise banks' earning potential. There is a risk that, in order to compensate, banks will take on greater risk. That said, the CBN decided in May 2015 to harmonise the CRR on public and private sector deposits at 31%. Based on data retrieved from the CBN, the net impact of the changes to the CRR suggests a liquidity injection. It must be highlighted though that this calculation is based on data as at end-February and as such, the magnitude of the change in liquidity conditions remains somewhat uncertain. If the CBN's recent actions indeed resulted in increased liquidity, it could very well support credit extension. A sharp acceleration in credit extension could generate new risks for the banking sector. This would especially be the case if NPLs start to rise at the same time when banks are extending more loans.

# Kenya

The banking sector currently consists of 43 commercial banks, one mortgage finance company, nine microfinance banks, seven representative offices of foreign banks, 94 foreign exchange bureaus, seven money remittance providers and two credit reference bureaus. Of the total commercial banks, 13 of them have over 50% foreign ownership. At the end of 2014 Q3, the number of bank customer deposit and loan accounts stood at 26,603,385 and 4,068,304, respectively.

The Kenyan banking sector continues to show strong growth. According to Central Bank of Kenya (CBK) data, total assets in the banking sector increased by 3.7% between the end of June and the end of September 2014, reaching KSh3.08trn. The largest item on the overall banking sector's balance sheet was loans and advances, accounting for 59.9% of total assets. The sub-sector also recorded strong growth over the period, reaching KSh1.91trn at the end of September, reflecting a 7.2% q-o-q expansion. In Q3 2014, 10 out of 11 sub-sectors recorded growth with regard to loans and advances, with tourism, restaurants & hotels the only sector recording a contraction. Personal/household loans and advances was the largest sub-sector, reaching KSh483.3bn, followed by trade (KSh377.7bn) and real estate (KSh280.8bn). Furthermore, deposits remain banks' main source of funding, accounting for 73.1% of total liabilities as at September 2014. The size of total deposits reached KSh2.25trn by the end of September 2014, up from KSh2.15trn at the end of June. The increased use of alternative delivery channels of banking services such as agency banking also contributed to increased deposits.

Banking sector capital also increased over the period, growing by 4.9% q-o-q to reach KSh458.1bn by the end of September. In turn, the ratios of core and total capital to total risk-weighted assets increased from 15% and 17.5% to 15.1% and 17.8%, respectively. This reflects stronger growth in the capital base compared to that of risk-weighted assets. Furthermore, looking at asset quality, the stock of gross NPLs increased by 2% from KSh101.7bn in

June 2014 to KSh103.7bn by the end of September. Nevertheless, the proportion of net NPLs to gross loans improved from 2.1% to 1.9% over the same period, while the ratio of gross NPLs to gross loans declined from 5.7% to 5.4%. Six out of 11 sectors registered increases in NPLs in Q3 2014, most notably the personal/household sector (+10.9% q-o-q to reach KSh26.5bn) and transport & communication (+20.3% to reach KSh8.9bn). According to the CBK, the general increase in NPLs is due to the spill-over effects of high lending interest rates and challenges in the domestic business environment. However, the CBK notes that banks have adopted enhanced appraisal standards to mitigate credit risk.

Looking at policy measures aimed at improving the country's banking penetration, the number of credit reports requested from credit reference bureaus by institutions stood at 4,779,273 in Q3 2014, up from 4,325,200 reports in the Q2 2014, reflecting a 10.5% q-o-q increase. More specifically, the number of credit reports requested by banks grew from 370,243 registered in the quarter ending June 2014 to 454,073 reports registered in the quarter ending September 2014. According to the CBK, as financial institutions embrace credit information sharing in processing credit facilities they are expected to offer customers with good track records more favourable terms. Turning to agency banking, financial institutions continue to make greater use of third-party agents to provide cash-in cash-out transactions and other services. At the end of September, 16 commercial banks had contracted 30,449 active agents, compared to 15 commercial banks with 26,750 active agents at the end of the previous quarter. The number of banking transactions undertaken through agents increased from 13.5 million registered in Q2 2014 to 14.5 million transactions registered in Q3 2014. Similarly, the value of banking transactions undertaken through agents increased from KSh72.5bn to KSh82.2bn over the same period. The use of agency banking continues to extend the reach of the banking system, allowing financial institutions to service the unbanked Kenyan public.



# Ghana

The Ghanaian banking sector is fairly well developed in an African context. The sector comprises 28 'Class 1' commercial banks. Of these, 12 are domestic-owned while the remaining 15 are foreign-owned. ARB Apex Bank functions as a 'central bank' for the Rural and Community Banks (RCBs), and is financed by the Rural Financial Services Project (RFSP) of the Ghanaian government.

