Regional Integration in the African Financial Sector

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Abstract

Over the last decade there has been an increase in integration of financial institutions across the African continent, either through acquisitions, mergers or through organic expansion into new markets, achieved by acquiring banking licenses or setting up operations from scratch. This paper takes a look at the drivers behind such expansion strategies and, more importantly, the factors that have marked the successes and failures of these strategies. The paper concludes by exploring how African banks should approach regional expansion in order to increase the probability of success and how the pan-African banking sector is likely to evolve during the next decade.

An overview of the regional financial sector landscape

Regional integration in the African banking sector is not new. Early examples of this are the continental presence that Barclays, Standard Chartered and ANZ Grindlays established during the colonial era. To this day, most of these banks' African operations remain intact and in recent years several other international banks have entered the African continent too, including Citibank and Millennium BCP. ANZ Grindlays operations in Africa were acquired by Standard Bank Investment Corporation (Stanbic) in 1993, while some of the international banks' operations were nationalised or sold to local investors. Union Bank in Nigeria, which was borne out of Barclay's Nigerian operation, is a good example of this.

The 1980s and 1990s were marked by banking liberalisation in most African countries to encourage efficiency in the financial sector. Policy reforms included the removal of interest rate controls, the removal of the requirements on banks to lend to specific sectors, privatising state-owned banks and making it easier for new private sector banks to be established. The 1990's was marked by a surge in new, privately held banks and, in many African countries, lax banking legislation and governance. The current decade has been characterised by tighter regulation, high growth, consolidation and regional expansion. However, the majority of banks on the continent are still small, with total assets of less than US$ 100 million.

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There are a comparatively large number of banks with assets of between US$ 100 million and US$ 1 billion. This band has grown in recent years due to consolidation, including forced consolidation brought about by the increase in capital requirements in the Nigeria. There are a relatively small number of banks with total assets that exceed US$ 1billion, concentrated in Nigeria and South Africa. It is worth noting that internationally, banks with assets of less than US$ 100 million have the lowest average profit rates and that the number of such banks is declining either because of mergers and acquisitions or because their assets are growing or they are re-focusing their businesses. A number of African regional banks have emerged. These include the Standard Bank group, Ecobank, UBA and Access Bank and a number of banking groups have embarked on regional banking strategies, including the First Rand group.

Mobile phone operators and microfinance lenders have started to encroach on the banking industry's turf. Kenyan banks have been threatened by M-Pesa to the point where they have sought the support of regulators to apply regulation to the mobile phone service providers offering banking related services. Microfinance lenders have proved that profits can be made from even the poorest borrowers.

The drivers and benefits behind regional expansion and integration in the financial sector

Lower operating costs and higher profit rates will drive the expansion of home grown African banks. Banks that have succeeded in their domestic markets and established a relatively high market share will be faced with the decision of whether to continue investing in growing their domestic market share or to expand into other African countries with similar environments where they can replicate their tried and tested banking models. For mature banks the cost benefit of expanding into other, similar African markets will often be more favourable than the cost benefit of increasing their domestic market share.

Consistent with international trends, we believe that the number of African banks with total assets of less than US$ 100 million will decline and banks with total assets greater than US$ 100 million will grow and move towards a new African banking efficiency frontier with higher average profit rates.

A question that is often asked in many African countries is whether or not they are over-banked. The study below is fairly simple and attempts to compare a sample set of Sub-Saharan banks with international benchmarks. While the study is quite crude, GDP per bank in South Africa and Nigeria is higher than it is in the United Kingdom or Brazil, indicating that these countries are not over banked. However, the banking sectors in these two countries specifically have undergone fairly severe consolidation. If South Africa and Nigeria are considered the African trend setters in our study and Zambia and Tanzania the laggards, then it is fair to extrapolate that the banking sectors in Zambia and Tanzania are due for fairly large consolidations. Such consolidations will be brought about by either:

- International banks acquiring domestic banks in these economies

- African multi-national banks' acquiring domestic banks in these economies
- Mergers taking place between domestic banks

We believe that African multi-national banks acquiring domestic banks in these economies will prevail. We believe this because of the number of regional banks that have embarked on regional expansion strategies, as well as the fact that banks will need to expand in order to achieve greater economies of scale and operational efficiencies to remain competitive. As the efficiency frontier moves, the small banks that are not able to carve a niche for themselves in the market will find it harder and harder to survive.

Country	no. of banks	GDP (US$ Mil)	GDP/bank (US$ Mil)	Population	Pop/bank
United States of America	8,430	14,264,000	1,692	306,663,000	36,378
United Kingdom	343	2,674,000	7,796	61,612,300	179,628
Brazil	233	1,572,000	6,747	191,241,714	820,780
South Africa	36	300,400	8,344	47,900,000	1,330,556
Tanzania	30	20,721	691	40,000,000	1,333,333
Nigeria	24	214,403	8,933	148,000,000	6,166,667
Zambia	17	14,323	843	11,862,740	697,808

Table 1: Banking structures in disparate countries

As far as the 'population per bank' figures in table 1 above are concerned, it must be noted that these figures are skewed by the relatively low number of bank accounts in Africa when compared to the United States, the United Kingdom or Brazil. We estimate that of the 800 million population of Sub-Saharan Africa, only around 71 million, or 9%, are banked.

Apart from achieving greater economies of scale and operational efficiencies, we believe there are three reasons that banks in Africa should consider embarking on regional expansion strategies. These include:

1. Many banks across the continent are on steep growth trajectories. As it becomes harder and more costly to increase domestic market share, a point will be reached where it is more cost effective to acquire new business in other jurisdictions
2. African economies are becoming more integrated and plans are in place to liberalise trade within the region, as well as integrate monetary policies with the eventual formation of an African Central Bank and a common currency. This will reduce the cost of regional expansion and ease the burden of turning a domestic bank into a multi-national one.

