



Impact of pan-African banks on financial development in sub-Saharan Africa

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March 2021

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Cover image: Skyline of the Central Business District of Nairobi, Kenya. April 2018.
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Acknowledgements

This synthesis paper provides evidence on the impact of regional banking on financial inclusion, deepening and stability, particularly in the context of the rapid rise across sub-Saharan Africa of pan-African banks (PABs) – namely bank subsidiaries headquartered in African countries. The evidence is based on existing literature and research funded by the UK Economic and Social Research Council (ESRC) and the Foreign, Commonwealth and Development Office (FCDO) through the Development and Economic Growth Research Programme (DEGRP). It includes evidence from the research project ‘Delivering inclusive financial development and growth’ (ESRC research grant reference ES/N013344/2).

The authors would like to thank Victor Murinde, Issouf Soumaré and Désiré Kanga for their helpful feedback on an earlier draft, and Louise Shaxson and Aaron Bailey-Athias for the final review of the paper. We also thank Katie Forsythe, Matthew Foley and Emilie Tant for their editorial support.

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Acronyms

AFTCA	African Continental Free Trade Area
BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest (Central Bank of West African States)
CAR	capital adequacy ratio
DEGRP	Development and Economic Growth Research Programme
EAC	East African Community
EPG	Evidence and Policy Group
FDI	foreign direct investment
GDP	gross domestic product
LIC	low-income country
LTD	loans-to-deposit
MoU	Memorandum of Understanding
NIM	net interest margin
NPL	non-performing loan
PAB	pan-African bank
POS	point of sale
SME	small and medium-sized enterprise
WAEMU	West African Economic and Monetary Union

Executive summary

In sub-Saharan African countries there has been a rapid rise of pan-African banks (PABs). These bank subsidiaries headquartered in African countries have expanded their activities across the continent following the retrenchment of traditional European and US banking groups after the global financial crisis in 2007/2008. At present, major PABs have a more significant footprint in sub-Saharan Africa than banks from outside the region (Mathieu et al., 2019). For instance, Ecobank, headquartered in Togo, has a presence in 33 sub-Saharan African countries, serving almost 23 million clients. These PABs are becoming increasingly economically and systemically important in their host economies, bringing an average of \$376 million of investment in subsidiaries annually, and holding over 10% of total deposits in 31 sub-Saharan African countries (ibid.).

This trend indicates how potentially important PABs' contributions are to the continent's financial development, but empirical evidence remains scarce. Drawing on a range of literature, including recent research undertaken by the DEGRP programme (e.g. Kanga et al., 2018; 2020a; 2020b), this paper aims to synthesise available evidence on PABs' impact on financial inclusion, deepening and stability in sub-Saharan Africa in order to provide insights for policy-making in the region, as well as identify research gaps. It also includes a special feature on three DEGRP papers that focus on PABs' impact on aggregate lending, firms' access to finance, bank risks and profitability, banking sector competition, and bank stability in the unique context of the West African Economic and Monetary Union (WAEMU).

Findings

In sub-Saharan African countries, the existing literature, together with the DEGRP papers, suggest that the impact of PABs on financial access, banking competition and efficiency, and financial stability are heavily underpinned by their higher exposure to the small and medium-sized enterprise (SME) segment, which exhibits higher default risks. PABs

also tend to be in lower-income countries, with weaker banking regulation, and to some extent weaker institutional qualities, while the opposite is true for other foreign banks. In particular, the current evidence suggests:

- **PABs increase financial access, but the evidence on this is stronger for firms than for households.** Firms engage more in traditional intermediation services and with the lower end of the market. PABs increase African firms' access to finance, with the strongest impact on small and large firms and young enterprises. The impact on households' financial access is less clear-cut, although anecdotal and descriptive evidence suggests that PABs have substantially increased their number of bank branches, ATMs and services compared to other foreign banks.
- **PABs' effects on micro-prudential stability are mixed.** PABs tend to have the least cyclical lending behaviour compared to other foreign and domestic banks, suggesting that they may decrease the procyclicality of financial intermediaries over time, thus helping to stabilise African economies in times of economic distress. However, the competition induced by PABs poses threats to banking stability: PABs and established banks are taking on more risky activities to maintain profitability, and PABs lag behind domestic and other foreign banks in loan provisioning, which may indicate overstatement of their capital base, especially given their higher exposure to the SME sector.
- **PABs are increasing macro-prudential risks.** There is some evidence that PABs are conduits for transmitting cross-border risks between countries in the region as their lending behaviour is affected by shocks from their home country; however, the impact is not significantly different from the behaviour of other foreign banks. This issue needs to be further examined in light of recent shocks to sub-Saharan African banking systems, such as the Covid-19 pandemic.



- **PABs increase banking competition and efficiency.** PABs tend to drive competition in the banking sector and have been cost-efficient in producing loans and other earning assets. However, their profitability is found to be lower than other foreign banks, reflecting PABs' slightly greater exposure to SMEs, which present higher default risks. PABs' active participation in other market segments (e.g. interbank, government bills and securities, and foreign exchange markets) may have helped enhance price discovery.

Implications

The above evidence on the impact of PABs on financial deepening, banking competition and efficiency, financial inclusion and stability will have the following implications for financial regulators:

- **Regulatory burden.** *The expansion of PABs will require supervisors to create a necessary window for cooperation and exchange of information between home and host regulators of PABs. Greater skills are also needed to supervise these regional banks, which often have untransparent ownership structures and*

operate in several regulatory environments and legal traditions. In addition, these regulatory and supervisory skills should be tailored depending on whether a country is the home (e.g. Kenya) or host (e.g. WAEMU countries) of expanding PABs. This is challenging for most sub-Saharan African countries with already very limited capacity to implement their own domestic prudential supervision. This burden could be eased by disclosing consolidated information more frequently and harmonising standards.

- **Home-host supervisory cooperation.** *The increasing systemic importance of PABs in individual countries, and in the region as a whole, will require home and host cooperation to tackle cross-border supervisory and crisis management issues. Leading efforts by central banks in the region on supervisory colleges and consolidated supervision (e.g. South Africa), cross-border supervision (e.g. Nigeria) and bilateral Memoranda of Understanding (MoUs) (e.g. Uganda) can provide a template for wider cooperation among home and host regulators, especially for systemically important PABs.*

- **Balancing banking stability and inclusion policies.** From the financial inclusion angle, PABs expand financial services to the relatively risky (perceived or actual) segments of the market, and this increased competition puts pressure on other banks to also expand their services to non-traditional clients and activities. From the financial stability angle, PABs tend to have higher exposure to assets with a higher probability of default, which weakens these banks' own balance sheets as well as the whole financial system, due to the fact that PABs have increasing market shares in host economies. Thus, regulators may strategically encourage the entry of targeted PABs that tend to reach a wider range of clients than other PABs, while ensuring that they are more closely regulated by host authorities.
- **Regulation for the growing sophistication of PABs.** PABs are now expanding their activities to include large corporate and investment banking, and they are employing digital innovation to reach more clients, as well as actively participating in interbank markets, treasury bill markets, foreign exchange markets and non-traditional transactions (e.g. real estate and infrastructure financing and insurance). While these activities

could potentially catalyse financial product innovation and price discovery in the region, regulators must ensure they are abreast of the growing sophistication of PABs. Ministers and central bank governors need to have regular, high-level discussions on the opportunities and threats of PABs to financial stability and to effectiveness of monetary policy – and on the best practices being employed by regulators within and outside the region to address these regional banking issues.

