The African Financial Development Gap: The Bright and The Dark

Sharing Experiences with MENA

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@AERCAfrica @LSenbet
Agenda 2063 (AU) and Agenda 2030 (UN)

- Long-run and ambitious development agendas
- At the center: inclusivity and sustainability of development
- Agenda 2063: self-reliance
  - Science and technology [Capacity]
  - Self-reliant domestic resource mobilization [Finance]
Agents of Inclusivity and Finance for Inclusive Growth

- Agents of inclusive growth
  - Youth, women, small farmers, SMEs, entrepreneurs (digital)
- Financial entrepreneurs: Innovating finance for all
- Bankability and insurability of agents of inclusivity
- “De-risking” instruments and facilities
  - Private-public partnership, international institutions, development partners
- Financing large scale projects/programs
  - Infrastructure, renewable energy, regional value chains, industrial clusters
Finance Matters

- The positive linkage between financial sector development and economic development provides a strong case for the development of a well-functioning financial sector in Africa.

- Supporting evidence in the context of Africa as well (e.g., Yartey and Adjasi, 2007; follow-up by Senbet and Otchere, 2008)

- Inclusive finance (incl.DFS) and inclusive growth
  - [Research Consortium for Inclusive Finance, partnership with AERC (www.aercafrica.org)]
The Implication for the Region

Fundamentals

- Suggests a linkage between financial sector development and poverty alleviation, as well as employment creation.

The central question is:

how to develop a well-functioning financial sector and build its capacity so as to exploit its potential contribution to economic development.

- Channel: Capacity of financial systems to perform multiple functions and not mere existence of the systems.
Stock Markets and Development

Multiple Functions as a Channel

- Stock Market Development
  - Capitalization
  - Information Production
  - Liquidity Provision

- Economic Development
  - Economic Growth
  - Capital Accumulation
  - Productivity Growth


**Challenge:** The African Financial Development Gap

- Growing evidence for the role of finance in economic development
  - *Multiple functions are channels for this linkage*

- Yet, most countries in Africa face a severe financial development gap relative to not only the advance economies but other peer low income economies.
Challenge: The MENA Financial Inclusion Gap

- Arab Monetary Fund, et al, Jan 2017 Report
  - In the race toward full financial inclusion, the Arab world lags behind other regions
  - Nearly 70 percent of adults (168 million) with no bank account ownership
  - 80 percent in the developing countries of the region with no account ownership
- Thus, largest area of exclusion from formal financial services; also, credit is less than half the global average; the youth are most excluded.
# FD and Selected Indicators

**Summary Stats: Senbet and co-authors (NBER project)**

<table>
<thead>
<tr>
<th>Variable</th>
<th>World (minus Africa)</th>
<th>Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Standard Deviation</td>
</tr>
<tr>
<td>Liquid liabilities / GDP</td>
<td>64.2%</td>
<td>47.4%</td>
</tr>
<tr>
<td>Private credit / GDP</td>
<td>57.7%</td>
<td>45.3%</td>
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<tr>
<td>Stock Market Capitalization / GDP</td>
<td>52.1%</td>
<td>60.0%</td>
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<tr>
<td>Stock Market Value Traded / GDP</td>
<td>34.1%</td>
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<tr>
<td>Ln(Population)</td>
<td>2.44</td>
<td>1.59</td>
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<tr>
<td>Ln(Population density)</td>
<td>0.44</td>
<td>1.94</td>
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<tr>
<td>Natural resources</td>
<td>0.5</td>
<td>2.41</td>
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<tr>
<td>Offshore center</td>
<td>4.4%</td>
<td>20.7%</td>
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<tr>
<td>Ln(Per capita income)</td>
<td>2.25</td>
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<tr>
<td>Population * GDP per capita</td>
<td>0.48</td>
<td>1.35</td>
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<tr>
<td>Real GDP growth rate</td>
<td>4.1%</td>
<td>2.5%</td>
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<tr>
<td>Inflation rate</td>
<td>5.2%</td>
<td>5.2%</td>
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<td>Current Account balance / GDP</td>
<td>0.2%</td>
<td>8.1%</td>
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<tr>
<td>KKM index</td>
<td>0.33</td>
<td>0.9</td>
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<tr>
<td>Bank concentration</td>
<td>0.65</td>
<td>0.19</td>
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<tr>
<td>Foreign ownership share</td>
<td>27.1%</td>
<td>25.9%</td>
</tr>
<tr>
<td>State ownership share</td>
<td>15.9%</td>
<td>19.7%</td>
</tr>
<tr>
<td>Manufacturing / GDP</td>
<td>16.8%</td>
<td>6.1%</td>
</tr>
<tr>
<td>Secondary/Primary school enrollment</td>
<td>0.81</td>
<td>0.24</td>
</tr>
<tr>
<td>Roads / Area</td>
<td>1.07</td>
<td>1.65</td>
</tr>
<tr>
<td>Railroads / Area</td>
<td>0.03</td>
<td>0.03</td>
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<tr>
<td>Urban population</td>
<td>63.6%</td>
<td>20.7%</td>
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<tr>
<td>Geographic branch penetration</td>
<td>29.76</td>
<td>80.07</td>
</tr>
<tr>
<td>Demographic branch penetration</td>
<td>16.51</td>
<td>17.28</td>
</tr>
</tbody>
</table>
Aggregate Financial Development in International Comparison, 2015