Total commercial bank assets increased by 32.8% y-o-y to reach GH¢36.2bn by end-2013. One year later, commercial bank assets had increased by 42.2% y-o-y to GH¢51.4bn, partly driven by a 41.6% y-o-y increase in gross advances. Meanwhile, on the liabilities side, total deposits reached GH¢32.4bn by December 2014, 39% y-o-y higher. Nonetheless, the increase in borrowing continued to outpace deposit growth, with the former 69.2% y-o-y higher. This meant the share of deposits in total liabilities declined from 71.9% in December 2012 to 63% two years later. Put differently, banks have become increasingly indebted over the past two years, through loans rather than deposits. The banking industry's capital adequacy ratio (CAR) stood at 18.5% in December 2013, but has since declined to 17.9% by December 2014. That said, the average CAR remained well above the regulatory requirement of 10%. Stress tests conducted by the Bank of Ghana (BoG) at the end of 2013 indicated that buffers were still adequate in the case of most banks and on aggregate. The exercise found that about two thirds of banks would still meet the regulatory CAR requirement when subjected to various stress tests while only one bank would have negative capital under certain scenarios.

Turning to asset quality, the NPL ratio declined from 13.2% in December 2012 to 12% in December 2013. According to the BoG, the NPL ratio declined

further to 11.3% in December 2014, with the private sector still accounting for the lion's share of NPLs, or 97.7% to be more precise. The BoG notes that "even though indigenous enterprises received only 58.4% of the private sector credit, they accounted for 81.4% of NPLs in the sector as at December 2014." Furthermore, the commerce and finance industry still accounts for the largest amount of NPLs, followed by services and manufacturing. Together, these three industries accounted for 66.7% of NPLs in December 2014, down from 66.9% a year earlier.

In its 2014 Article IV Consultation report, the IMF noted that, though the Ghanaian banking sector remains well capitalised and liquid, there are some emerging risks that need to be monitored carefully. Firstly, macroeconomic imbalances and slowing economic growth may lead to a deterioration in banks' asset quality. Furthermore, the recent sharp drop in international oil prices could potentially push NPLs higher, should the associated impact on oil industry profits result in significant spillover effects. Furthermore, banks hold significant amounts of government securities, thereby exposing them to interest rate and sovereign risks. Back in May 2014, the IMF raised concern about the sharp increase in short-term foreign borrowing. That said, the Fund highlighted that the risk was mitigated by the fact that the loans originated mainly from parent banks. Based on the latest data retrieved from the BoG, it would seem that banks' preference has shifted towards longer-term foreign borrowing. Short-term foreign borrowing increased by 14.6% y-o-y in December 2014, while the corresponding figure for long-term foreign borrowing reached 175.9% y-o-y; although, the latter was from a very low base.



## Emerging Banking Trends

SSA enjoys certain key advantages that will enable the region to equal or even surpass at least some of its emerging market counterparts in terms of financial sector development in the coming decade and beyond. As highlighted previously in this report, a number of SSA financial markets are unusually open to foreign banks and microfinance firms compared to other emerging market economies. The region has also often been at the forefront of new technological advances and other innovative methods to reach new customers and simplify access to banking, especially in more rural locations.

However, more than anything else, SSA represents massive financial sector growth potential due to the fact that the market is still largely unsaturated. In an attempt to take advantage of this opportunity, and partly on account of policy and regulatory changes, banks in the region have had to evolve, both from operational and strategic perspectives. This section briefly outlines some of the trends that have emerged in recent years highlighting how the sector has adapted to fulfil the banking needs across the SSA region and, in turn, may help accelerate the pace of financial sector development.

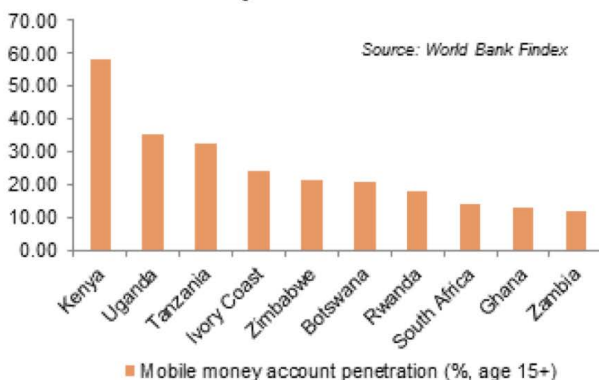
## Evolving Information and Communication Technology

The advent of modern technology and other innovations have successfully enabled a handful of pioneers to provide banking services to a far wider income customer base than ever before. More specifically, the emergence of mobile technology as an alternative to more traditional banking has allowed for services to be provided to lower income households often residing at distant rural locations. This was made possible by the rapid diffusion of affordable cellular technology on the African continent. According to the World Bank, SSA *“leads the world in mobile money accounts: while just 2% of adults worldwide have a mobile money account, 12% in SSA have one.”*