Further research is needed to better understand the drivers and impacts of PABs on their host economies' financial development, and on regional financial stability as a whole. Future research topics may include understanding the behaviour of PABs by bank size and characteristics of home and host countries; the impact of PABs on deposit and lending rates, monetary policy transmission, contagion risks from PABs' home to host countries and vice versa; and implications of regulatory changes (e.g. Basel regulations) and shocks (e.g. Covid-19) for PABs. Gathering international best practices on cross-border supervision and home-host regulatory cooperation from other regions with similar characteristics to sub-Saharan Africa (e.g. developing countries in Asia) may provide important insights.

1. Introduction

Following the financial liberalisation reforms in sub-Saharan Africa in the 1990s, the region's banking systems have steadily shifted from being predominantly state-owned to privately owned, and towards higher levels of foreign ownership (Mecagni et al., 2019). Since then, cross-border financial flows and banking activities have become more important in the African financial landscape (Kanga et al., 2018; 2020a; 2020b). This is evident with the dominance of foreign banks, which on average comprise more than half of the total bank population (57%) and total assets of the banking sector (59%) in sub-Saharan African countries as of 2013 (World Bank, 2020). Foreign banks hold the entire (100%) total bank assets in Burkina Faso, Eswatini and Madagascar, and almost all bank assets in Zambia (99%) and Mozambique (95%) (ibid.).

This trend has been apparent since the mid-2000s, and the rise of global 'universal banking' conglomerates has also led to a rapid increase in the entry of foreign banks' subsidiaries with headquarters in Africa (i.e. PABs). Since the global financial crisis in 2007/2008 and the retrenchment of traditional European and US banking groups, the number of PABs in sub-Saharan Africa increased from 94 in 2003 (23% of bank population) to 132 in 2008 (28% of total bank population) and to 173 in 2012 (35% of bank population) (Pelletier, 2018). As of 2015, 10 major PABs¹ based in Kenya, Nigeria, South Africa and WAEMU have a more significant footprint in sub-Saharan Africa than banks from outside the region (Mathieu et al., 2019). PABs are also becoming economically and systemically important in their host economies, bringing in an average of \$376 million of investment in subsidiaries annually, and holding over 10% of total deposits in 31 sub-Saharan Africa countries (ibid.). The consolidated assets of major PABs such as Bank of Africa BMCE Group in Morocco,

Standard Bank Group in South Africa and Ecobank Group in Togo are equivalent to as much as 28%, 45% and 430% of the gross domestic product (GDP) of their respective home countries.

Existing literature suggests that drivers of foreign bank entry can vary according to the host country's geographical location or income level (Claessens et al., 2001; Cull and Martinez Peria, 2010), and that the origin of foreign banks matters in assessing their impact on their host country's financial sector development (Van Horen, 2007; Claessens and Van Horen, 2014). Several studies examine the impact of foreign banks in general in sub-Saharan Africa, but there has been less research specifically on the impact of PABs. Despite their increasing presence and economic significance in sub-Saharan African countries, the limited existing literature focusing on PABs is largely descriptive and anecdotal, while empirical evidence remains scarce. This paper aims to synthesise available evidence on PABs' impact on financial inclusion, deepening and stability in sub-Saharan Africa, in order to provide insights for policy-making in the region as well as identify research gaps. It draws on research funded under DEGRP, setting this in the context of the wider literature (see Box 1) and highlighting three DEGRP papers focusing on PABs' impact on aggregate lending, firms' access to finance, banking sector competition and bank stability in the context of WAEMU.

The next section provides a brief discussion of determinants of the expansion of PABs in sub-Saharan Africa. Section 3 presents evidence on PABs' impact on the continent's financial development, particularly on financial inclusion, banking sector efficiency and competition (deepening) and financial stability. Section 4 focuses on implications for supervisory and regulatory oversight, and the final section provides conclusions.

1 Not counting PABs with headquarters in North Africa (Mathieu et al., 2019).

Box 1 The contribution of DEGRP to research on regional banking in sub-Saharan Africa

DEGRP funds world-class scientific research on inclusive economic growth in LICs. The programme's principal aim is to generate policy-relevant, high-quality research and to promote effective communication of that research to key policy decision-makers around the world.

It is supported by the **Evidence and Policy Group (EPG), based at ODI**, whose goal is to maximise the profile, uptake and impact of DEGRP research. Its main outputs are individual research programmes, published papers and convening programmes for academics, regulators, policy-makers and other stakeholders. Research projects show a great diversity of method and topic, with a wide range of theoretical, quantitative, qualitative, cross-border and case-study analyses, with topics spanning from high-level macroeconomic research to in-depth examination of particular issues.

In relation to this synthesis paper, the authors find that despite rapidly expanding PABs in sub-Saharan Africa and a greater interest in this from regulators, economists and the private sector, empirical research investigating the impact of these regional banks on financial deepening, inclusion and stability remains scant.

The DEGRP-funded projects produced the first set of papers (by Kanga et al., 2018; 2020a; 2020b) that investigated a more direct impact of PABs on competition, firms' access to credit, bank risks and profitability, and banking stability in WAEMU countries.

The research papers completed under the programme* created evidence on the impact of PABs in the unique context of WAEMU, and could jump start empirical investigation on the potential differential effect of PABs in sub-Saharan Africa's sub-regions. Thus far, the existing (but very limited) empirical studies on PABs treat sub-Saharan Africa countries homogenously. Prior to the DEGRP papers, there were only three empirical papers that provided a sub-regional lens on PABs: determinants of expansion of East-African PABs (Kodongo et al., 2015); indirect evidence on the impact of PABs on banking competition in WAEMU (Léon, 2016); and PABs' market power and revenue diversification in Africa's sub-regions (but for selected West African countries, not necessarily within WAEMU) (Nguyen et al., 2016).

Furthermore, there is an aim to accompany this synthesis paper with a dissemination event, which will deepen and broaden its impact. The event will be co-hosted by the **Making Finance Work for Africa partnership**, an initiative that supports the development of the African financial sector through working with African governments, the private sector and development partners to coordinate financial sector development interventions across the continent, avoiding duplication and maximising development impact.