Source: Global Financial Development Indicators (June 2017 Version), World Bank
Access to and Use of Financial Services, 2010-2015

- Bank accounts per 100 adults, 2015
- Bank branches per 100,000 adults, 2015
- Firms with line of credit to total firms (all firms) (%), 2010-2015
- Account at a formal financial institution (% age 15+), 2014

Source: Global Financial Development Indicators (June 2017 Version), World Bank
Measuring the African financial development gap:

- Obtain predicted levels of financial development for SSA countries, based on regression analyses of other low- and middle-income countries [benchmark indicators]

Thus, characterizing the financial development path

- Projecting on African countries

For the majority of SSA countries, the actual levels of banking sector development are below predicted levels

The measured African financial development gap is stark

- Except: Cape Verde and Mauritius above the line; Kenya close to the line
Benchmarking Financial Development

$$FD_i = \alpha + \beta_1 Population_i + \beta_2 Population\ Density_i + \beta_3 Natural\ Resources_i + \beta_4 Offshore\ Center_i + \beta_5 Per\ Capita\ Income_i + \beta_6 Population*GDP\ Per\ Capita_i + \beta_7 Real\ GDP\ Growth\ Rate_i + \beta_8 Inflation\ Rate_i + \beta_9 Current\ Account\ Balance/GDP_i + B_{10} KKM\ Index_i + \beta_{11} Bank\ Concentration + B_{12} Foreign\ Ownership\ Share_i + B_{13} State\ Ownership\ Share_i + B_{14} Manufacturing/GDP_i + B_{15} Secondary/Primary\ enrolment + \varepsilon_i$$

Exogenous determinants, based on Beck et al. (2008)

Plausibly exogenous, Financial development affects these variables at a lag, Beck et al. (2008)

Macroeconomic variables

Index of institutional development

Banking sector structure and ownership variables

Other variables
The African Financial Development Gap

Actual vs. predicted
The African Financial Development Gap

- **Analyzing determinants of financial development:**
  - Population density seems to matter more for Africa – financial development is more sensitive to population density than elsewhere
    - The imperative of infrastructure development for financial development?
  - Natural resources ‘curse’: Similar in Africa and elsewhere
  - Macroeconomic conditions and institutional environment: Not as important
Toward Resolution of the African Financial Development Gap

- Extensive financial sector reforms over two decades
- At a broader level, a more liberalized financial environment has emerged in Africa.
- Reforms have also been stimulated by rapid improvements in global conditions and advanced technology connecting Africa with the rest of the globe.
- African financial systems on the move
  - Improved depth and intermediation
  - Improved financial access
  - Improved integration of informal/formal
  - Growing evidence for real impact
African Financial Systems

On the Move

- Stock market phenomenon
  - Stock exchanges have proliferated in Africa
  - Early 1990s, just 5 in SSA and 3 in North Africa; now about 29 stock exchanges in Africa
  - The phenomenal growth was registered particularly in Sub-Saharan Africa, excluding the older markets in South Africa (1887), Egypt (1883), and Morocco (1929)
  - Despite the challenges faced in terms of low capitalization and liquidity, evidence for attractive African stock market both in absolute and risk-adjusted basis
  - Encouraging outgrowth: regional integration

- Private sector and home grown innovations
  - *Mobile Banking*
  - *The Rise of Equity Bank*
  - *FinTech in Africa: attracting attention from Silicon Valley*
We study the branch expansion strategies of Equity Bank and other banks, and their impact on access to banking services in Kenya in view of the vital role of financial inclusion in developing economies.