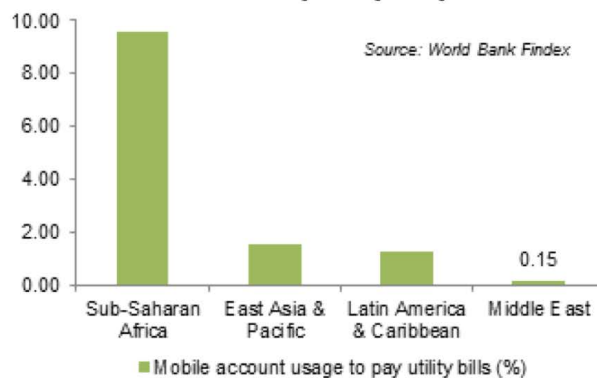
One of the most successful mobile money models in Africa is considered to be Kenya’s MPESA. The mobile phone-based money transfer and microfinancing service was developed by Vodafone for Safaricom. According to Bloomberg, MPESA had roughly 18.2 million customers by 2014. Figures retrieved from the World Bank’s Global Findex Database, published in April 2015, suggest that

58.4% of the adult population (aged 15 and over) in Kenya had a mobile money account in 2014. Mobile money account penetration rates are also relatively high in Uganda and Tanzania. The latter represents another country where MPESA is offered, this time through Vodacom. Other SSA countries with high mobile money account penetration rates include the Ivory Coast, Zimbabwe, Botswana, Rwanda and South Africa. Even in less developed financial markets, public-private partnerships between governments and foreign mobile technology providers have started making progress. A recent example of this is found in the Democratic Republic of Congo (DRC), where the government has started transferring civil servant salaries via mobile technology. Although launched back in December 2012, Airtel DRC noted that 66,000 government employees had already received their salaries via Airtel Money by March 2013. On 8 December 2014, allAfrica reported that Airtel DRC had surpassed one million *“revenue-earning customers.”*

Mobile Money Account Penetration 2014



Use of Mobile Money to Pay Utility Bills 2014



Another interesting finding that emerged from the recently published Global Findex Database pertains to the fact that the use of mobile money services is relatively advanced in SSA when compared to other regions across the globe. The World Bank estimates that, of the adult population that regularly pays utility

bills, the proportion which does so using a mobile device in SSA equaled 9.6% in 2014, significantly higher when compared to other regions such as the Middle East, Latin America & Caribbean and East Asia & Pacific. This bodes well in relation to the outlook for financial inclusion and deepening.

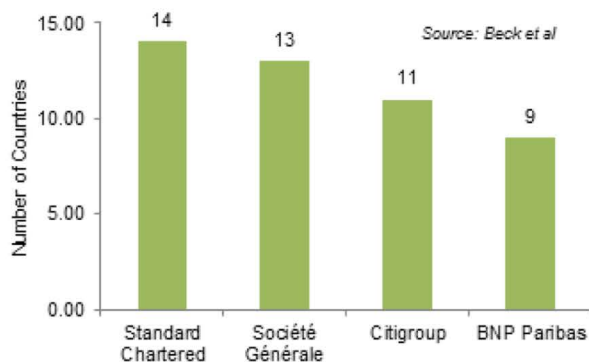


## Pan-African Banks

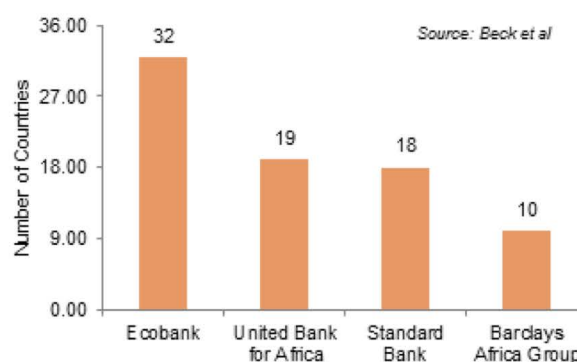
The SSA region has witnessed a rapid expansion of pan-African banking groups in recent years. There are various reasons for this, although two factors in particular played an important role in this regard. Firstly, as domestic markets become saturated, banks are often forced to look beyond borders for potential growth opportunities. Secondly, regulatory changes in the country where banks are domiciled could also influence ambitions to expand beyond borders. For example, following the consolidation of Nigeria's banking sector in 2005, Nigerian banks had considerably more capital which was utilised to grow banks' loan books. However, excess capital also incentivised an expansion into economies outside of Nigeria.

According to Beck et al (2014) – a study jointly commissioned by the Association of African Central Banks, the German Federal Ministry for Economic Cooperation and Development and the International Bank for Reconstruction and Development – foreign banks operating in Africa comprise two distinct groups, international banks domiciled outside of Africa and African cross-border banks. As already mentioned, there is an increasing presence of subsidiaries of major global banks on the continent which has undoubtedly improved the availability and quality of financial services in recent years. That said, large banks from well-developed financial markets on the African continent have made the biggest impact in this regard. These banks mostly have their origins in South Africa and Nigeria.

