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, entrpreneurs (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:

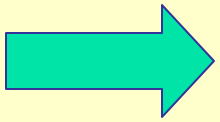
how to develop a well-functioning financial sector and build its capacity so as to exploit its potential contribution to economic development.

- *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

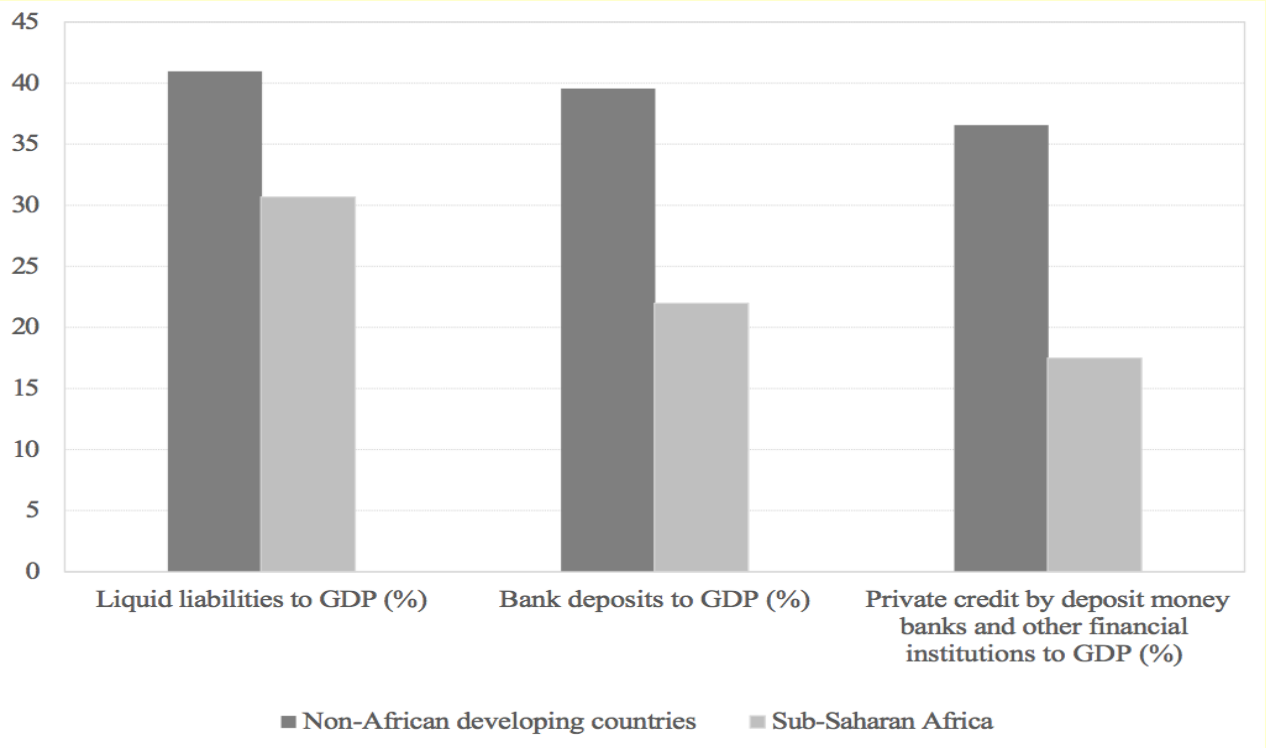
- Arab Monetary Fund, et al, Jan 2017 Report
  - In the race toward full financial inclusion, the Arab world lags behind other regions
  - Nearly 70 percent of adults (168 million) with no [bank] account ownership
  - 80 percent in the developing countries of the region with no account ownership
- Thus, 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)*