Kenya 2006-2009 offers a “laboratory” for the study of financial access, especially in light of the emergence of Equity Bank.

The presence of domestic private banks (including Equity Bank), government or government-influenced banks, or foreign banks is associated with increased financial access at the district level.
Why Equity Bank?

- Innovation for the underserved: The Case of Equity Bank
  - A pioneering Kenyan commercial bank that innovated a banking service strategy targeting the bottom of the pyramid

- A comprehensive study of Equity Bank and its social impact by a global research team [Allen, Carletti, Cull, Qian, Senbet, Venzuela]

- This innovative institution has fostered access to banking in the traditionally underserved areas.
  - Adopted a deliberate branch expansion strategy, targeting the most disadvantaged localities, including arid and semi-arid areas, and those who are minorities who do not even speak Swahili.
  - Equity Bank is traded on the Nairobi Stock Exchange

- Hence, it has also played a vital role in integrating informal finance into the formal – and even into a stock market.
Equity Bank’s Business Model

The business model of the bank is based on affordability and accessibility:

**Affordability:** To open a bank account only requires an ID and a photo (which can be taken in the branch itself). By contrast, foreign banks, such as Barclays, require a minimum balance of about US$ 222.

**Accessibility:** Local languages are spoken in its branches. In central Kenya, 30-40% people speak only a minority language.
Data

Combining a new dataset on bank penetration at the district level with household level survey data:

**Bank penetration dataset**

Based on branch-level information aggregated as a district-level panel on the number of branches by bank.

Covers 45 commercial banks that operated in 65 Kenyan districts in the period between 2006 and 2009.

**FinAccess household surveys**

Conducted by Financial Sector Deepening Trust Kenya. 4,420 completed interviews in 2006 and 6,598 in 2009.

Data on access to financial services and individual/household characteristics.
Branch Expansion: Urban Districts

Urban Districts

- Foreign banks
- Govt banks
- Local private banks

2006 vs 2009
Branch Expansion: Low Population Density Districts

Low Population Density Districts

- Foreign banks
- Govt. banks
- Local private banks

2006 vs. 2009
Bank Expansion Strategies

**Stylized Facts**

- All bank groups exhibited substantial branch expansion between 2006 and 2009
- All groups showed higher penetration in urban, highly populated, and educated districts
- **Domestic private banks had greater presence** in under developed districts, and foreign banks had the least presence in those districts
- Domestic privates are lead by Equity Bank – playing vital role in fostering banking services in under developed districts

*Now formal analysis*
Methodology

**Bank Expansion Strategies: Regression Analysis**

\[ Branches_{dt} = \mu_t + \alpha X_d + \varepsilon_{dt} \]

**Use of Bank Accounts: Probit Model**

\[ \Pr(Banked_{idt} = 1) = F(\mu_d + \alpha Equity_{dt} + \beta Branches_{dt} + \gamma z_{idt}) \]

**Access to Credit: Ordered Probit Model**

The dependent variable takes the value:
- 0 = the individual does not have a bank account/loan,
- 1 = the individual has a bank account,
- 2 = the individual has a loan from a bank.
### Branch Expansion Strategies