**International Banks: Presence in SSA 2013**



**SSA Banks: Presence in Africa 2013**



The international banks with the largest footprints across Africa originate mostly from the United Kingdom (UK), France and the United States. Some of these banks have a strong presence in their previous colonial territories, but have also started to expand beyond these areas. According to Beck et al (2014), by 2013, Société Générale from France had already expanded its operations to 17 African countries (13 SSA countries) – excluding countries where the only presence is a representative office – with most of these located in West and North Africa. Citigroup from the US had a presence in 15 African countries in 2013 (11 SSA countries), followed by the UK's Standard Chartered with operations in 14 African countries, all of which are located in SSA. BNP Paribas, another French domiciled bank, had a presence in 13 African countries (9 SSA countries) in 2013, again with a particular concentration in West and North Africa. Beck et al (2014) highlights that international banks from other countries have also managed to expand their African footprints in recent years.

When focusing on African cross-border banks, for the purpose of this report, only banks domiciled within the SSA region are considered. Ecobank, has the biggest presence in Africa, rendering banking services in 32 countries by 2013. The United Bank for Africa, domiciled in Nigeria, has operations in 19 countries across Africa. Standard Bank has a

comprehensive Africa presence with the company operating in around 18 African countries. The company remains focused on its African strategy. Standard Bank's affiliation with the Industrial Commercial Bank of China (ICBC), following ICBC's purchase of a 20% stake in Standard Bank in early 2008, remains a strategic advantage in terms of tapping into Asia's growing presence in Africa. Meanwhile, Barclays Plc recently combined its operations in Africa to standardise its business across the continent as part of its 'One Bank in Africa' strategy. The UK bank increased its stake in the Absa Group of South Africa to 62.3% and consolidated the assets of the latter with that of its other African operations and subsequently rebranded the business as Barclays Africa Group, although the Absa brand would be retained solely for operations in South Africa. Barclays Africa Group delivered banking services in 10 African countries by 2013.

The rapid rise of cross-border banking presents both opportunities and challenges. Financial sectors across the SSA region stand to benefit from gains in efficiency, innovation and financial deepening. On the other hand, the rise of pan-African banks raises the possibility of financial sector contagion across borders. As such, there is a need to improve banking sector oversight and strengthen regulatory frameworks as financial markets become more integrated.

## Regional Integration

The development of the SSA banking sector is still to an extent constrained by the small size of national markets. In many cases, this prevents banks operating in their home country from realising the benefits of economies of scale. Increased regional economic and financial integration represents an opportunity to overcome this obstacle. According to the Partnership for Making Finance Work for Africa (MFW4A), regional financial integration can yield the following benefits:

- Consolidate scarce savings, investment projects and finance related infrastructure;
- Increase competition, which should in turn contribute to innovation in relation to financial offerings;
- Reduce inefficiencies in lending given a wider pool of bankable projects; and
- Expand opportunities for risk diversification.

Despite the fact that the benefits of regional financial integration are already being recognised, progress with integrating financial systems has been moderate and in some cases, it has yet to deliver the desired results. Despite a relatively advanced level of financial integration, the IMF notes that the West African Economic and Monetary Union (WAEMU) has only contributed to increased financial depth in some segments of the financial system (e.g. the market for government securities).

Also, the launch of the West African Monetary Zone (WAMZ), scheduled for January 2015, has repeatedly been postponed. WAMZ intends to introduce a common currency to be used among member nations (Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone). This currency would then be integrated with the CFA franc – the regional currency of the WAEMU region – later down the line. Meanwhile, even though it has contributed to a higher degree of financial integration in the region, the Common Monetary Area (CMA) in Southern Africa still presents many of the same limitations in reaching the unbanked populations as observed in South Africa itself. Furthermore, while the East African Community (EAC) has made progress in terms of a customs union and common market, progress towards complete financial integration has been slow. The reasons why progress towards complete financial integration has been slow is mainly ascribed to the difficult policy choices facing governments on national and regional levels and the difficulty of surrendering national ownership of market infrastructure. In addition, the financial costs of integration are occasionally considered to be too high, especially for small countries which see these costs as tangible, whereas benefits seem abstract and far in the future. Also, according to the IMF, progress towards financial integration *“will require strong political will in the various sub-regions, including overcoming the vested interests of those currently benefiting from limited competition in domestic markets.”*



## Regulation and Oversight

There has been a rapid expansion of pan-African banks in recent years, even more so for banks that originate from the continent itself. The IMF highlights that African cross-border banks are now much more important in Africa than the long-established EU and US banks. Anecdotal evidence suggests that the expansion of African cross-border banks has yielded benefits in relation to increased competition and economies of scale, especially in cases where host markets are small. That said, the expansion of pan-African banks also goes hand-in-hand with various challenges relating to governance, supervision and questions about cross-border resolution. Furthermore, the IMF notes that countries across the SSA region have made varying progress with implementing Basel II requirements, which could *“pose risks to national and regional financial stability.”* Some of the above-mentioned challenges and risks are explored in more detail below:

