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INVESTMENT MATTERS

MAY 2012

Banking Report

CEO Briefing Report

Africa investor provides a family of products and services that support our clients' investment processes in major asset classes across Africa. Our goal is to leverage our deep understanding of Africa's financial markets to turn data-driven insights into tools that our clients can use to meet their investment process needs.

BANKING on CHANGE

Africa's financial services industry is offering unprecedented prospects for foreign and local investors. *Africa investor* uncovers how to get in on this ever-evolving growth story

Africa's banking sector is becoming an increasingly attractive option for foreign investors. Improving business climates, a growing middle class and large, still mostly unbanked populations are luring both foreign and local investors and institutions with an eye on this growth story.

"This is a unique time for Africa," says Maria Ramos, CEO of Absa Group. "I don't think we have ever been at this point where we are attracting this amount of positive attention on our continent."

Regional African banks, such as Togo-based Ecobank or Nigeria's UBA Group, are already getting in on the act, focusing their footprints on the so-called 'Middle Africa' (sub-Saharan Africa ex-South Africa), while international banks, including the UK's Standard Chartered, and South Africa's Absa, Standard Bank and Nedbank are also focusing their strategies on expansion into the continent.

"We are all excited about the prospect of banking across Africa, on building our businesses across Africa," says Ramos. "I know my bank is, and we've just moved the Barclays head office from Dubai to Johannesburg and that is a big vote of confidence on what's going on in the continent."

"Banking in Africa has a very exciting, very bright future," Arnold Ekpe, CEO of Ecobank, told *Africa investor*. "It is under-banked, so there's huge growth; it is endowed with natural resources; the terms of trade are improving; a middle class section is emerging; you have technology penetration – mobile phone and internet – huge growth opportunities there, and you have good demographics; 50% of the population is less than twenty years old. So the scene is right for the banking industry to undertake a growth strategy. The challenge is whether banks can do it in a manner that results in positive value for the shareholders."

Attractive prospects

According to Accenture, the attractiveness of the financial markets in many countries in Africa is undergoing a rapid change, driven by strong growth and ongoing efforts to tackle traditional barriers to expansion, and is becoming an increasingly sought-after investment destination.

"What makes a market attractive for a particular institution is dependent on their capabilities and business model," says Simon Russell, Managing Executive of Accenture's South African Financial Services practice. In the case of Africa this can include historical presence, similar language, or adjacent markets to an existing presence. However, in general, development in business environment and economic growth are making a set of countries more attractive, and are rapidly improving the conditions in many others.

According to Accenture's Tipping Point Index (see box), these include relatively small and stable countries, such as Namibia and Botswana, where a larger percentage of the population is achieving middle income status. Larger economies, such as Nigeria, Kenya and Ghana, have much greater populations, and although they are on average poorer, they are experiencing rapid economic growth and significant gains in access to financial services. Combined with improving financial sector governance and infrastructure, these make a powerful case for growing financial services markets in Africa.

EXPERT INSIGHT

The key indicators that accelerate development in Africa's financial sector include:

Financial sector reform: Many countries are making reforms to strengthen governance and regulation, upgrade payment infrastructure and increase financial access. For example, deliberate regulator action, including the establishment of an asset management company to resolve the bad debt portfolios of Nigerian banks, has stabilised the Nigerian banking industry. The industry non-performing loan (NPL) ratio has reduced to less than 5% as at December 31, 2011, from previous unsustainable levels in excess of 35%.

Technology: Accessing technology from cards and point of sale, and in particular mobile phones, to increase access, extend reach and reduce costs.

Payments reform: These potentially present revenue and growth opportunities in transaction services.

Increasing trade and economic openness: A significant amount of growth comes from the resource and commodities sector, where countries with strong institutions can drive economic development. Increasing FDI and investment in infrastructure are also driving growth and unlocking financing opportunities.

Simon Russell, Managing Executive of Accenture's South African Financial Services practice

Getting in on the growth story

For financial services institutions looking to get into the continent, operating in Africa can be tough, and the business models that are required for success need to be adapted for local market demands. This is where partnerships are invaluable. Mike Brown, CEO at Nedbank, says; "Partnerships are extremely important [to Nedbank]. It's very difficult to think that you can sit in Johannesburg and understand the nuances and importance of local customs and what goes on in individual markets because people often talk about Africa, but it's actually more than 50 very different countries."

The bank has an alliance agreement with Ecobank in place. "We have consistently deepened that alliance over the last four years," says Brown, "culminating in a very important step in December last year where Ecobank's Nigerian franchise purchased Oceanic Bank in Nigeria. That will make the combined operation in Nigeria a top three bank by physical distribution and a top five bank by assets."