<table>
<thead>
<tr>
<th></th>
<th>Whole Sample</th>
<th>Urban Excluded</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dep. variable:</strong></td>
<td>Equity Bank excluded</td>
<td>Equity Bank</td>
</tr>
<tr>
<td>Number of branches</td>
<td>Equity Bank excluded</td>
<td>Equity Bank</td>
</tr>
<tr>
<td>over number of banks</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Factor</th>
<th>Whole Sample</th>
<th>Urban Excluded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>-3.403**</td>
<td>0.101**</td>
</tr>
<tr>
<td>Arid and Semi-Arid</td>
<td>-3.504**</td>
<td>0.834**</td>
</tr>
<tr>
<td>log(Density population)</td>
<td>-0.068</td>
<td>-0.019</td>
</tr>
<tr>
<td>Language: Minority</td>
<td>-4.961**</td>
<td>-1.119**</td>
</tr>
<tr>
<td>Language: Swahili</td>
<td>-5.047**</td>
<td>-1.146**</td>
</tr>
<tr>
<td>Dummy (2009=1)</td>
<td>0.101**</td>
<td>0.007</td>
</tr>
<tr>
<td>log(Density population)</td>
<td>0.007</td>
<td>0.049</td>
</tr>
<tr>
<td>Language: Minority</td>
<td>0.009</td>
<td>0.708**</td>
</tr>
<tr>
<td>Language: Swahili</td>
<td>0.035</td>
<td>0.539</td>
</tr>
<tr>
<td>Constant</td>
<td>8.567***</td>
<td>1.193**</td>
</tr>
</tbody>
</table>

| Observations            | 129                         | 125                         |
| Adjusted R-squared      | 0.748                       | 0.217                       |

| Observations            | 129                         | 125                         |
| Adjusted R-squared      | 0.524                       | 0.204                       |
## Branch Expansion Strategies

<table>
<thead>
<tr>
<th>Dep. variable: Number of branches over number of banks</th>
<th>Foreign Banks</th>
<th>Govt. Banks</th>
<th>Private Domestic</th>
<th>Equity Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>-4.032**</td>
<td>-4.368***</td>
<td>-2.958**</td>
<td>-6.440</td>
</tr>
<tr>
<td>Arid and Semi-Arid</td>
<td>-4.146**</td>
<td>-4.598***</td>
<td>-3.051**</td>
<td>-7.276*</td>
</tr>
<tr>
<td>log( Density population)</td>
<td>-0.080</td>
<td>-0.102*</td>
<td>-0.063</td>
<td>-0.311**</td>
</tr>
<tr>
<td>Language: Minority language</td>
<td>-5.801**</td>
<td>-6.808***</td>
<td>-4.588**</td>
<td>-17.880***</td>
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<tr>
<td>Dummy (2009=1)</td>
<td>0.118**</td>
<td>0.213***</td>
<td>0.102**</td>
<td>1.045***</td>
</tr>
<tr>
<td>Constant</td>
<td>10.054***</td>
<td>11.702***</td>
<td>7.711***</td>
<td>25.869***</td>
</tr>
</tbody>
</table>

| Observations                                           | 129          | 129         | 129              | 129         |
| Adjusted R-squared                                     | 0.750        | 0.747       | 0.717            | 0.524       |

** denotes significance at 10% level; *** at 5% level; ** at 1% level.
Key Findings

- All kinds of banks, including Equity Bank, had greater branch penetration in urban and English speaking districts.
- But Equity Bank differs in at least two dimensions:
  - The coefficients associated with rural, arid, and semi-arid are insignificant but negative for other banks.
  - The positive coefficient on the 2009 year dummy (bank expansion) is 1/10 to 1/5 that for Equity Bank.
- The sensitivity to population density is lower for Equity Bank.
- Overall, Equity experienced significant bank expansion, particularly in under developed and rural areas.
# Use of Banking Services and Equity Bank Presence

<table>
<thead>
<tr>
<th>Dep. variable: Bank account</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank branches</td>
<td>0.0010***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity Bank presence</td>
<td>0.0424***</td>
<td>0.0222**</td>
<td></td>
<td></td>
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<tr>
<td>Foreign bank presence</td>
<td>0.0255</td>
<td>0.0273</td>
<td></td>
<td></td>
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<tr>
<td>Gov. influenced banks presence</td>
<td>0.0298**</td>
<td>0.0287*</td>
<td></td>
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<tr>
<td>Local Private banks presence</td>
<td>0.0392**</td>
<td>0.0216</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Foreign bank branches</td>
<td></td>
<td></td>
<td>0.0044</td>
<td>0.0103***</td>
<td></td>
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<tr>
<td>Gov. influenced bank branches</td>
<td></td>
<td></td>
<td>0.0019</td>
<td>-0.0019</td>
<td></td>
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<tr>
<td>Local private bank branches</td>
<td></td>
<td></td>
<td>-0.0028</td>
<td>-0.0072***</td>
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</tbody>
</table>

| Observations | 10922 | 10922 | 10922 | 10922 | 10922 |
| Pseudo R-squared | 0.332 | 0.326 | 0.327 | 0.331 | 0.333 |
| District Fixed Effects | YES | YES | YES | YES | YES |
| Control Variables | YES | YES | YES | YES | YES |
The presence of Equity Bank in a specific district is strongly and positively related to the probability of having a bank account.