* www.soas.ac.uk/inclusive-finance

2. Drivers of regional banking in sub-Saharan Africa

Regional and international developments have also contributed to the expansion of PABs in sub-Saharan Africa. First, financial liberalisation in the late 1980s to early 1990s has since eased the entry of foreign banks into the region. Second, the global financial crisis in 2007/2008 that triggered tighter regulations and higher capital requirements in advanced economies led to a retrenchment of traditional foreign banks (i.e. European) from the region, opening up opportunities for PAB players to fill the gap left by these banks (Léon, 2016; Mathieu et al., 2019; Zins, 2018).

In addition, particular home country factors have been observed to drive PABs to expand in the region. In South Africa, for instance, the end of apartheid paved the way for liberalisation of the financial sector and subsequent ownership of banks, and the expansion of South African banks abroad (Beck et al., 2014). In Nigeria, the Central Bank's regulation to increase banks' minimum capital requirement by more than 10-fold in 2005 led to bank consolidation, mergers and acquisitions, consequently raising excess capital at home and enabling the capital capacities of banks to expand beyond Nigeria (Beck et al., 2014; Christensen, 2014; EIB, 2016). Most PABs' business models in Togo, South Africa and Nigeria also follow their home corporate clients' expansion within sub-Saharan Africa, while others have parent banks (e.g. Ecobank, Intercontinental Bank, United Bank of Africa) whose corporate strategies aim to widen their presence on the continent (Lukonga and Chung, 2010; Beck et al., 2014).

Based on a scan of the literature, most empirical studies on the determinants of cross-border banking in sub-Saharan Africa generally cover foreign banks. Only three studies focused on quantitatively estimating the drivers of PABs' expansion within sub-Saharan Africa.

The first is by Kodongo et al. (2015) studying Kenyan banks' expansion in East Africa from 2002 to 2012. Among home country 'push' factors, the authors find that Kenyan banks' investments abroad are positively associated with FDI outflows, indicating that banks tend to follow their clients abroad. They also find that Kenyan banks' investment in foreign subsidiaries increases as the Kenyan financial market deepens. This implies that deeper financial markets might have facilitated Kenyan banks to exploit more income at home, which subsequently enabled them to finance activities abroad. Among host country factors, Kenyan banks tend to invest in countries with low inflation or lower bank efficiency than their own (to compete through relatively better cost management than host countries' banks). Notably, the authors also found robust results showing that, while governance issues may be considered by Kenyan banks in their plans to expand abroad, these are not relevant as Kenyan banks implement their foreign activities. This suggests Kenyan banks may be less affected by low institutional qualities in host economies, since they may be similar to their operating conditions at home.

Pelletier (2014) analyses a wider scope of sub-Saharan African countries in identifying the differences in determinants of market shares between PABs and global banks from advanced economies. The author finds that PABs are more prevalent in countries with weak banking regulation (i.e. lower minimum capital requirements) and lower levels of income, while the opposite is true for global banks. In addition, macroeconomic growth of host countries is more important for increasing market shares of global banks, while it is less important for PABs. There is some weak self-selection evidence that PABs tend to be in host countries with weak economic growth and institutional quality (Table 1).

Table 1
Host country factors driving expansion of PABs and global banks in East Africa

Host country determinants	Indicator	PABs	Global banks
Concentration of banking market	Herfindahl-Hirschman Index (lagged)	(+) not significant	(-) not significant
Strength of regulation of the banking sector	Minimum capital requirements	(-) significant	(+) significant
	minimum capital adequacy ratio	(-) not significant	(-) not significant
Institutional quality	Bad governance index	(-) not significant	(+) not significant
Income level	GDP per capita	(-) significant	(+) not significant
Macroeconomic growth	GDP growth	(-) not significant	(+) significant

SOURCE: PELLETIER (2014).

NOTES: THE POSITIVE SIGN INDICATES THE SAME DIRECTION OF RELATIONSHIP BETWEEN THE HOST COUNTRY DETERMINANT INDICATOR AND THE EXPANSION OF PABS OR GLOBAL BANKS, WHILE A NEGATIVE SIGN INDICATES THE OPPOSITE DIRECTION OF RELATIONSHIP. FOR EXAMPLE, THE HIGHER THE MINIMUM CAPITAL REQUIREMENT, THE LOWER THE EXPANSION OF PABS (NEGATIVE SIGN TO INDICATE THE OPPOSITE DIRECTION OF RELATIONSHIP).

The third empirical study, by Mathieu et al. (2019), investigates both home and host country determinants of expansion of eight major PABs present in 41 sub-Saharan African countries. The authors find that cross-border investment of PABs in subsidiaries is significantly driven by:

1. **Home country (push) factors.** PABs searching for better yields and an increased diversification of assets and risks outside the location of parent banks;

2. **Host country (pull) factors.** Such as increasing market size and macroeconomic stability of investment destination;
3. **Country pair factors** ('gravity' model). Influenced by geographical and cultural proximity.

Table 2 shows the specific variables that significantly influence PABs' investment in the region.

Table 2
Host and home country factors in PABs' expansion across sub-Saharan Africa

Home factors	Host factors
Market size and macroeconomic stability conditions	
GDP (+), inflation (+), openness to trade (+), volatility of exchange rate vis-à-vis \$ (-)	GDP (+), GDP growth (-), inflation (-), volatility of exchange rate vis-à-vis \$ (-)
PABs' size and profitability	
Total equity for all PABs except one PAB (+), return on equity (-)	
Country-pair variables, cost of doing business	
Physical distance (-), shared border (+), common language (+)	

SOURCE: MATHIEU ET AL. (2019).

3. Impact of pan-African banks on financial development in sub-Saharan Africa

Cross-country studies find that higher foreign bank entry generally increases efficiency and competition (Mathieu et al., 2019), stability in credit markets (Arena et al., 2007) and financial inclusion with increased credit to small firms (de la Torre et al., 2010; Beck et al., 2011; Kanga et al., 2018). However, the impact of foreign banks on host economies' financial deepening and stability is more nuanced by country context and the origin of cross-border banks. Empirical evidence focusing on regional banking (i.e. PABs) in sub-Saharan Africa is extremely scarce, with key findings from existing literature and the DEGRP papers outlined below.

3.1 Impact on financial depth

The number of subsidiaries of the 14 largest PABs in sub-Saharan Africa tripled from 53 to 169 between 2006 and 2015 (Mathieu et al., 2019). One PAB alone (Ecobank, headquartered in Togo) has operations in 33 African countries. Such banks offer financial products and services ranging from personal, commercial and SME banking to corporate and investment banking (Table 3). In addition, PABs' participation in other segments of the financial system can contribute to further deepening of the financial market. For instance, Christensen (2014) reported that, in Nigeria, the participation of PABs in open market operations has helped moderate the level of the interest rate structure, while in Malawi, PABs remove or inject foreign exchange into the system depending on exchange rate developments, opening up scope for their role in currency substitution (ibid.).