- Supervisory Capacity** - In a report published in January 2015, the IMF notes that supervisory capacity remains constrained and under-resourced across large parts of Africa. The rapid rise of pan-African banks necessitates improvement in relation to transparency, prudential oversight and regulatory frameworks, especially in countries where large cross-border banks are domiciled. While acknowledging that progress is being made, the IMF cautions that *“efforts to strengthen oversight in some cases need to be intensified.”*
- Governance Challenges** - According to the IMF, the propriety of owners and shareholders of bank holding companies are not always adequately assessed and the ownership structures of banking groups are often not transparent enough. In this regard, the IMF highlights the case of Ecobank as a prime example. At the start of 2014, the Nigerian Security and Exchange Commission (SEC) released a report criticising the top management of the bank over poor corporate governance practices. There were also accusations of fraudulent/questionable transactions on bad debt and bonus awards. Ecobank experienced a turbulent 2014 with internal infighting resulting in a reshuffling of the top management structure. Despite this, the IMF notes that total lending has continued to expand rapidly, which raises some concerns when noting the bank's large presence across the SSA region.
- Regulatory Oversight** - The IMF highlights that at least two of the large cross-border African banks operate as subsidiaries of unregulated holding companies. Banks operating as subsidiaries may well be exposed to risks stemming from their holding company or even other financial organisations that form part of the same group. In some cases, regulations requiring subsidiary banks to be separately capitalised could serve to negate this risk, although the IMF cautions that this does not completely eliminate the risk. As a result, it remains vitally important that the host country has strong regulatory oversight capabilities to ensure issues are identified early enough to prevent contagion across borders.

Cooperation on the supervision of cross-border banks has got underway, but much still needs to be done. For example, prior to granting a foreign bank a license to operate in Nigeria, the CBN requires a Memorandum of Understanding (MOU) with the regulators in the particularly bank's home country. Also, quarterly meetings of the West African Monetary Institute (WAMI) include discussions pertaining to the potential financial risks stemming from pan-African banks operating in the region. Furthermore, the IMF notes that *“several joint inspections have taken place and supervisory colleges established for a few pan-African banks, and others are planned.”* The multilateral organisation proposes that supervisory colleges be established for all the major African cross-border banks and that MOU's be used between the host and home countries in all cases. Finally, without adequate resolution mechanisms, supervision may yield little benefit. According to the IMF, *“most African countries also need to enhance resolution at the national level. While some countries have sought to reduce spillover risks through ring-fencing approaches, this cannot avoid the need for cross-border collaboration. Ex-ante understandings are needed across jurisdictions as to respective responsibilities in the event of difficulties.”*

## Market Saturation

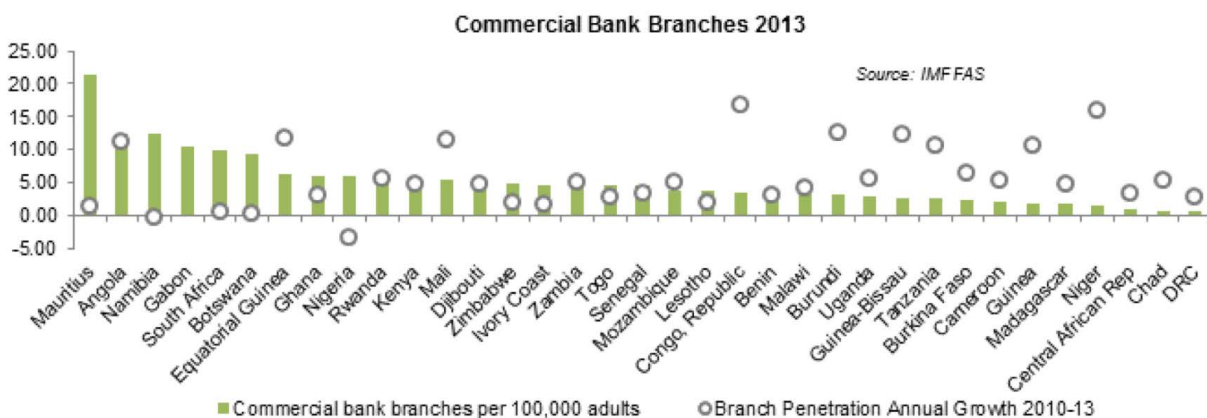
The banking sectors of a number of SSA countries have exhibited significant growth in recent years. That said, it is important to examine whether banking sector growth has resulted in higher levels of financial inclusion across the SSA region. Financial inclusion yields various benefits, according to the Global Partnership for Financial Inclusion (GPFI), some of which include *“poor households that are using loans or savings to accelerate consumption, absorb shocks such as health issues, or make household investments in durable goods, home improvements or pay school fees.”* According to the GPFI, macroeconomic evidence suggests that economies with deeper financial

intermediation tend to experience faster economic growth, while higher levels of financial inclusion are also associated with lower levels of income inequality. From a banking perspective, the level of financial inclusion represents a barometer of market saturation, which in turn signals the potential for further banking sector growth across the SSA region. This section will firstly examine how banks have extended their reach across the subcontinent to gain access to new clients. Secondly, this section will briefly consider whether banking sector growth in general has in fact resulted in higher levels of financial inclusion.