- The effect is beyond the presence of other banks.

The presence of all bank categories has a positive impact, but with a hierarchical increase in bank access:

- Domestic privates (4%), government (3%), foreign (2%); with foreign banks targeting high income segment.

Access increases with the number of branches in a district.
# Access to Credit

<table>
<thead>
<tr>
<th>Ordered Probit</th>
<th>Average Marginal Effects</th>
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<tr>
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<td>Financial</td>
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<td></td>
<td>Access=0</td>
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<tr>
<td>Bank branches</td>
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<td>Equity Bank presence</td>
<td>0.2637***</td>
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<td>Observations</td>
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<td>Pseudo R-squared</td>
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<tr>
<td>District Fixed Effects</td>
<td>YES</td>
</tr>
<tr>
<td>Control Variables</td>
<td>YES</td>
</tr>
</tbody>
</table>
Identification Strategy and Additional Tests

- Difficult to establish impact if branch expansion is non-random
- Instrumental variables
  - Based on Equity Bank’s shift in banking strategy, business model
  - % of people speaking a minority language in a district
- Difference-in-differences
  - Look at districts with no Equity presence in 2006
  - Compare change in likelihood of account for
    (a) Districts Equity had entered by 2009 [treatment]
    (b) Districts without Equity presence 2006, 2009 [control]
## IV, Diff-in-Diff Results

<table>
<thead>
<tr>
<th></th>
<th>IV GMM</th>
<th>IV Probit</th>
<th>Difference in Differences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dep. variable: Bank account</td>
<td>(1)</td>
<td>(2)</td>
<td>(3) (4) (5)</td>
</tr>
<tr>
<td><strong>First stage</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minority language district</td>
<td>-0.9086***</td>
<td>-0.9069***</td>
<td></td>
</tr>
<tr>
<td>Minority language district*2009</td>
<td>0.2313***</td>
<td>0.2333***</td>
<td></td>
</tr>
<tr>
<td><strong>Second stage</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank branches</td>
<td>0.0012***</td>
<td>0.0010***</td>
<td>-0.0021</td>
</tr>
<tr>
<td>Equity Bank presence</td>
<td>0.0939***</td>
<td>0.0984***</td>
<td>0.0293** 0.0198** 0.0280**</td>
</tr>
<tr>
<td>Foreign bank presence</td>
<td></td>
<td></td>
<td>0.0038</td>
</tr>
<tr>
<td>Gov. banks presence</td>
<td></td>
<td></td>
<td>0.0181**</td>
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<td>Local Private banks presence</td>
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<td></td>
<td>0.0095</td>
</tr>
<tr>
<td>Foreign bank branches</td>
<td></td>
<td></td>
<td>-0.0026</td>
</tr>
<tr>
<td>Gov. bank branches</td>
<td></td>
<td></td>
<td>-0.0007</td>
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<tr>
<td>Local private bank branches</td>
<td></td>
<td></td>
<td>-0.0034</td>
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<tr>
<td>Observations</td>
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<td>10922</td>
<td>5314</td>
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<td>Centered R-squared</td>
<td>0.759</td>
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<tr>
<td>Partial R-square of excluded IVs</td>
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<tr>
<td>p-value of excluded instruments</td>
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<tr>
<td>p-value of Hansen J statistic</td>
<td>0.1924</td>
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<td>Pseudo R-squared</td>
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<td>0.348</td>
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<tr>
<td>District Fixed Effects</td>
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<td>YES</td>
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<tr>
<td>Control Variables</td>
<td>YES</td>
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### IV Estimations