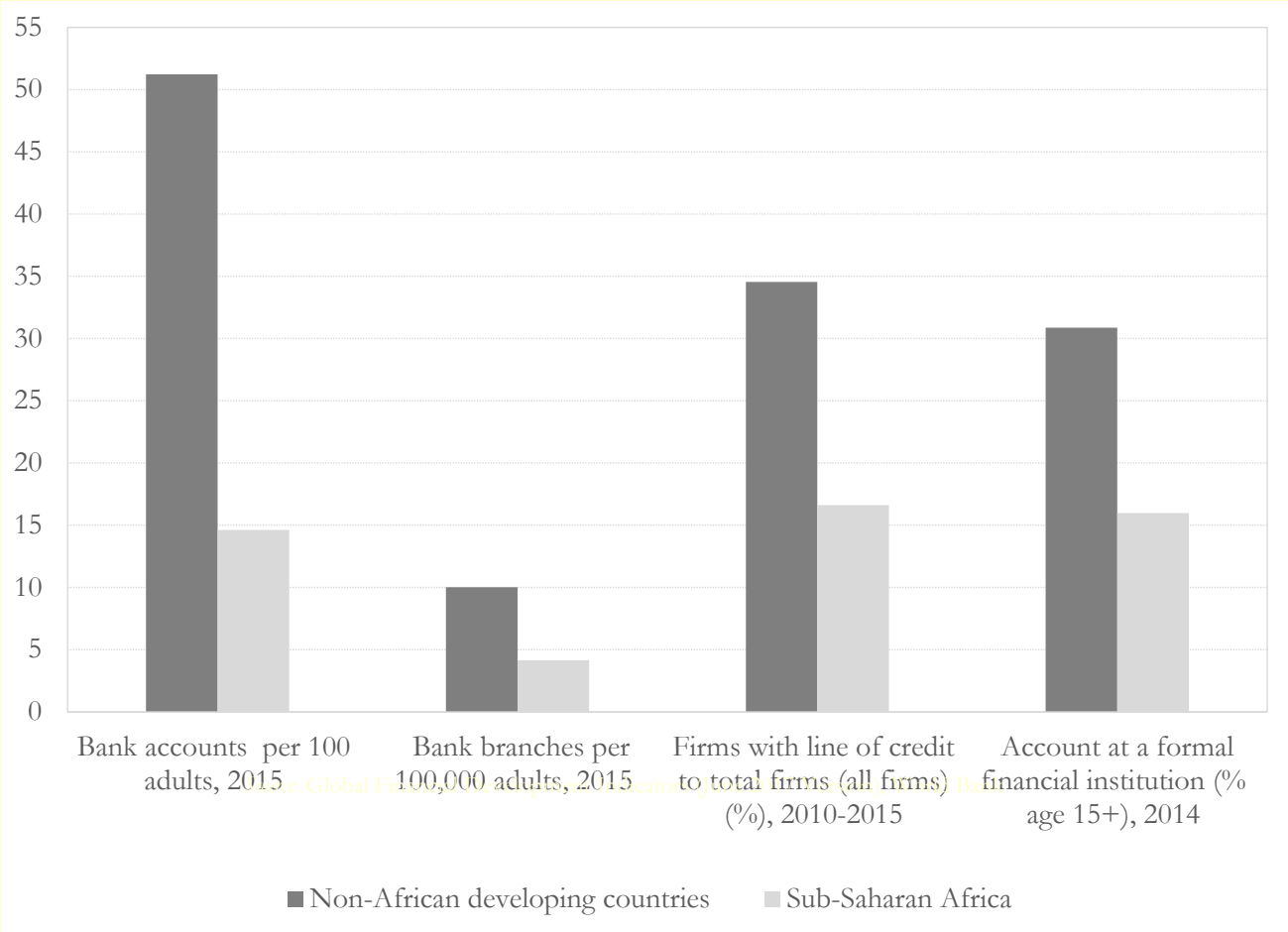
Variable	World (minus Africa)		Africa	
	Mean	Standard Deviation	Mean	Standard Deviation
Liquid liabilities / GDP	64.2%	47.4%	27.5%	17.7%
Private credit / GDP	57.7%	45.3%	17.6%	22.7%
Stock Market Capitalization / GDP	52.1%	60.0%	25.6%	43.8%
Stock Market Value Traded / GDP	34.1%	50.9%	6.5%	20.0%
Ln(Population)	2.44	1.59	2.24	1.33
Ln(Population density)	0.44	1.94	0.09	0.12
Natural resources	0.5	2.41	0.15	0.77
Offshore center	4.4%	20.7%	0.0%	0.0%
Ln(Per capita income)	2.25	1.04	0.38	0.94
Population * GDP per capita	0.48	1.35	0.03	0.07
Real GDP growth rate	4.1%	2.5%	4.8%	2.7%
Inflation rate	5.2%	5.2%	9.3%	15.0%
Current Account balance / GDP	0.2%	8.1%	-3.8%	6.7%
KKM index	0.33	0.9	-0.54	0.58
Bank concentration	0.65	0.19	0.81	0.14
Foreign ownership share	27.1%	25.9%	44.4%	24.4%
State ownership share	15.9%	19.7%	13.3%	16.6%
Manufacturing / GDP	16.8%	6.1%	11.0%	7.3%
Secondary/Primary school enrollment	0.81	0.24	0.33	0.18
Roads / Area	1.07	1.65	0.21	0.22
Railroads / Area	0.03	0.03	0	0
Urban population	63.6%	20.7%	36.2%	17.2%
Geographic branch penetration	29.76	80.07	7.97	22.49
Demographic branch penetration	16.51	17.28	2.86	3.64