## Commercial Bank Reach

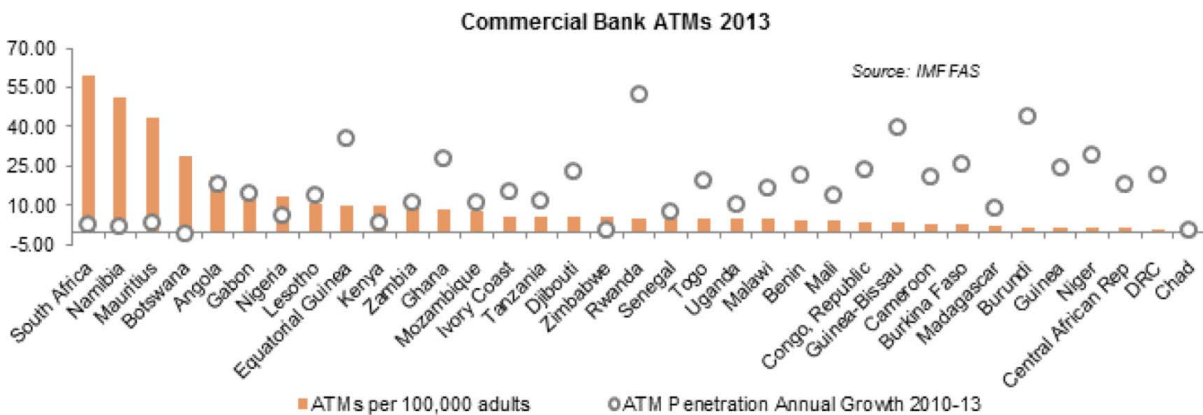
Figures retrieved from the IMF Financial Access Survey (FAS) database suggest that, for every 100,000 adults, there were 21.4 bank branches in Mauritius in 2013. Other SSA countries with relatively high commercial bank branch penetration rates (number of commercial bank branches as a proportion of the adult population) include Angola, Namibia, Gabon, South Africa and Botswana. Encouragingly, some of the countries that fare poorly in this regard have made some progress in recent years. As is evident from the graph below,

a number of countries with relatively low branch penetration rates have actually recorded strong growth in this metric over the 2010-13 period. Regardless, this does not detract from the fact that branch penetration remains low across SSA in general. For the 35 countries listed in the graph below, the average number of commercial bank branches per 100,000 adults reached just 5.1 in 2013, up from 4.4 in 2010. This is still much lower than the global average, which the World Bank estimates at 11.7 in 2012.



South Africa leads the way when the focus shifts to ATMs. According to the IMF's FAS database, for every 100,000 adults, there were roughly 59.8 ATMs in South Africa in 2013. Other countries with relatively high ATM penetration rates (number of commercial bank ATMs as a proportion of the adult population) from a SSA perspective include Namibia, Mauritius and Botswana. Again, a number

of countries with relatively low ATM penetration rates have actually recorded strong growth in this metric over the 2010-13 period. Although, it must be highlighted that this growth occurred from a very low base in a number of cases. For the 35 countries included in this assessment, the average number of commercial bank ATMs per 100,000 adults reached 10.4 in 2013, up from 8.3 in 2010.



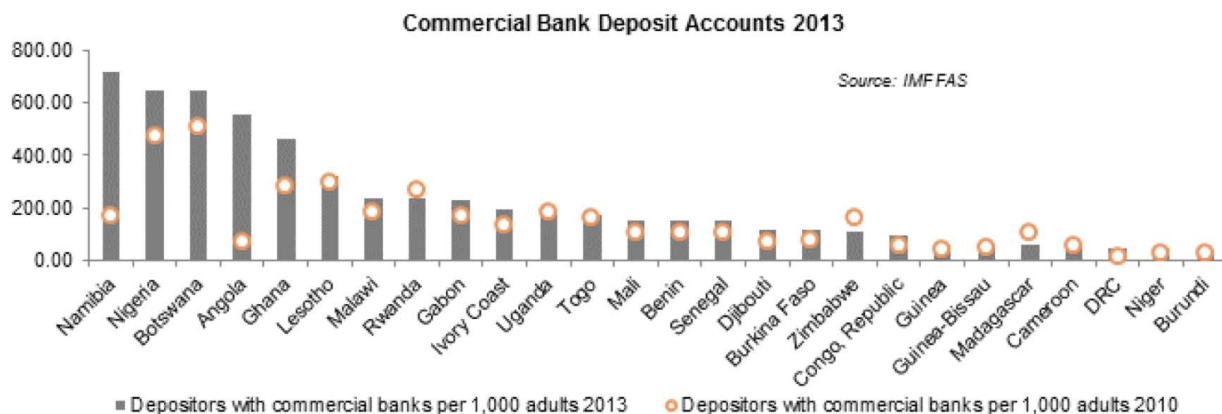
Even though commercial bank branch and ATM penetration rates have improved on average across the SSA region, these rates remain below global averages. Also, while an increase in the number of branches and ATMs may have contributed to the expansion of banking sectors across the region in recent years, it would not have drastically increased the level of financial inclusion across the subcontinent. The reason for this relates to the high cost of establishing branches and installing ATMs. As such, branches and ATMs are often