<table>
<thead>
<tr>
<th></th>
<th>IV GMM</th>
<th>IV Probit</th>
<th>Marginal effects</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Second stage</td>
<td>First stage</td>
<td>Second stage</td>
</tr>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>Bank branches</td>
<td>0.0012***</td>
<td>-0.0000***</td>
<td>0.0010***</td>
</tr>
<tr>
<td>Equity Bank presence</td>
<td>0.0939***</td>
<td></td>
<td>0.0984***</td>
</tr>
<tr>
<td>Minority language district</td>
<td>-0.9086***</td>
<td></td>
<td>0.2333***</td>
</tr>
<tr>
<td>Minority language district x Dummy(2009)</td>
<td>0.2313***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Observations</td>
<td>10922</td>
<td>10923</td>
<td>10922</td>
</tr>
<tr>
<td>Centered R-squared</td>
<td>0.7585</td>
<td></td>
<td></td>
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<tr>
<td>Uncentered R-squared</td>
<td>0.9311</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Probability of positive outcome (predict, p)</td>
<td></td>
<td></td>
<td>0.1128</td>
</tr>
<tr>
<td>Partial R-squared of excluded instruments</td>
<td></td>
<td>0.2822</td>
<td></td>
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<tr>
<td>p-value of test of excluded instruments</td>
<td></td>
<td>0.0000</td>
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<tr>
<td>p-value of Hansen J statistic</td>
<td></td>
<td>0.1924</td>
<td></td>
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<tr>
<td>District Fixed Effects</td>
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<tr>
<td>Control Variables</td>
<td>YES</td>
<td>YES</td>
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</tr>
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</table>
The presence of branches of Equity Bank has had a positive and significant impact on the household use of bank accounts and bank credit.

The results are robust and endogeneity issues addressed.

- Similar results obtain when we use a difference-in-difference estimator
- The positive association between Equity’s presence and bank service usage was higher for Kenyans with low income, no salaried job and less education, etc.

Thus, an innovative banking business model that can be inclusive and profitable [Profits meet social impact].
The central question for Africa and MENA:

- How to develop a well-functioning financial sector that is **inclusive, dynamic, innovative, and sustainable** to support the development imperatives facing the continent (e.g., AU Agenda 2063, UN Agenda 2030)

- The current state of affairs is grossly inadequate in financing the bold transformative agendas for Africa.

- At the center of the Agenda 2063, for instance, is self-reliance, including capacity for domestic resource mobilization. The development of domestic financial systems is key for domestic resource mobilization.
The Five Pillars

1. Include
2. Innovate
3. Integrate
4. Regulate
5. Capacitate
African and MENA Finance and the Way Forward

**Financial Inclusion**

- Inclusivity of finance as a key driver of inclusive growth in Africa.
- Financial inclusion empowers the very agents of inclusivity of development – youth, women, small farmers, SMEs – since these agents are among the financial excluded in society.
- Yet, finance has not been inclusive although African financial systems have recently grown both in quantity and depth.
- Re-enforcing the growing observation that financial system development is not sufficient for financial inclusion.
Financial Inclusion

Multidimensional

Access
making financial services available and affordable to users

Usage
making customers use financial services frequently and regularly

Quality
making financial services tailored to clients’ needs
Financial Inclusion

• The ultimate financial inclusion is when all segments and members of the economy are beneficiaries of accessibility, availability, and usage of the formal financial system.

• It is characterized by appropriately designed financial products (by mainstream financiers) which are fairly priced and readily accessible.

• An inclusive financial system can reduce the need for informal sources of finance, whose costs can be exorbitant (e.g., pay day lenders)
  ■ Who can extract huge rents in an environment characterized by financial exclusion but huge latent demand.
What Factors Enhance Financial Inclusion?

- The available evidence finds that there is a strong positive linkage between financial inclusion and infrastructure development – both physical and electronic connectivity, including network of paved roads, telephone and internet usage.

- Adult literacy and urbanization matter for financial inclusion. Rural areas are more likely to be excluded from finance
  - The inclusion gap can be bridged greatly through innovative technology-oriented solutions
African and MENA Finance and the Way Forward

**Financial Innovation**

- Africa and MENA must innovate.
  - The opportunities afforded Africa from innovation are enormous.

- Africa is innovating.
  - Home grown innovations which have received global attention, with Kenya at the center of this remarkable movement.
  - One can also innovate without the benefit of technology advances based on bold vision and new ideas.
  - Although the mobile money revolution spearheaded in Kenya is well known, less attention is given to a remarkable banking sector innovation lead by Equity Bank.