Moreover, PABs are becoming important not only in terms of presence, but also systemically in their host countries. For instance, the share of seven major PABs alone to total deposits in Benin, Chad, the Central African Republic and Mali was greater than 70% as of 2013 (Enoch et al., 2015). In addition, major PABs account for 20%

or more of their respective host country banking system assets (Beck et al., 2014). The total assets of major PABs in Morocco, South Africa and Togo is equivalent to as much as 28%, 45% and 430% of GDP, respectively (Table 3).

However, in terms of credit provision, PABs seem to lag behind the performance of domestic banks and other foreign banks. In absolute terms, the average volume of loans of foreign affiliates of global multinational banks in sub-Saharan Africa remains higher (€1.6 billion) than that of domestic banks (€1.3 billion) or PABs (excluding those headquartered in South Africa, €265 million) from 2006–2015 (EIB, 2016). During a similar period, domestic banks have higher loans-to-deposit (LTD) ratios (76%) than PABs or global foreign banks (60%), indicating that domestic banks remain the most active in lending (ibid.).

This may reflect the findings of Nguyen et al. (2016), who indicate that foreign banks with a certain market power are more active than their domestic counterparts in exploiting non-traditional banking and in earning higher non-interest income from their operations across the continent. However, the authors find that, even with relatively higher market power, PABs tend to earn less from non-traditional businesses, indicating that PABs provide more financial intermediation services than non-regional counterparts. This is especially the case for the higher LTD ratios of PABs than those of domestic banks in Côte d'Ivoire (132% vs. 94%) and Togo (179% vs. 97%) (Togo being the hub of PABs in WAEMU²). Major PABs also exhibit strong intermediation roles, with more than 50% LTD ratios, and up to 83% and 92% in the cases of South Africa's Standard Bank Group and Morocco's Bank of Africa Group, respectively (Table 3). Thus, it is not surprising that, in the context of WAEMU, Kanga et al. (2018) find empirical evidence that PABs positively (but not significantly) affect credit growth. Meanwhile, the

2 Figures are based on feedback received on an earlier draft by the authors from Murinde, Kanga and Soumaré.

Table 3
Bank characteristics of major PABs in sub-Saharan Africa as of 2019

	KCB Group (Kenya) ¹	UBA Group (Nigeria) ²	Bank of Africa, BMCE Group (Morocco) ³	Standard Bank Group (South Africa) ⁴	Ecobank Group (Togo) ⁵
Number of countries with bank operations in sub-Saharan Africa (+ North Africa)	6	20	17 (+3)	20	33
Number of countries with bank operations outside Africa	0	3 (UK, France, US)	11 (Europe, Asia, North America)	5 (Brazil, US, China, UAE, UK, Channel Islands)	1 (France)
Number of employees	7,584	20,000	12,800	50,691	14,878
Total assets ⁶	Ks 898,572 mn (9.2% of GDP)	N 5,604,052 mn (3.8% of GDP)	\$32,913,856,000 (27.5% of GDP)	R 2,275,589 mn (44.8% of GDP)	\$23,641,184,000 (430% of GDP)
Of which, loans and advances to customers	Ks 535,371 mn	N 2,061,147 mn	\$19,456,030,000	R 1,181,067 mn	\$9,276,608,000
Total liabilities	Ks 768,831 mn	N 5,006,074 mn	\$30,016,377,000	R 2,066,105 mn	\$21,755,407,000
Of which, deposits from customers	Ks 686,583 mn	N 3,832,884 mn	\$21,141,710,000	R 1,426,193 mn	\$16,246,120,000
Total equity	Ks 129,741 mn	N 597,978 mn	\$2,897,480,000	R 209,484 mn	\$1,885,777,000
Net interest income	Ks 56,130 mn	N 221,875 mn	\$1,033,443,000	R 62,919 mn	\$749,729,000
Loans-to-deposit ratio (%) ⁷	78%	53.8%	92.0%	82.8%	57.1%
Net interest income as % of total assets ⁸	6.2%	4.0%	3.1%	2.8%	3.2%
Non-performing loan (NPL) ratio (%)	10.9%	n/a	n/a	n/a	9.7%
Cost to income ratio (%)	45.9%	n/a	n/a	56.4%	66.2%
Return on equity (%)	20.7%	n/a	n/a	16.8%	13.2%
Total capital adequacy ratio (CAR)	19.0%	n/a	n/a	16.7%	11.6%
Number of business offices/branches	342 branches, of which 282 are in Kenya	1,000 business offices	Over 1,230 branches	1,115 branches, of which 529 are in South Africa)	847 branches
Customer touch points	1,055 ATMs, 23,302 agents and points of sale (POS)	2,539 ATMs; 24,168 POS	1,800 POS	11,976 ATMs, of which 6,728 are in South Africa	2,664 ATMs, 39,912 express point agents
Customers	22.9 million	Over 18 million	About 6.6 million	14.8 million, of which 9.4 million are in South Africa	More than 23 million
Banking services	Personal banking, corporate banking, investment banking and insurance	Corporate, commercial, SME, consumer and personal banking	Commercial banking, investment banking, specialised financial services	Personal and business banking, corporate and investment banking	Personal banking, commercial banking, corporate and investment banking

SOURCES: PABs' WEBSITES AND ANNUAL REPORTS: 1. KCB (2020); 2. UBA WEBSITE AND [PRESS RELEASE](#), AND UBA (2020); 3. BANK OF AFRICA (BOA, BMCE GROUP) [WEBSITE](#), BOA (2020); 4. STANDARD BANK [WEBSITE](#) AND SGB (2020); 5. ECOBANK GROUP (2020); 6. AUTHORS' COMPUTATIONS: DIVIDING TOTAL ASSETS BY NOMINAL GDP AS OF 2019; GDP DATA BASED ON WORLD DEVELOPMENT INDICATORS; 7. AUTHORS' COMPUTATIONS: DIVIDING LOANS AND ADVANCES TO CUSTOMERS BY DEPOSITS FROM CUSTOMERS; 8. AUTHORS' COMPUTATIONS: DIVIDING NET INTEREST INCOME BY TOTAL ASSETS.

authors find that other foreign banks (i.e. French banks) have a strong and negative impact on bank lending, especially for small banks and in LICs.

Meanwhile, PABs have also played a role in development. PABs have actively become lead arrangers of new syndicated and bilateral loans for infrastructure in sub-Saharan Africa, filling the gap left by traditional lenders (i.e. France, Germany, UK) following stricter international regulatory requirements after the global financial crisis, which indirectly penalise the cross-border lending of these European banks (IMF, 2014). In addition, PABs' expansion has provided jobs – with a presence in 20 sub-Saharan African countries, Standard Bank Group alone employs over 50,000 staff, who might have been directly receiving knowledge transfers and managerial skills and techniques from parent offices. The PABs' impact on financial inclusion will be discussed in detail in Section 3.3.