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



Measuring the African Financial Devt Gap

Allen, Carletti, Cull, Qian, Senbet,Venzuela (NBER 2015)

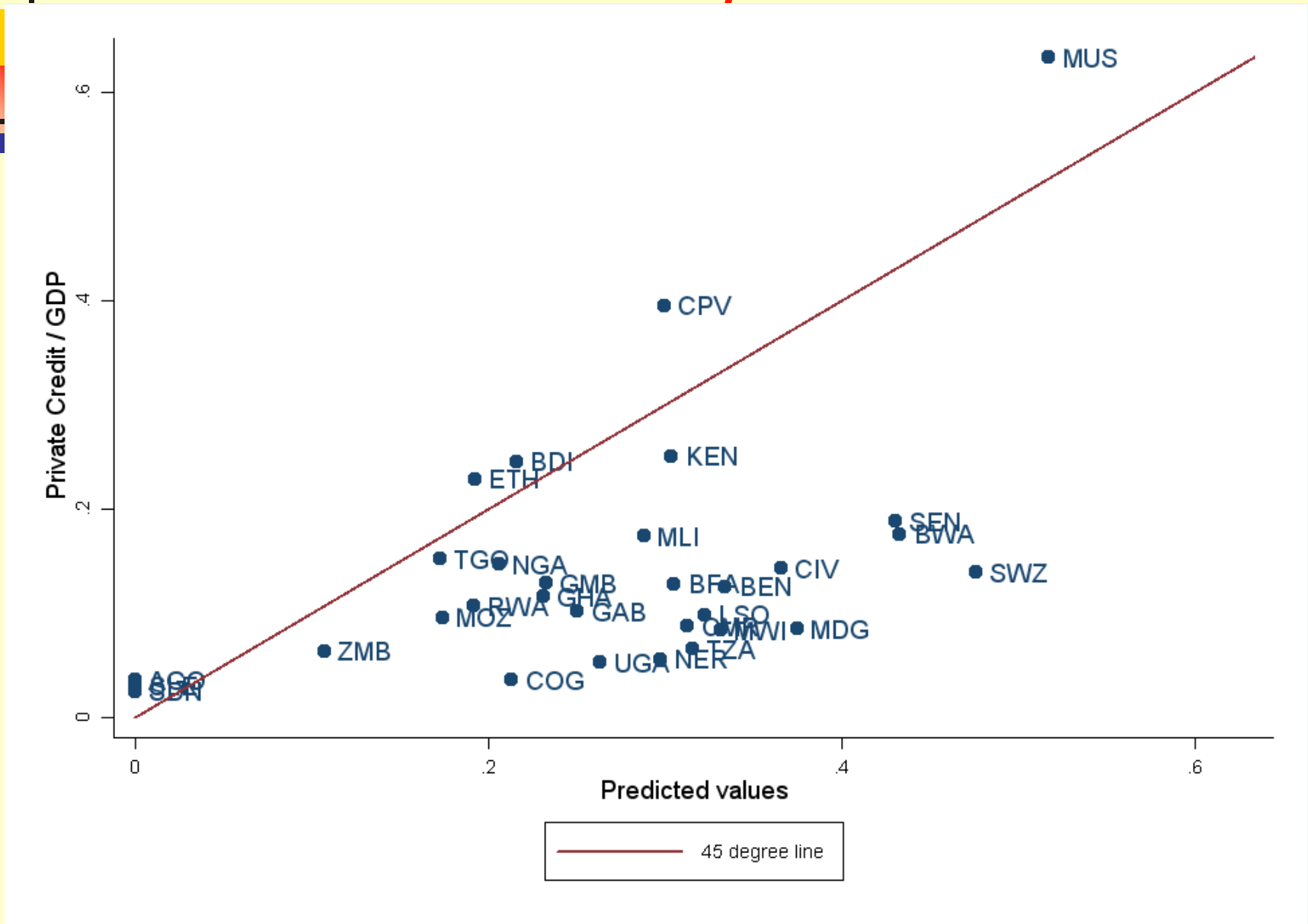
- Measuring the African financial development gap:
  - Obtain predicted levels of financial development for SSA countries, based on regression analyses of *other* low- and middle-income countries [benchmark indicators]
- Thus, characterizing the financial development path
  - Projecting on African countries
- 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