concentrated in urban areas, mostly out of reach for the large unbanked populations from more rural areas. However, having a strong infrastructural presence in urban areas may still yield benefits over the longer term as urbanisation accelerates across SSA. According to the United Nations (UN) Population Division, there were 48 urban agglomerations in Africa with a population of more than one million in 2010. By 2025, the UN expects there to be 85 agglomerations in Africa of at least one million people, of which 17 are forecast to be located in Nigeria.

## Financial Inclusion

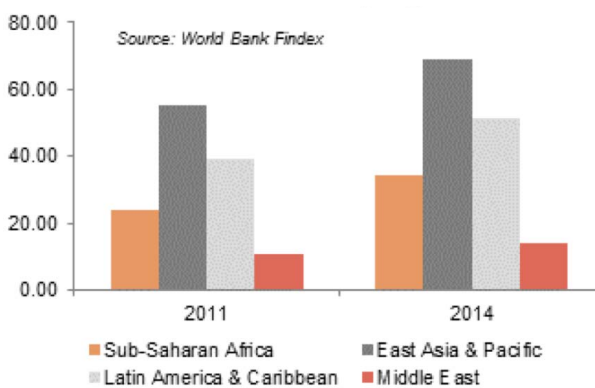
A large proportion of the African populace still does not make use of formal financial services. According to the IMF's FAS database, the number of deposit accounts with commercial banks per 1,000 adults (deposit account penetration) was highest in Namibia in 2013, followed by Nigeria, Botswana, Angola and Ghana. Information for South Africa and

Kenya was not available. Encouragingly, deposit account penetration increased markedly in most of these countries from the levels observed in 2010. That said, from the graph below it is clear that for the majority of the remaining countries, deposit account penetration growth has been fairly limited in recent years.





In its most recent Global Findex Database, the World Bank estimates that roughly 34% of the adult SSA population had a financial/money account in 2014, up from 24% in 2011. However, these figures need to be interpreted with caution, as the 2011 estimate only included accounts at formal financial institutions, while the 2014 estimate includes mobile money accounts as well. Regardless, when compared to other regions around the globe, it is clear that account penetration remains low in SSA.



The main reason for the low level of financial inclusion in SSA, based on survey responses, pertains to low income levels in general. The second most significant barrier to the use of formal financial services relates to the distance that needs to be travelled to access such services. Other notable barriers include the cost involved with financial services and onerous regulatory requirements.

Given the opportunities presented by these markets, many financial institutions have been spurred to reconsider the way in which they do business. Should banks be able to tap into the large unbanked populations across the SSA region, it could lead to a significant increase in new deposits. Also, even at lower profit margins, the benefits associated with leveraging economies of scale should contribute to returns on the bottom line. However, the challenge in relation to exactly how these issues need to be addressed remains. The next section will consider various strategies employed as banks attempt to deliver banking services to SSA's large unbanked populations.



## Reaching the Unbanked

As already alluded to previously in this report, a large proportion of the African populace still does not make use of formal financial services. The main reason for this phenomenon relates to geographic challenges in reaching the unbanked populations located in rural areas. Also, lower-income households still deem formal financial services to be too expensive while regulatory requirements are seen as being overly cumbersome. Below we consider some of the different banking models and financial service transmission mechanisms currently employed by banks to deliver financial services across Africa. Where possible, we highlight the advantages and disadvantages of each model and also consider the potential thereof in bridging the gap between formal financial services and the large SSA unbanked population.