- Innovation for the underserved: The Case of Equity Bank
  - A pioneering Kenyan commercial bank that innovated a banking service strategy targeting low income customers and traditionally underserved territories.
DIGITAL IN AFRICA

KEY STATISTICAL INDICATORS FOR THE REGION’S INTERNET, MOBILE, AND SOCIAL MEDIA USERS

TOTAL POPULATION

1,231 MILLION
URBANISATION:
41%

INTERNET USERS

362 MILLION
PENETRATION:
29%

ACTIVE SOCIAL MEDIA USERS

170 MILLION
PENETRATION:
14%

MOBILE SUBSCRIPTIONS

995 MILLION
vs. POPULATION:
81%

ACTIVE MOBILE SOCIAL USERS

150 MILLION
PENETRATION:
12%

SOURCES: POPULATION: UNITED NATIONS; U.S. CENSUS BUREAU; INTERNET: INTERNETWORLDSSTATS; ITU; INTERNETLIVESTATS; CIA WORLD FACTBOOK; FACEBOOK; NATIONAL REGULATORY AUTHORITIES; SOCIAL MEDIA AND MOBILE SOCIAL MEDIA: FACEBOOK; TENCENT; VKONTAKTE; LIVEINTERNET.RU; KAKAO; NAYER; NIKI AGHAEI; CAFEBAZAAR.IR; SIMILARWEB; DING; EXTRAPOLATION OF TNS DATA; MOBILE: GSMA INTELLIGENCE; EXTRAPOLATION OF EMARKETER AND ERICSSON DATA.
Financial Innovation for the Masses: DFS

- The huge unbanked and underserved population in Africa and MENA is ample opportunity for innovative financial entrepreneurs.
- Africa’s global leadership in mobile money, thanks to M-Phesa, is an inspiration that transformative home grown innovations are possible in this region.
- There is now a proliferation of start-ups which capitalize on technology-oriented solutions, as particularly evidenced by the advent of FinTechs in Africa.
- A new and remarkable development characterized by inclusive innovation and mass movement.
Financial Innovation for the Masses

FinTechs

- FinTech startups in Africa are mobilizing mass market access to financial services
  - Savings, credit, insurance, other digital fin services.
  - Thus, inclusive innovation to impact mass livelihoods
  - Profit opportunity meets social impact opportunity
- About **300 FinTech startups active across Africa**
  - Top destinations: *South Africa, Nigeria, and Kenya*
  - 57 African FinTech startups have raised about $100 million in just two years (2015-2017) [*Disrupt Africa, 2018*].
  - *Funding:* venture capital-Silicon V and impact investors
FinTechs/Traditionals: Cooperation or Mutual Extinction

- FinTech startups arise in the advanced economies to disrupt the traditional financial industry and its delivery mechanisms of financial services.
- *Something different is evolving in Africa.*
- Traditional banks have been unwilling or unable to bridge the huge financial inclusion gap in Africa.
- But fear of obsolescence and need to innovate under disruptive pressure from startups
- Otherwise partner with startups. The indication is that banks, such as Barclays and Standard Bank in South Africa, have opted for partnership
- *Mutually beneficial:* Startups may also benefit from partnering with the banks in enhancing their administrative and operational capacities.
Given the thinness and illiquidity of the disparate national stock exchanges, it is imperative that these markets be consolidated through regional cooperation and initiatives.

- Harmonize trading laws and accounting standards, and promote convertibility of currencies.
- Overcome political economy
  - Countries tend to treat stock markets as national symbols as they do national airlines.

Setting up a stock exchange is no different from setting up a museum if the exchange fails to serve multiple functions it is designed to perform – liquidity, information production, price discovery, markets for corporate control, etc.
Financial Integration: The Good News

- There is a growing recognition for financial integration in Africa

- Key Initiatives for and regionalization and consolidation of markets
  - **BVRM (Abidjan)** – the world’s first regional stock exchange serving 8 Francophone West Africa
    - Benin, Burkina Faso, Guinea Bissau, Cote d'Ivoire, Mali, Niger, Senegal and Togo.