$FD_i = \alpha + \beta_1 Population_i$ $+ \beta_2 Population\ Density_i$ $+ \beta_3 Natural\ Resources_i$ $+\beta_4 Offshore\ Center_i$	Exogenous determinants, based on Beck *et al.* (2008)
$+\beta_5 Per\ Capita\ Income_i$ $+\beta_6 Population*GDP\ Per\ Capita_i$	Plausibly exogenous, Financial development affects these variables at a lag, Beck *et al.* (2008)
$+\beta_7 Real\ GDP\ Growth\ Rate_i$ $+\beta_8 Inflation\ Rate_i$ $+\beta_9 Current\ Account\ Balance/GDP_i$	Macroeconomic variables
$+B_{10} KKM\ Index_i$	Index of institutional development
$+ \beta_{11} Bank\ Concentration$ $+B_{12} Foreign\ Ownership\ Share_i$ $+B_{13} State\ Ownership\ Share_i$	Banking sector structure and ownership variables
$+B_{14} Manufacturing/GDP_i$ $+B_{15} Secondary/Primary\ enrolment$ $+ \varepsilon_i$	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*

Kenya Financial Lab and Equity Bank

- 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.

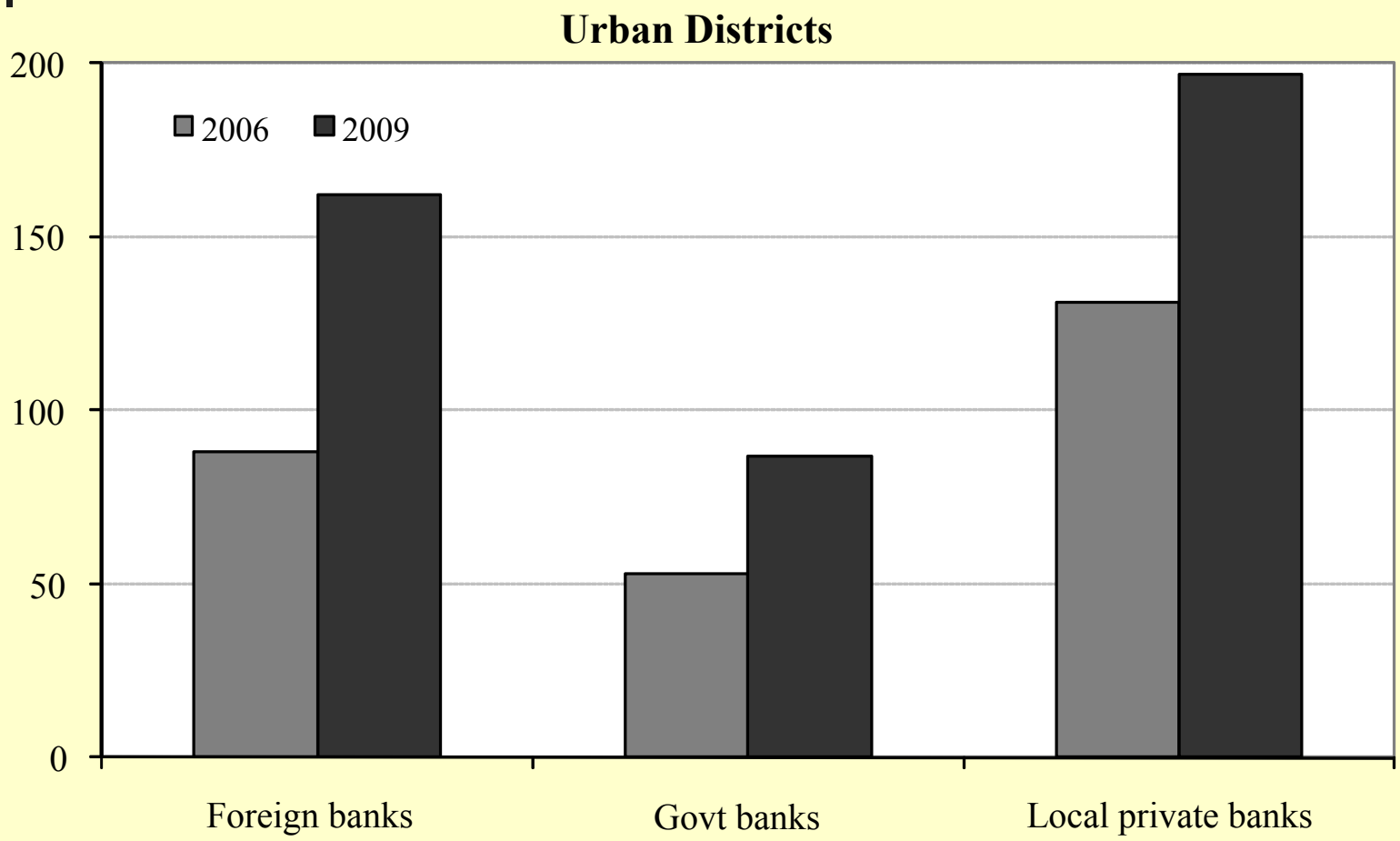
FinAccess household surveys

Conducted by Financial Sector Deepening Trust Kenya.