3.2 Impact on financial inclusion

The evidence on PABs' contribution to improving financial inclusion in their host economies is scarce, and when available, largely observed on a case-by-case basis. For instance, Kenyan PABs are observed to leverage their expertise in agent and mobile banking to reach unbanked populations in East Africa, while Moroccan PAB subsidiaries in francophone West Africa largely focus on lending to SMEs (Born and Mathieu, 2015; Beck et al., 2014). Attijariwafa Bank, one of the largest banks in Morocco, targets reaching out to populations that do not have banking access, as well as lending to SMEs and financing large infrastructure projects on the continent (Christensen, 2014). In Uganda, PABs were reported to be more willing to serve non-prime borrowers than major international banks (ibid.).

The impact of PABs in expanding physical points and covering millions of customers have been more visible. Nigerian banks alone are responsible for the 20%, 26% and 35% growth of bank branches in Ghana, Sierra Leone and the Gambia, respectively, and are reported to be increasingly present outside of capital cities (Enoch et al., 2015). The major five PABs presented in Table 3 are responsible for 4,534

bank branches, 18,234 ATMs and almost 90,000 agents and POS. Ecobank Group alone reaches 23 million people across 33 countries, while KCB Group reaches 22.9 million clients in the seven countries where it operates.

On a larger scale, there is significant empirical evidence that PABs tend to operate in countries with weaker banking regulation, lower income levels and, to some extent, in host countries with weak institutional quality (Pelletier, 2014) compared to global banks that tend to operate in countries with stronger macroeconomic environments. Thus, PABs provide these countries with more opportunities to access formal financial intermediary services. There is also some (weak) evidence that PABs offer more loans to the SME segment than global banks (ibid.). These trends on PABs' host country and market segment preferences are promising, since foreign banks have typically concentrated services in sub-Saharan Africa's large corporates and extractive sectors and have been reluctant to engage with the lower end of the market (Beck et al., 2014).

To quantitatively assess the impact of PABs on financial inclusion, Léon and Zins (2020) extended Beck's (2015) work by examining the determinants of financial inclusion for both firms and households. The authors find a robust and positive causal impact of PABs on access to credit for African firms. The results for individuals are less clear-cut, however, and the authors find some indication that PABs tend to target only the more educated middle class. In addition, the authors suggest that, while PABs' increased market share led to more customers of financial services, PABs do not offer less expensive credit and do not target opaque customers, implying that PABs may be competing over the same customers with other foreign banks. This somewhat reaffirms the findings by Zins (2018) that higher education and income – which are typically not available to opaque or informal customers – are the main factors that can increase customers' probability of having access to traditional or mobile banking services in sub-Saharan Africa.

Beyond access, Beck (2015) establishes the positive impact of PABs in alleviating financial constraints



WOMEN ENTREPRENEURS FIND SUCCESS WITH THEIR LOCAL BUSINESS IN SOUTH AFRICA. PHOTO: BARBARA KINNEY / CLINTON FOUNDATION.

of firms in the region, which is felt most strongly by small and large firms and young enterprises (i.e. those under 10 years old). In contrast, the author also finds that the higher share of foreign banks from developed countries is associated with lower firm access to credit, especially for young firms. This resonates with Kanga et al.'s (2018) findings that PABs within WAEMU are found to have a much higher impact on facilitating firms' access to credit (with the greater effect for SMEs) compared to banks from outside the continent.

3.3 Impact on bank competition and efficiency

Given that PABs are technically foreign banks but also organic to African countries, they are argued to have the best of both worlds: foreign banks' advantages of having larger scale and expertise (which is usually absent in domestic banks) and domestic banks' advantages of better knowledge of local customers and environment (which is generally difficult to obtain for banks from outside the region) (see Zins and Weill, 2018a). Despite this, the existing literature assessing the impact of foreign banks on bank competition and efficiency across the continent remains largely limited to studies treating foreign banks as a homogenous

group (Kirkpatrick et al., 2008; Okeahalam, 2008; Cull and Martinez Peria, 2010). Below we highlight the findings of the few available studies that delineate PABs' efficiency performance and impact on banking sector competition.

With PABs' unique local and foreign advantages, Zins and Weill (2018a) find that, compared with other foreign banks (both from developed and developing countries) and domestic banks in Africa, PABs are the most cost-efficient in terms of producing loans and other earning assets, all other factors being equal. Their efficiency over foreign banks from developed countries further increases the higher the institutional similarity (e.g. similar colonial histories) and the closer the geographic distance between home and host countries. Interestingly, the authors also find that bank size matters for efficiency – medium-sized banks are significantly cost-efficient, but not large banks. Their findings present a case for favouring PABs' expansion, especially if they are of medium size in their host economies.

While regional banks on the continent may produce more loans efficiently, the European Investment Bank (2016) finds that PABs (excluding those headquartered in South Africa) tend to have lower profitability compared to other banks

operating in sub-Saharan Africa. This can be related to these PABs' relatively lower portfolio quality (e.g. higher impaired loans to gross loans ratio) and operational efficiency (e.g. higher average cost to income ratio), reflecting the fact that domestic banks and PABs are slightly more exposed to the SME segment, which exhibits higher default risk. This is consistent with the findings of Pelletier (2018) and Kanga et al. (2020b), indicating the relatively poorer performance of PABs in terms of profitability compared to other foreign banks. Pelletier (2018) suggests this is driven by the global banks': (1) cheaper sources of funding, which lowers interest expenses and consequently increases net income (hence, higher profitability); and (2) higher receipt of home bank support on technological infrastructure and technical knowledge transfers (e.g. risk management techniques, which lowers operating costs (hence, higher operational efficiency). Meanwhile, in the context of WAEMU, Kanga et al. (2020b) argue that PABs' lower profitability compared to French banks may be driven by the latter's advantage of securing credit-worthy and profitable transactions, with French banks being the oldest and most entrenched banks in WAEMU (thus, acquiring 'local advantages').

However, in the last decade, foreign affiliates of global multinational banks are showing an increasing ratio of impaired loans to gross loans, implying increasing exposure to the SME segment in view of more competition in the large corporates segment (EIB, 2016). This indicates that rising competition from other players such as PABs is forcing established players to get out of their comfort zone in order to maintain their growth rate and profitability (ibid.). It is thus not surprising that banking competition in WAEMU countries has intensified during PABs' rapid rise in the region since the mid-2000s (Léon, 2016; Kanga et al., 2018). Indeed, financial regulators in Africa recognise that PABs play an instrumental role in improving competition, which thus contributes to market development on the continent (IMF, 2015). The impact of rising competition induced by PABs will have financial stability implications (discussed in Section 3.4).

How the efficiency and competition gains from PAB entry translate into lower lending

rates and increased credit in the real economy remains a contentious issue. For instance, Beck et al. (2014; citing World Bank, 2013) show that PABs headquartered particularly in East African Community (EAC) countries are efficient in terms of having lower interest rate spreads and overhead costs than other private domestic banks and banks from outside the EAC. These EAC PABs also introduced innovative models that allowed them to break into their new markets even faster than their competitors. However, these efficiency gains seem to translate into higher bank profits instead of lower costs for clients (ibid.).