- Branch:** In a research paper published in 2014, iVeri Payment Technologies (iVeri) notes that, even though banks are employing different methods to attract new clients, branches still fulfil a crucial role in the retail banking landscape. According to the KPMG 2013 Africa Banking Industry Customer Satisfaction Survey, of the people who already utilise banks, 99% of respondents said that they still use branches. While branches allow for a full financial services offering delivered by trained staff in a secure location, they are expensive and most importantly, inaccessible to prospective rural clients.
- Mobile:** In recent years, mobile technology has made significant progress in overcoming some of the challenges relating to reaching the unbanked. However, it is important to distinguish between mobile money and mobile banking, the former being mostly responsible for the significant growth in mobile payment services being offered in countries such as Kenya and Tanzania. Mobile money usually offers money transfer and payment services, whereas mobile banking solutions aim to offer a more comprehensive set of financial services usually backed by an account at a formal financial institution. A common example of the latter is the mobile banking apps offered by commercial banks. The disadvantage of mobile money is that it does not offer a full range of financial services; and thus, users are still not fully financially 'included' – users will not share in the benefits of financial inclusion, such as being able to apply for credit.
- Online Banking:** Online banking refers to the scenario where financial services are accessed via the internet, but excludes the access of mobile money or mobile banking services. Internet penetration across SSA is still relatively low. According to the World Bank, for every 100 people, only 16.9 were internet users (including mobile access) in 2013 across the SSA region, much lower than the global average of 38.1. Furthermore, the World Bank estimates that SSA had only 0.3 fixed broadband subscribers (excluding mobile access) for every 100 people in 2013, compared to the global average of 9.6. On account of the low internet penetration (especially fixed broadband) across SSA, online banking probably does not represent a particularly viable option to reach SSA's large unbanked populations, where the costs associated with computers, modems and fixed lines are probably too high in any case.
- ATM:** iVeri notes that ATMs have the potential to be a very popular banking channel in SSA. Furthermore, ATMs "often experience high withdrawal rates as the preference for cash is still very high in most of Africa." Unfortunately, similar to the case for bank branches, the installation of ATMs is expensive. Also, ATMs are most efficient in areas with high population density and are thus not really suited to serve the large unbanked populations which are widely dispersed over large areas.
- Mobile Branch:** A mobile branch represents a fairly new approach employed by banks across Africa in an attempt to reach prospective clients in rural locations. The approach usually involves a van or truck furnished with banking equipment. This approach saves clients the cost of having to travel to a branch while offering many of the same services offered by the latter. The only disadvantage being that the mobile branch is only accessible on certain days, and the time between 'access' days may be longer if destinations are particularly remote. That said, the mobile branch model combined with simple-to-use mobile banking could bridge this gap.
- Agency Banking:** Agency banking refers to the scenario where a third-party, such as a local supermarket or post office, provides financial services on behalf of a bank. The bank usually provides the third-party or agent with the necessary equipment and technology to provide the financial services. Possible disadvantages of this model include trust issues, lower security and the fact that the staff was not trained by the bank and may thus be less knowledgeable. However, if these obstacles are addressed, agency banking could well be used as an efficient supplement to the mobile banking and/or mobile branch models.

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# Contact details

## KPMG Africa

### Seyi Bickersteth

**Chairman KPMG Africa**

**T:** +234(1)4620045, 2805984

**E:** seyi.bickersteth@ng.kpmg.com

### Bryan Leith

**COO KPMG Africa**

**T:** +27116476245

**E:** bryan.leith@kpmg.co.za

### Benson Mwesigwa

**Africa High Growth Markets  
KPMG Africa**

**T:** +27609621364

**E:** benson.mwesigwa@kpmg.co.za

### Molabowale Adeyemo

**Africa High Growth Markets  
KPMG Africa**

**T:** +27714417378

**E:** molabowale.adeyemo@kpmg.co.za

### Bisi Lamikanra

**Head, Financial Services  
KPMG in Africa**

**T:** +2348034020982

**E:** bisi.lamikanra@ng.kpmg.com

### Eric Aholi

**Partner, Financial Services  
KPMG in East Africa**

**T:** +254202806000

**E:** ericaholi@kpmg.co.ke

### Sipho Malaba

**Partner, Financial Service  
KPMG in South Africa**

**T:** +27827190670

**E:** sipho.malaba@kpmg.co.za

### Pierre Fourie

**Partner, Financial Services  
KPMG in South Africa**

**T:** +27824908077

**E:** pierrejnr.fourie@kpmg.co.za

### Olatoude de Souza

**Partner, Financial Services  
KPMG in Cote d'Ivoire**

**T:** +22520225753

**E:** odesouza@kpmg.ci

### Corrie Fourie

**Partner, Financial Services  
KPMG in Zambia**

**T:** +27827190275

**E:** corrie.fourie@kpmg.co.za

### Jean Yves Parant

**Partner, Financial Services  
KPMG in DRC**

**T:** +243990010020

**E:** jparant@kpmg.cd

### Jose Silva

**Partner, Financial Services  
Angola**

**T:** +351917596694

**E:** jlsilva@kpmg.com

### Joleen Young

**Head, Payments Advisory  
KPMG in Africa**

**T:** +27714029165

**E:** joleen.young@kpmg.co.za

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