3. As African banks mature and become more sophisticated, comparative advantages should become apparent. Very often a bank in one country would have developed a particular core competency or a unique product or service offering with relatively high replication costs or barriers to entry. Local environmental nuances would have enabled such development. Banks will realise that they would be able to exploit these developments through expansion into new markets where there will be relatively low rivalry.

Lessons learnt and how to devise a strategy for regional expansion

Probably the best example of regional integration in the African financial sector must be the expansion across the continent of Ecobank, who were founded in Togo in 1985 with capital of US$ 32 million and now have a presence in 27 African countries. Ecobank was founded as a private venture but with the support of Ecowas and their strategy was to fill the gap between international banks and state-owned banks on a regional basis.

There are a number of other banks that have successfully embarked on regional expansion strategies, most notably Access Bank, ABSA/Barclays, Standard Bank and UBA. While Ecobank is not the largest, with shareholders funds of around half a billion US Dollars and total assets of US$ 6.55 billion, the bank has been incredibly successfully in breaking into new markets, rapidly gaining traction in these markets and enjoying relatively high profit rates.

In considering the banks that have embarked on regional expansion campaigns in Africa and their relative successes' and failures, there are a number of observations that can be used to devise or update a regional expansion strategy. Firstly, Africa is a continent separated along tribal lines with strong ethnic and cultural ties. A bank that wishes to truly become pan-African will need to transcend these tribal and cultural barriers and this is best achieved by recruiting a mix of shareholders, managers and staff from the different cultural groups and geographies in which the bank hopes to establish a presence. We believe that this is the principle advantage that Ecobank has had over UBA and Access Bank.

Secondly, business models need to be adapted for the environments and the communities they serve. We would suggest banks looking to expand into new jurisdictions, or just beyond their existing cultural bounds in their current jurisdiction, consider the multi-local model. Specifically, we believe that an organisational structure comprised of a number of clusters that each have their own linguistic and cultural identities that operate as separate profit centres within the group will serve banks planning to expand across Sub-Saharan Africa best. For example, a Lusaphone cluster could be headquartered in Luanda and comprise operations in Angola, Mozambique and Sao Tome and Principe. A Francophone cluster could be headquartered in Abidjan and comprise operations in the Ivory Coast, Senegal and the Democratic Republic of Congo and so on. This will ensure a pan-African culture is developed within the bank. Ecobank was started by ex-Citibankers who brought the Citibank model with them but adopted it for each market they entered.

Lastly, corporate governance needs to be sound. The board needs to be independent, without political alignments and representative of the jurisdictions that the bank plans to operate in. The board and management of the bank also need to represent the different cultures that the bank needs to be aware and appreciative of.

Before embarking on a regional expansion campaign we believe it is imperative that the bank has fine tuned its banking model in its domestic market and is able to identify areas in its new markets where it will have comparative advantage and be able to differentiate itself strongly enough to compete effectively. Furthermore, we believe that expansion, be it organic or through a merger or acquisition, should be based on efficiency principles and comparative advantage.

What does the future have in store for regional integration in the financial sector across Africa?

Africa is currently going through a baby boom. Sub Saharan Africa has a population of around 800 million and this is set to reach 1.5 billion by 2040. This will drive demand for banking services, although these services may take a different guise to those currently offered by commercial banks. Microfinance is set to grow, particularly in rural areas, as is mobile phone banking for remitting and receiving funds and for making payments. Relative to the developed world though, Africa will remain a cash based society and physical infrastructure will be important in penetrating the unbanked market, particularly for opening accounts and accepting and dispensing cash. There are between 1 and 2 branches per 100,000 people in Sub-Saharan Africa, depending on the country. India has 10 times as many branches per 100,000 people. Of course, banks could enter into arrangements with supermarkets and other retailers to act as their agents in rural areas, thereby reducing the cost of banking the un-banked and accelerating the penetration of these new markets.

There are currently around 115 million active mobile phones in Sub-Saharan Africa but only 71 million people are banked. The mobile phone not only presents an opportunity to bank the un-banked but will also allow multi-national banks and mobile phone operators in the region to offer cross border banking services, including multi-currency remittances and cross-border payments. More importantly, as the Sub-Saharan Africa becomes more and more integrated and national boundaries become less and less important, financial sector firms will be able to offer products and services on a regional basis and firms that have a multi-national presence in the region will be able to position themselves to take advantage of this.

Intra-regional trade is set to grow, providing an opportunity for multi-national banks in the region to finance and facilitate trade. The average percentage of exports within the Sub-Sahara African trade bloc is currently 7.1%. Exports within the East African community are 16.5% and we believe that intra-regional trade within Sub-Saharan Africa could reach this percentage or higher in the next decade.

Most importantly, as banks achieve greater economies of scale and operational efficiencies and as their domestic market shares become saturated, they will seek to expand into other similar environments. We believe that in the next decade we will witness the emergence of a number of large pan-African banks with footprints in at least 30 countries, listings on multiple exchanges and total assets in excess of US$ 1 billion. These banks will prevail on the continent and will acquire most of the smaller, privately held banks along the way. The only banks with assets of less than US$ 100 million to survive will be those who serve a niche in the market, such as financing small business, micro lending or banking a specific industry sector or geography. Lastly, we believe we will also see consolidation in the African 'bulge bracket' banking sector (US$ 1 billion+ in total assets) on a regional basis, in much the same way as Santander acquired Abbey National in Europe and Bank of Scotland merged with Halifax in the United Kingdom.