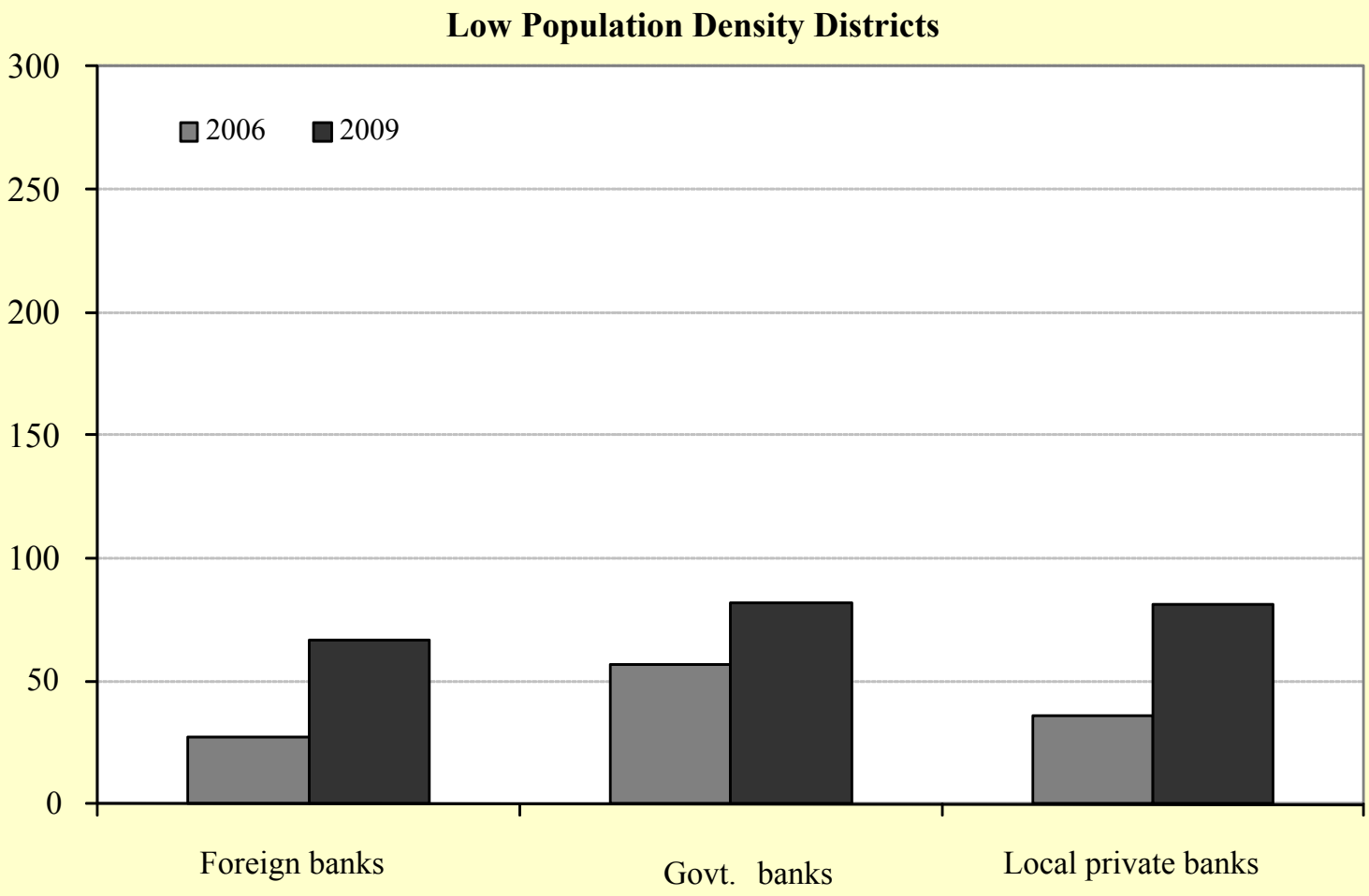
4,420 completed interviews in 2006 and 6,598 in 2009.

Data on access to financial services and individual/household characteristics.

Branch Expansion: Urban Districts



Branch Expansion: Low Population Density Districts



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

	Whole Sample		Urban Excluded	
Dep. variable: Number of branches over number of banks	Equity Bank excluded	Equity Bank	Equity Bank excluded	Equity Bank
Rural	-3.403**	-6.440	0.101**	0.834**
Arid and Semi-Arid	-3.504**	-7.276*		
log(Density population)	-0.068	-0.311**	-0.019	-0.191**
Language: Minority language	-4.961**	-17.880***	-1.119**	-7.685***
Language: Swahili	-5.047**	-18.666***	-1.146**	-8.194***
Dummy (2009=1)	0.101**	1.045***		
log(Density population) x d2009			0.007	0.049
Language: Minority language x d2009			0.009	0.708**
Language: Swahili x d2009			0.035	0.539
Constant	8.567***	25.869***	1.193**	8.364***
Observations	129	129	125	125
Adjusted R-squared	0.748	0.524	0.217	0.204