In the unique context of WAEMU countries which have a common currency and a regional central bank, foreign banks (including PABs) generally enhance price competition (e.g. lower bank mark-up price above marginal cost), particularly in lower-middle-income countries such as Côte d'Ivoire and Senegal (Kanga et al., 2018). By ownership, however, the channels through which PABs and French banks affect price competition differ – the former improves pricing competition among small banks, the latter among big banks.

3.4 Impact on financial stability

Foreign banks can preserve the stability of financial systems in their host economies via the following multiple channels (see Beck et al., 2014):

- by filling the financing gaps left by shareholders following episodes of domestic banking crises;
- providing diversified fund sources from cross-border banks (from different home countries) that have non-synchronised business cycles and exposures to funding shocks;
- providing substitute lending options to households and firms when domestic banks are constrained; and
- inducing upgrades in financial regulation as authorities deal with new and sophisticated entrants.

Unfortunately, evidence on the impact of PABs on financial stability of their host countries are limited to the empirical studies below.

Zins and Weill (2018b) investigate how ownership of banks in Africa influences the cyclicity of lending of 190 commercial banks in 20 African countries from 2002 to 2015 by observing the sensitivity of loan growth to GDP per capita growth of the host country. Banks' behaviour around business cycles critically impacts the stability of the financial system and macroeconomy. If banks are procyclical, they will lend more during economic booms or cut credit during downturns, inducing overheating or amplifying economic downturns, respectively. The authors find that lending is procyclical for all types of foreign and domestic banks in Africa, but PABs are the least procyclical. In addition, the authors find that there is no significant difference in procyclicality observed between domestic banks (state-owned and private banks) and other foreign banks (from high and low-income countries). This evidence therefore provides support in favour of expanding PABs in order to decrease the procyclical nature of financial intermediaries, which in turn, can help stabilise African economies in times of economic distress.

The authors suggest that three main factors contribute to the relatively less procyclical behaviour of PABs. First, PABs' 'indigenization'³ process of relying on local labour, IT and management functions enables them to conduct higher relationship lending activities based on soft information, making them less procyclical than other foreign banks. Second, since in many cases PABs have a high market share in host countries, they consider their host countries as a 'second home market'⁴ and thus have an incentive to be loyal to their host countries in times of recession. Third, PABs can also benefit from home headquarter support and internal capital during periods of unfavourable economic circumstances in their host countries.

Meanwhile, the competition induced by expanding PABs can also pose threats to banking

stability as established banks take on more risky activities to maintain profitability. As discussed in Section 3.2, in view of increasing competition from PABs, other foreign banks have recently been observed to tap into other market segments with relatively higher risks (as discussed in Section 3.3); this may benefit financial inclusion but can undermine the soundness of the banking system (e.g. higher NPL ratios). This mechanism is consistent with the 'competition-fragility' hypothesis⁵, suggesting that, as banks lose market power, their capacity to charge higher interest rates declines, and thus they resort to higher-risk activities to develop new sources of non-interest income in order to maintain profitability. As banks take on more risky transactions but with higher returns, their financial soundness deteriorates, leading to the fragility of the banking system.

The 'competition-fragility' hypothesis is consistent with the observation in WAEMU wherein smaller PABs (hence, lower market power compared to other foreign banks) significantly tend to reduce the capital ratio – an indicator of stability – of the overall banking system (Kanga et al., 2020b). More specifically, Kanga et al. (2020a) empirically investigate how the expansion of PABs has affected banking competition and stability, finding that a higher PAB presence (more than 50% of total number or assets in the banking sector) is associated with increasing banking sector instability as PABs behave according to the 'competition-fragility' hypothesis. Meanwhile, other foreign banks in WAEMU, particularly French banks, behave differently to increased competition. To maintain profitability amid lower interest rates brought about by tighter competition, French banks in WAEMU seem to improve their screening processes and reduce their risky assets to ensure payoffs for loans, lowering the probability of defaults, in turn improving their capital, and the whole process ultimately contributes to banking stability (i.e. via 'competition-stability' hypothesis).

3 Coined by Beck et al. (2014).

4 For example, the big six European multinational banks (MNBs), namely Raiffeisen and Erste (both Austria), Intesa Sanpaolo and UniCredit (both Italy), Societe Generale (France) and KBC (Belgium) remained committed to emerging European countries (i.e. Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia) in that their lending behaviour was no different from that of domestic banks during the global financial crisis (2008–2009) and onset of the Eurozone crisis (2010). This supports the notion that these countries are treated as a 'second home market' by these European MNBs (Bonin and Louie, 2017).

5 See Keely (1990).



Kanga et al.'s (2020a) findings are supported by the empirical findings of Dwumfour (2017) on the 'competition-fragility' impact of foreign banks (in general, including PABs) in Africa. Dwumfour (2017) finds that a higher number of foreign banks is associated with increasing NPLs and declining ratio of total regulatory capital to its risk-weighted total assets of the banking system – indicators of higher risks to bank stability. However, the impact of foreign banks on these indicators reverses during episodes of actual banking crises. His findings indicate that, while foreign banks in Africa tend to increase the threat of banking instability, they can also help stabilise the banking industry in times of crisis.

Since the global financial crisis, another emerging issue is the financial contagion risks associated with increasing home-host networks and the systemic importance of cross-border banks. Indeed, most PABs have become systemically important in their host economies. Major PABs account for 20% or more of their respective host countries' banking system assets (Beck et al., 2014). Many are also often important players in treasury bill markets, foreign exchange markets and payment systems (Christensen, 2014). In addition, PABs have significant and direct exposure to industrial and commercial ventures that can potentially give rise to moral hazards and introduce distortions in banks' lending practices (Mathieu et al., 2019).

Based on ownership links, Kenya, Nigeria, Morocco and South Africa are the main centres of

connection among sub-Saharan Africa's banking sectors (Mathieu, 2019), making them potential channels of spillovers during episodes of significant domestic (home) shocks. In addition, Moroccan and South African PABs have large cross-border investment connectivity links outside Africa, potentially causing them to be channels of contagion in the event of crises, both to and from African and non-African financial systems.

To find empirical evidence on whether there is a differential impact on cross-border transmission of shocks according to ownership of foreign banks, Zins and Weill (2018b) analyse the sensitivity of foreign banks' lending activities in host countries with respect to the macroeconomic conditions in their home countries. The authors find limited evidence that all types of foreign banks (including PABs) are influenced by the GDP per capita of their home country, indicating that, to some extent, their presence enhances transmission of external shocks to host countries. However, foreign banks' lending is more sensitive to growth in the host economy than in the home economy. Based on these findings, the authors suggest that, while bank lending procyclicality may decrease with the expansion of PABs in host countries, their presence (together with other foreign banks) may potentially increase cross-border contagion. At the time of writing, this is the only study that empirically assesses the potential contagion (home to host) risks associated with PABs.