According to Russell, there is a mixture of capabilities that are required for banking success in Africa. For one, he says, regional and pan-African banks need to develop scale in their operations in order to lower costs; this may mean common technology platforms or regional operations centres. Lowering the cost of the operating model is critical to enable the profitable delivery of services to large, low-income populations at an affordable price. As the majority of a bank's cost comes from distribution, this is a key area that must be addressed.

In addition, banks should increase the level of self-service for manual transactions (ATMs & multi-functional ATMs, direct channels, replace cash with card/mobile payment); or work with partners to increase distribution reach (agents, point of sale, mobile, retailers).

Another crucial strategic aspect is the development of mobile payment and banking capabilities (such as Safaricom's M-PESA platform). Mobile is a critical channel, given the penetration of mobile phones, the cost of developing traditional banking infrastructure and the existing success of many players in acquiring customers. However, the challenge is to make a model that is useful for customers and profitable for providers; depending on the regulatory structure, mobile solutions will often require a partnership between mobile operators and banks.

However, it is important to remember localisation. Generic solutions may not be relevant for different income groups or cultures; financial services providers will need to work with the existing money or commercial culture to understand banking behaviour and patterns of distinct customer segments. This may include working with traditional providers, such as Barclays with Susu collectors in Ghana. It may also include working with microfinance organisations that provide grassroots financial services and education in communities.

Getting in on this growth story will require an adventurous spirit but it is also important to know what pitfalls to avoid. Says Russell, "[Banks will] need a clear view of the segments they are targeting in each country: mass or the smaller high net-worth. If they choose to target the mass population, they will need scalable and low cost distribution models with a sense of local culture." In some markets, a local partner is crucial to better understand context, such as Nedbank's alliance with Ecobank. However, this is more relevant for non-African institutions or those that have no local connections.

Domestic dominance

On the ground, domestic players are succeeding in these markets and outside players can learn a lot from them. In Kenya, for example, Equity Bank has been highly successful at growing a customer base with low-cost products and services, a community focus and a successful expansion strategy. This involves setting up a small presence using a mobile branch in order to establish a customer base, before setting up a physical branch. The bank then works with the M-PESA channel to provide an innovative savings product and tap into the enormous M-PESA customer base.

In Nigeria, as a result of recent M&A activity, there are two new banks in the industry top five; Access Bank (business combination with Intercontinental Bank) and Ecobank (through its acquisition of Oceanic Bank). Ecobank is quickly growing into a pan-African bank, with a targeted strategy focusing on commercial customers and trade, a disciplined operating model using common systems and regional operations to develop scale efficiency. The bank also places emphasis on working with partners such as the Bank of China and Nedbank to benefit and capture growing trade and investment related business.

Despite this local dominance, there is space for outside players. For South African banks and foreign banks looking to enter the continent, the best strategies involve finding the natural route. For example, cultural affinity can work in a bank's favour: French banks finding a market in francophone West Africa, or Morocco's Attijariwafa Bank expanding through Islamic West Africa, Portuguese banks in Angola, Mozambique, and so on.

Another option is to follow the existing trade routes. South Africa's FNB has followed this route in Kenya and India, positioning itself favourably to benefit from the trade routes which exist between Kenya and India.

This growth story in financial services is linking to the resource boom on the continent. Institutions must therefore ready themselves to provide the necessary services to support the growing resources industry. Foreign banks are establishing a presence with key African trading partners. For example, Brazilian banks are using their shared Portuguese to establish a presence for corporate and commercial banking in Angola and Mozambique, where recent oil and gas finds hold huge potential.

> "We are all excited about the prospect of banking across Africa, on building our businesses across Africa"

Innovation for progress

The way forward for African banks, and their resultant success, will no doubt rest on innovative new financial services products. According to the African Development Bank (AfDB), almost 80% of the African population is unbanked and the opportunities are therefore myriad.

According to Accenture's Russell, key opportunities will be around mobile banking and extending core product sets beyond payments and transactional accounts to include credit and savings products. Success will require the tailoring of products to low-income customers; such as micro-savings, micro-credit and micro-insurance offerings. Traditional product structures, such as fees and initial balances, can render many products uneconomic for customers, so finding a lower cost point to serve large numbers of low value accounts is therefore critical for extension of retail financial services, he says.

Technology development will be the main driver of innovation, such as in the development for payments infrastructure. It will be an enabler for point of sale (POS) and account functionality that can substitute for cash, which is a major inefficiency for businesses, governments and central banks, as well as customers. It is also a major security issue. The Nigerian government, for example, is actively pushing the agenda to develop the country's payment infrastructure and move away from cash transactions.

Also crucial will be the development of mobile technology. With increasing coverage, phone penetration and falling prices of devices, it offers a powerful combination for provision of all kinds of services, including financial. The increase in features and smart phone penetration, and the roll-out of 3G and 4G services, will only raise the functionality on offer, at which point the potential for innovation is very significant.