Branch Expansion Strategies

Dep. variable: Number of branches over number of banks	Foreign Banks	Govt. Banks	Private Domestic	Equity Bank
Rural	-4.032**	-4.368***	-2.958**	-6.440
Arid and Semi-Arid	-4.146**	-4.598***	-3.051**	-7.276*
log(Density population)	-0.080	-0.102*	-0.063	-0.311**
Language: Minority language	-5.801**	-6.808***	-4.588**	-17.880***
Language: Swahili	-5.902**	-6.953***	-4.680**	-18.666***
Dummy (2009=1)	0.118**	0.213***	0.102**	1.045***
Constant	10.054***	11.702***	7.711***	25.869***
Observations	129	129	129	129
Adjusted R-squared	0.750	0.747	0.717	0.524

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

Dep. variable: Bank account	(1)	(2)	(3)	(4)	(5)
Bank branches	0.0010***				
Equity Bank presence	0.0424***		0.0222**		0.0555***
Foreign bank presence		0.0255	0.0273		
Gov. influenced banks presence		0.0298**	0.0287*		
Local Private banks presence		0.0392**	0.0216		
Foreign bank branches				0.0044	0.0103***
Gov. influenced bank branches				0.0019	-0.0019
Local private bank branches				-0.0028	-0.0072***
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

Key Findings

- 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 hierarchial 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

	Ordered Probit	Average Marginal Effects		
		Financial Access=0	Financial Access=1	Financial Access=2
Bank branches	0.0039***	-0.0007***	0.0005***	0.0002***
Equity Bank presence	0.2637***	-0.0496***	0.0360***	0.0135***
Observations	10922			
Pseudo R-squared	0.2918			
District Fixed Effects	YES			
Control Variables	YES			

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

	IV GMM	IV Probit	Difference in Differences		
Dep. variable: Bank account	(1)	(2)	(3)	(4)	(5)
First stage					
Minority language district	-0.9086***	-0.9069***			
Minority language district*2009	0.2313***	0.2333***			
Second stage					
Bank branches	0.0012***	0.0010***	-0.0021		
Equity Bank presence	0.0939***	0.0984***	0.0293**	0.0198**	0.0280**
Foreign bank presence				0.0038	
Gov. banks presence				0.0181**	
Local Private banks presence				0.0095	
Foreign bank branches					-0.0026
Gov. bank branches					-0.0007
Local private bank branches					-0.0034
Observations	10922	10922	5314	5314	5314
Centered R-squared	0.759				
Partial R-square of excluded IVs	0.2822				
p-value of excluded instruments	0.0000				
p-value of Hansen J statistic	0.1924				
Pseudo R-squared			0.348	0.348	0.348
District Fixed Effects	YES	YES	YES	YES	YES
Control Variables	YES	YES	YES	YES	YES

IV Estimations

	IV GMM		IV Probit		
			Marginal effects		
	Second stage	First stage	Second stage	Second stage	First stage
Dep. variable: Bank account	(1)	(2)	(3)	(4)	(5)
Bank branches	0.0012***	-0.0000***	0.0010***	0.0052***	-0.0000***
Equity Bank presence	0.0939***		0.0984***	0.5989***	
Minority language district		-0.9086***			-0.9069***
Minority language district x Dummy(2009)		0.2313***			0.2333***
Observations	10922	10923	10922	10922	10922
Centered R-squared	0.7585				
Uncentered R-squared	0.9311				
Probability of positive outcome (predict, p)			0.1128		
Partial R-squared of excluded instruments:		0.2822			
p-value of test of excluded instruments		0.0000			
p-value of Hansen J statistic	0.1924				
District Fixed Effects	YES	YES	YES	YES	YES
Control Variables	YES	YES	YES	YES	YES

Equity Bank

Profitable, Yet Socially Impactful

- 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].