4. Policy implications

4.1 Regulatory burden

Typically, parent banks' subsidiaries in other countries operate under the rules and regulations of the host country. For home supervisors, the expansion of bank holding companies abroad places a regulatory burden on them since they have to provide a necessary window to cooperate and exchange information with the host countries (Enoch et al., 2015). There is also an additional burden for host regulators in terms of supervision and crisis management of PABs, since most of these banks are increasingly becoming systemically important in host countries (Beck et al., 2014; Enoch et al., 2015; Mathieu et al., 2019; Mecagni et al., 2019).

Most countries in sub-Saharan Africa already have very limited capacity to implement their own domestic prudential supervision. Therefore it is challenging for them to build the necessary home-host cooperation and skills to supervise sophisticated PABs with often untransparent ownership structures spanning several regulatory environments and legal traditions (EIB, 2016). These uneven supervisory capacities, with weak oversight capacity in some jurisdictions, already presents risks; these can be eased to some extent by harmonising standards (IMF, 2015).

Several studies and analyses identify **disclosure of more frequent and quality information** as a common first step that will enable supervisors to assess the financial health of PABs. This, in turn, will enhance the sustainability of PABs' contribution to the continent's financial market stability and development (EIB, 2016). Initially adopting simpler ownership structures and being more transparent when disclosing **consolidated information** on accounts, exposures, procedures and ownership structures would not only aid supervision by national and regional authorities, but also help strengthen market trust in the

soundness of PABs, easing their access to capital markets and other sources of long-term financing (EIB, 2016). This is especially relevant for PABs that are not subject to consolidated supervision and are not supervised by monetary authorities (Christensen, 2014). **Harmonising the disclosure of consolidated information** can be initiated by home supervisors of major PABs, such as in South Africa, Togo, Morocco, Nigeria and Kenya.

4.2 Home-host supervisory cooperation

Financial regulators⁶ have taken steps to upgrade regulatory frameworks at the national level (e.g. closing the regulatory gaps on bank holding companies, raising accounting standards) and address cross-border issues by creating cross-border supervisory colleges, signing Memoranda of Understanding (MoUs) and exchanging information (Enoch et al., 2015).

Following these efforts, some issues identified by the regulators include:

- the need for participation of the most senior decision-making officials in supervisory colleges;
- MoUs must contain provisions for equal treatment of locally, regionally and other foreign-owned banks; and
- MoUs should include not only supervisory issues, but also address crisis management and resolution, to clearly delineate home-host responsibilities in times of crisis (Christensen, 2014; Enoch et al., 2015).

The latter issue is especially important in answering some of the following questions⁷:

- If a PAB group that is systemically important experiences serious financial distress, which central bank will be the lender of last resort, the home or host central bank?

6 The authorities gave feedback at a high-level seminar during the 2014 IMF Annual Meetings (the participating countries included Kenya, Morocco, Nigeria, South Africa, WAEMU, and Ghana and Guinea as host countries for a number of cross-border banks) as well as through written comments (Enoch et al., 2015).

7 Largely adapted from Christensen (2014).

- Under what circumstances should governments of either home or host central banks provide bail-outs or substantial support to troubled PABs that are systemically important?
- Under what conditions should ring-fencing of subsidiaries (from parent banks) be put in place?
- Is it warranted to impose higher regulatory standards (e.g. higher liquidity and capital buffers) for systemically important PABs?

To begin with, banking supervisors in the region that are already conducting cross-border and consolidated supervision can provide a framework that can improve cooperation between home and host regulators of systemically important PABs. For instance, South Africa has conducted **consolidated supervision** since 2001, the Central Bank of Nigeria has been implementing **a framework for cross-border supervision** since 2011, and Uganda has signed **MoUs** with five out of nine home bank regulators of foreign banks (Christensen, 2014).

4.3 Balancing banking stability and inclusion policies

The findings of empirical studies on the impact of expansion of PABs on financial stability (Section 3.4) have important implications for stability-inclusion trade-offs for policy-makers. On one side, PABs induce competition. Following this, PABs tend to take on more risky assets, such as extending loans to SMEs or firms and households with accessible soft information but less documented credit history. This provides an opportunity for expanding financial inclusion, as PABs extend services to perceived (or actual) riskier segments of the market. However, this increases their exposure to assets with higher probability of default that will not only weaken their own financial institution, but the whole financial system due to their increasing market shares in host economies in recent years. Conversely, foreign banks that take on more safe assets amid competition may increase bank stability or even stabilise the industry in times of crisis (e.g. Dwumfour, 2017; Kanga et al., 2020a), but their transactions may lead to financial exclusion as they cherry-pick clients with low probability of default.

However, regulators can leverage on previous studies identifying ways through which banking stability can be preserved amid increasing cross-border banking. For instance, Dwumfour (2017) finds that, while foreign banks are generally associated with instability, when large banks are well-regulated in concentrated markets, banking stability could be improved. Thus, regulators may encourage entry of targeted PABs that tend to have a better track record of reaching a wider client base (e.g. KCB Group), while ensuring structures are in place for a closer regulation of their activity by host authorities.

From a macro-financial risk lens, PABs tend to be less cyclical than other foreign banks and their entry (with other foreign banks) can even reduce bank instability in times of crisis. Thus, the findings of Kanga et al. (2020a) will be useful to consider – within certain thresholds (e.g. below 50% of total number of assets in the banking sector), PABs (which tend to provide more inclusive financial services) can potentially expand without threatening bank stability. Thus, as PABs' market share grows in host countries, it is imperative for regulators to ensure that their core financial soundness indicators (e.g. CAR, NIM, NPLs, corporate governance) are intact.

4.4 Regulation for the growing sophistication of PABs

While PABs tend to engage in more traditional financial intermediation, their banking services are now expanding to include large corporate and investment banking (see Table 3) and digital innovation (e.g. mobile banking) to reach a wider client base. In addition, large PABs actively participate in interbank markets, treasury bill markets and foreign exchange markets, and other non-traditional transactions (e.g. real estate and infrastructure financing and insurance).

The above activities could potentially catalyse much-needed financial product innovation and price discovery in the region. At the same time, they present a continuous challenge for sub-Saharan African financial regulators trying to keep up with PABs' growing sophistication. All previous policy implications and suggestions will come into play:



A PORT WORKER ON A VESSEL IN WALVIS BAY IN NAMIBIA.
PHOTO: © JOHN HOGG / WORLD BANK

- the need for a more granular disclosure of information on non-traditional sources of income and activities outside the banking industry;
- home-host cooperation on reporting of observed financial innovations implemented at home;
- information sharing on emerging risks from new PAB technologies and business models, and how to monitor and supervise these; and
- paying closer attention to the growing networks and transactions of PABs, both in the financial and real sectors.