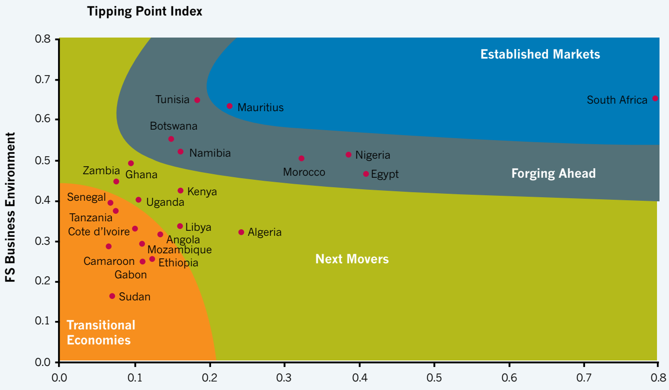
The way forward

There are still major factors holding the continent back in terms of providing effective and mature financial services. Clearly, in some countries, stability and governance is still an issue for investment, particularly from foreign financial services institutions, and the cost of providing banking services and products to customers is unsustainably high. As Ecobank's Arnold Ekpe told *Africa investor*, "African banks have not done too well in risk management and we need to do better. In terms of people, there are massive skill gaps once you move out of South Africa. And then there's infrastructure, which still has got a long way to go."

In addition, large informal sectors, migrant populations, lack of identity, address and credit information all pose a challenge for traditional banking and financial services models. Providers will need to continue to innovate to find new ways of addressing these issues, such as working with communities to establish credit worthiness; using mobile phones as a channel for identification, and thorough analytics of financial behaviour of the self- and informally-employed to build up a credit profile.

Many development indicators also still trail other regions and are a drag on the productive economy; public health and education attainment, for example. However, the rate of change in Africa is very strong in the positive direction. "[These issues] are opportunities, in my opinion," said Ekpe. "They're challenges, but also opportunities." Ai

Accenture's Tipping Point Index – Financial market readiness



Source: 2012 Accenture

Rank	Country	TPI Score
1	South Africa	0.71
2	Mauritius	0.48
3=	Tunisia	0.43
3=	Morocco	0.43
4=	Egypt	0.42
4=	Nigeria	0.42
5	Namibia	0.39
6	Botswana	0.38
7	Kenya	0.31
8	Ghana	0.30
9	Algeria	0.28
10	Zambia	0.27
10	Libya	0.27
11	Uganda	0.26
12=	Senegal	0.23
12=	Angola	0.23
12=	Tanzania	0.23
12=	Cote d'Ivoire	0.23
13	Mozambique	0.22
14	Gabon	0.21
15	Ethiopia	0.19
16	Cameroon	0.18
12=	Sudan	0.11

Established FS Markets

Forging Ahead

"Tipping Point"

Next Movers

Transitional Economies

* North African countries are greyed out to reflect 2010 TPI pre-Arab Spring

In 2010, Accenture developed the Tipping Point Index (TPI), which examines underlying variables related to the Financial Services Business Environment and the FS Market Attractiveness to provide an understanding of the market development and potential in leading African economies.

Four levels of market development

While the overall growth story for the African continent is positive, key factors such as the levels of development, business environment, financial depth and market scale all vary considerably between countries.

To provide a comparative lens for analysing and benchmarking different countries, Accenture's Tipping Point Index assesses the financial market readiness of 23 of the largest economies in Africa by comparing a range of key factors. These factors can be grouped into three categories. Based on their analysis of the criteria in the three categories of Financial infrastructure, Consumer financial services and Economic development factors, Accenture has divided African nations into four distinct groups:

- "Established Financial Services Markets" that are relatively deep and mature, with an existing diverse and thriving financial sector
- "Forging Ahead" economies, which tend to be larger, wealthier or more institutionally developed markets and are undertaking reforms aimed at creating more attractive financial services markets
- "Next Movers", consisting of a larger set of economies that have high potential and are in the process of overcoming entrenched barriers of low income, financial access, and institutional or governance deficiencies
- "Transitional Economies", where the market potential is currently constrained by problems such as poverty, lack of financial inclusion, difficult business and civil environments and a lack of financial infrastructure.

Findings

- Financial services development in South Africa and Mauritius is well ahead of other countries
- Next movers and transitional economies are in some cases impacted by a lack of existing markets e.g. no equity capital market – or lack of data availability
- Some of the transitional or unrated economies may have hidden potential (e.g. Angola, Mozambique, Zimbabwe) that could be released through institutional change, but generally they are not ready
- North African countries strongly depend on civil and political developments in the region

While a number of economies have a sound business environment for FS market development – relatively few also have the existing scale of population and depth of financial market assets to be immediately attractive.

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