- Prospects for other regions
  - **West African Stock Markets [in progress]**: BVRM, Nigeria, Ghana, Siera Leone, Cape Verde
  - **East Africa** – Kenya, Uganda, Tanzania, Rwanda [in progress]
  - Southern Africa (SADC)

- African stock markets and regionalization as opportunities for **financial globalization** of Africa – the case of Africa-based funds
Financial Integration: The Rise of pan-African Banks

- Banking groups domiciled in Africa with subsidiaries in several countries.
- Groups are domiciled in South Africa, Nigeria, Kenya, and Morocco
  - Also, headquartered in a small country – Togo - Ecobank with a 32-country coverage
- Pan-African banks as an increasing share of domestic banking.
  - Have better knowledge of the African terrain and are positioned to transfer know-how to other countries
  - They increase competition in the domestic banking systems
  - They broaden the availability of financial services.
Financial Integration: Prospects for Globalization of African Finance

• The added advantages of market consolidation are:
  - enhanced capacity to mobilize resources for large scale investment projects (e.g., regional infrastructure projects)
  - promotion of Africa’s integration into the global financial economy.

• The thin size of African stock markets and absence of liquidity have been major hindrances to foreign investing in Africa.
Financial Globalization: Encouraging Forces and Trends

Encouraging forces and trends favor the prospect of integration of Africa and MENA into the global financial economy:

- **The world capital markets**, including those in emerging economies, are **becoming more integrated** with increasing capital mobility across national boundaries. Barriers to international capital flows have also been greatly reduced.

- **There are rapid advances in information technology connecting Africa with the rest of the globe**, and hence facilitating capital flows and global financial innovation. Thus, global investors seeking the benefits of diversified investment portfolios across national boundaries will be better able to access African financial systems.

- **As Africa and MENA** move toward integration into the global financial economy, the **development of a well-functioning and deep financial sector that is also regionally integrated should be in fast track agenda**. Thus, the African financial systems we want should be integral to the Africa we want as per Agenda 2063.
African and MENA Finance and the Way Forward

Financial Regulation

■ African and MENA financial regulatory frameworks need to catch up with the rapid pace of innovation and dynamism of finance.

■ Financial regulation should be an enabler and not a stifler.
  ■ Ill-designed regulation can impede the provision of inclusive financial services and stifle innovation.
  ■ Regulating financial excesses does not imply that regulation has to be commensurately excessive.
  ■ Financial regulation should refrain from protecting vested interests against innovative technology driven services by new entrants (e.g., Traditional taxi revolt in Kenya against Uber) [Competition policies and even playing field]
Financial Regulation: Shadow Banks

- The 2008 crisis revealed *shadow banking* with institutions engaged in non-transparent activities similar to what banks normally do:
  - But operating *outside* the banking regulatory regime, but they were among key culprits for the global crisis
    - Investment banks, money market funds,
- Regulatory regimes have since been reformed to address shadow banks, including those who operate across countries in an interconnected way.
- Shadow banks are bound to accompany the development of African and MENA financial systems; calling for proactive regulatory and disciplinary mechanisms for shadow banks,
Financial Regulation: Digital Financial Services

- How do you regulate digital financial services which have multiple players with (currently) multiple jurisdictions?
  - *Banks, shadow banks, mobile network operators, etc.*

- More specifically, relevant to Africa and MENA, should digital financial services be regulated by the banking regulator or a telecom regulator, or both, when these activities are both in the domain of banks and telecom?

- *Toward Functional regulation:* Regulation should be similar across providers (banks and non-banks) as long as these institutions provide services which are *functionally equivalent*. Not based on which institutions provided these functions *[Global Financial Inclusion Task Force Report, March 2016]*
African and MENA Finance and the Way Forward

Financial Capacity

- As African and MENA countries commit to the development of well-functioning and inclusive financial systems, they should be aware that risk is endemic to dynamic and increasingly complex systems.
  - Financial risk is unavoidable but manageable.
- Hence, as African and MENA financial systems develop, and even increasingly integrate into the global financial economy, there should be a commensurate commitment to the development of talented financial power with sufficient capacity to manage and control risk.
- The development of financial capacity should, in fact, be broader, and it should even include capacity to regulate.
Thank You!

Lemma W. Senbet

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