These topics are best discussed on a regular basis between high-level finance ministers and central bank governors, together with financial sector leaders and international organisations, since this will affect not only financial development, but also the effectiveness of monetary policy, and thus, economic growth. For instance, in Southeast Asia a closed-door dialogue is held annually among central bank governors, chief operating officers or heads of the top three banking and

financial institutions, plus representatives from selected international organisations, to discuss emerging opportunities and risks in the financial sector. Outcomes from this dialogue make an important contribution to cooperation between finance and central bank regulators on regional economic and financial integration and stability.

While these are being developed, a prudent approach might be to consider applying some absorbency requirement framework (e.g. leverage ratio) for regionally systemic PABs (IMF, 2015). To complement this, regulators may also create a space for the market-disciplining role of banks' peer monitoring to mitigate the risks being taken by PABs (see Raga and Tyson, 2021a). Meanwhile, international organisations, such as the Bank for International Settlements, the IMF and World Bank, should include greater meaningful inputs from sub-Saharan African regulators and financial experts in crafting financial rules that are appropriate for building banking stability in a regional and lower-income country context (see de Velde, 2019).

5. Conclusions

Financial reforms and national regulations in sub-Saharan Africa, as well as external global shocks, have triggered the expansion of PABs in the region, making their footprint more significant than other foreign banks'. PABs have become economically and systemically important in their host economies – bringing an average of \$376 million of investment in subsidiaries annually and holding over 10% of total deposits in 31 sub-Saharan Africa countries (Mathieu et al., 2019).

The following key findings from existing literature together with DEGRP papers highlight that **PABs' higher exposure to the SME segment and other risky activities shapes their impact on financial inclusion, banking competition and efficiency, and financial stability in sub-Saharan Africa.**

First, PABs tend to be in countries with lower income, weak banking regulation and, to some extent, weaker institutional qualities, while the opposite is true for other foreign banks. LICs are typically dominated by the lower segment of the financial market (e.g. SMEs, households and small businesses with limited documentation of credit history), which PABs tend to cater to. Meanwhile, less strict banking regulation, for instance in terms of lower minimum capital requirements, enables PABs to use a larger part of their capital in these environments.

Second, PABs lag behind in terms of loan provision compared to other banks. However, this may reflect their more traditional intermediation services and strategies (e.g. relationship banking) of having wider client reach but lower values of total loans compared with other foreign banks' transactions, which tend to favour large corporates and low-default customers.

Third, PABs tend to drive competition in their host economies' banking industries and have been cost-efficient in producing loans and other earning assets. However, PABs' profitability is found to be lower than other foreign banks. This reflects their exposure to riskier SMEs, which require higher bank monitoring and screening efforts, affecting PABs' portfolio quality

(e.g. higher NPL) and operational efficiency (e.g. higher cost to income ratio).

Fourth, there is consistent evidence in the limited empirical studies that PABs tend to increase firms' access to finance, an issue cited as the biggest obstacle for most enterprises in sub-Saharan Africa (World Bank, 2021). While the impact on households is less clear-cut, anecdotal and descriptive evidence suggest the critical role of PABs in substantially increasing the number of bank branches, ATMs and services to more opaque customers compared to other foreign banks.

Fifth, PABs were found to have the least cyclical behaviour compared to other foreign and domestic banks, suggesting that PABs may decrease the procyclicality of financial intermediaries over time and help stabilise African economies during periods of economic distress. However, the competition induced by PABs poses threats to banking stability as PABs and established banks take on more risky activities to maintain profitability. There is also weak evidence that PABs' lending behaviour tends to be affected by shocks in their home countries, although the impact is not significantly different from other foreign banks.

Based on the above observations from the literature, the implications for financial regulators are as follows:

Primarily, the expansion of PABs will impose a regulatory burden for supervisors, especially if a PAB is systemically important in either, or both, of the home and host countries. Uneven supervisory capacity can be eased to a certain extent by harmonising standards and disclosing more frequent and consolidated information.

Home-host cooperation must take place in a more regular and structured way. Initial efforts have been made to upgrade regulatory frameworks at the national level and address cross-border issues by creating cross-border supervisory colleges, signing MoUs and exchanging information. However, senior decision-makers need to participate in these

efforts. MoUs should include not only supervisory issues but also crisis management and resolution protocols. Initially, a vector for South-South cooperation can be opened wherein central banks that have already implemented consolidated supervision, cross-border supervision and MoUs (e.g. in South Africa, Nigeria and Uganda) could extend their knowledge to other home and host supervisors of major PABs, initiating pathways for intra-African collaboration.

The empirical evidence on the impact of PABs' expansion on financial stability will necessitate policy-makers balancing their financial inclusion and stability objectives. Concretely: PABs make important contributions to expanding financial services in countries with less favourable environments and cater to higher-risk segments (e.g. SMEs) that are often neglected by other foreign banks. However, their expansion increases overall risk to banking systems (e.g. higher aggregate NPLs), the competition they induce pushes other established banks to take on more risky sources of income to maintain profitability, and PABs' increasing systemic importance poses financial contagion risks. Based on existing evidence, policy-makers can be strategic in encouraging the entry of targeted PABs that tend to reach clients more widely (e.g. KCB Group), while ensuring they exhibit less cyclical lending behaviour and that their financial soundness is more closely regulated by host authorities as they gradually expand.

Lastly, PABs do not only expand, they also develop financial intermediary innovations (e.g. mobile banking) in order to capture a wider range of clients at a lower cost, and participate in other markets (e.g. interbank, government securities, foreign exchange, insurance and infrastructure financing) to maintain profitability.

Hence, there is a continuous challenge for sub-Saharan African financial regulators to keep up with the growing sophistication of PABs. These emerging risks and opportunities need to be discussed regularly by high-level finance ministers and central bank governors, together with financial sector leaders and international organisations, since this will affect financial development as well as the effectiveness of monetary policy, and thus economic growth.

Further research is needed to better understand the drivers and impact of PABs on their host economies' financial development, and on regional financial stability as a whole. Topics may include:

- behaviour of PABs by bank size and by characteristics of home and host countries;
- role of regional economic integration agreements (e.g. African Free Trade Continental Area) or regional authorities (BCEAO) in facilitating the entry of PABs;
- impact of PABs on deposit and lending rates, and monetary policy transmission;
- PABs impact on the development of interbank markets, liquidity creation and long-term financing and product innovation;
- contagion risks from PABs' home to host countries and vice versa;
- international best practices on cross-border supervision and home-host regulatory cooperation from regions with similar characteristics to sub-Saharan Africa (e.g. developing countries in Asia);
- implications of current Basel regulations (with Basel III and potentially Basel IV) on PABs; and
- implications of Covid-19 for current and future cross-border banking in Africa.

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Research jointly supported by the ESRC and FCDO