African and MENA Finance
The Way Forward

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

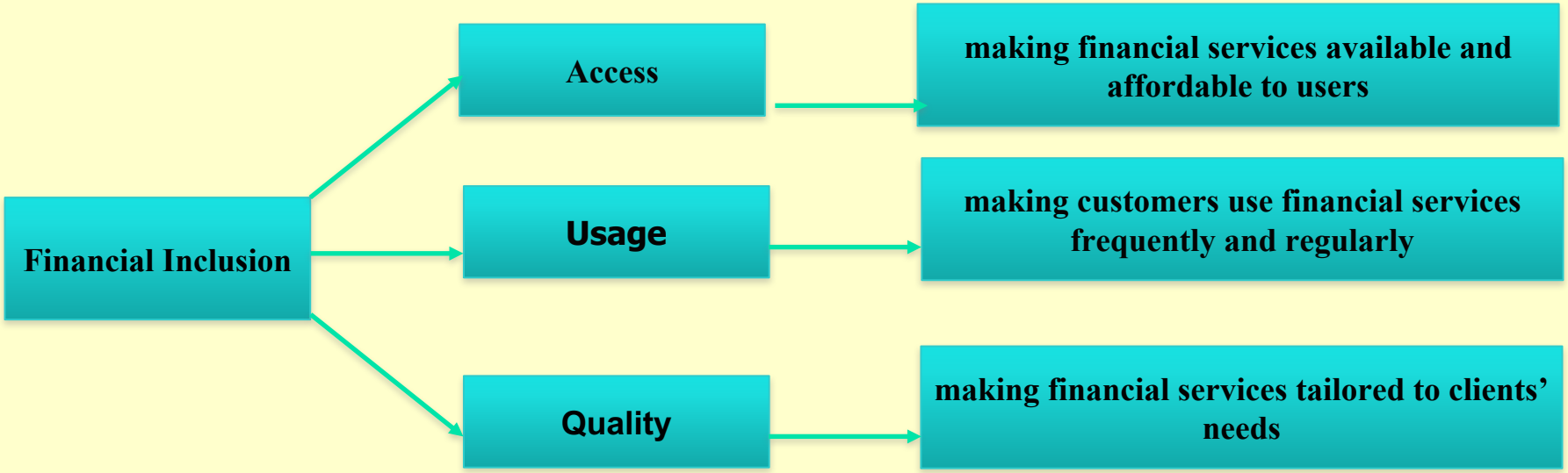
African and MENA Finance and the Way Forward

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



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.

JAN 2017

DIGITAL IN AFRICA

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

TOTAL POPULATION	INTERNET USERS	ACTIVE SOCIAL MEDIA USERS	MOBILE SUBSCRIPTIONS	ACTIVE MOBILE SOCIAL USERS
1,231 MILLION	362 MILLION	170 MILLION	995 MILLION	150 MILLION
URBANISATION: 41%	PENETRATION: 29%	PENETRATION: 14%	vs. POPULATION: 81%	PENETRATION: 12%

SOURCES: POPULATION: UNITED NATIONS; U.S. CENSUS BUREAU; INTERNET: INTERNETWORLDSTATS; ITU; INTERNETLIVESTATS; CIA WORLD FACTBOOK; FACEBOOK; NATIONAL REGULATORY AUTHORITIES; SOCIAL MEDIA AND MOBILE SOCIAL MEDIA: FACEBOOK; TENCENT; VKONTAKTE; LIVEINTERNET.RU; KAKAO; NAVER; 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 i*n Africa.
- A new and remarkable development characterized by **inclusive innovation and mass movement**.

AFRICA

Fintech Startups

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 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.

African Finance and the Way Forward
Financial Integration of Fragmented Markets

- 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. U
- **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!

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