



4-2011


## African Financial Systems: A Review

Franklin Allen  
*University of Pennsylvania*

Isaac Otchere  
*Carleton University*

Lemma W. Senbet  
*University of Maryland*

Follow this and additional works at: [https://repository.upenn.edu/fnce\\_papers](https://repository.upenn.edu/fnce_papers)

 Part of the [African Studies Commons](#), [Entrepreneurial and Small Business Operations Commons](#), and the [Finance and Financial Management Commons](#)

---

### Recommended Citation

Allen, F., Otchere, I., & Senbet, L. W. (2011). African Financial Systems: A Review. *Review of Development Finance*, 1 (2), 79-113. <http://dx.doi.org/10.1016/j.rdf.2011.03.003>

This paper is posted at ScholarlyCommons. [https://repository.upenn.edu/fnce\\_papers/238](https://repository.upenn.edu/fnce_papers/238)  
For more information, please contact [repository@pobox.upenn.edu](mailto:repository@pobox.upenn.edu).

---

## African Financial Systems: A Review

### Abstract

We start by providing an overview of financial systems in the African continent. We then consider the regions of Arab North Africa, West Africa, East and Central Africa, and Southern Africa in more detail. The paper covers, among other things, central banks, deposit-taking banks, non-bank institutions, such as the stock markets, fixed income markets, insurance markets, and microfinance institutions.

### Keywords

Banks, financial markets, insurance

### Disciplines

African Studies | Entrepreneurial and Small Business Operations | Finance and Financial Management

Review

# African financial systems: A review

Franklin Allen<sup>a,\*</sup>, Isaac Otchere<sup>b</sup>, Lemma W. Senbet<sup>c</sup>

<sup>a</sup> Finance Department, The Wharton School, University of Pennsylvania, Suite 2300 SH-DH, Philadelphia, PA 19104-6367, United States

<sup>b</sup> Sprott School of Business, Carleton University, Canada

<sup>c</sup> Robert H. Smith School of Business, University of Maryland, United States

Available online 22 April 2011

## Abstract

We start by providing an overview of financial systems in the African continent. We then consider the regions of Arab North Africa, West Africa, East and Central Africa, and Southern Africa in more detail. The paper covers, among other things, central banks, deposit-taking banks, non-bank institutions, such as the stock markets, fixed income markets, insurance markets, and microfinance institutions.

© 2011 Production and hosting by Elsevier B.V. on behalf of Africagrowth Institute. Open access under [CC BY-NC-ND license](#).

*JEL classification:* G0; G1; G2

*Keywords:* Banks; Financial markets; Insurance

## 1. Introduction

Africa is a continent made up of 53 countries. The continent is economically and culturally diverse, with different regional economic blocs. The financial systems in these countries are as diverse as the countries. Reviewing the financial systems of such a heterogeneous group of countries presents a challenge. Therefore, to make the review more concise, we categorize the countries along geographic lines into four groups, namely, Arab North Africa, West Africa, East and Central Africa, and Southern Africa.<sup>1</sup> This review covers, among other things, a brief consideration of the economies, central banks, deposit-taking banks,

non-bank institutions, such as the stock markets, fixed income markets, and microfinance institutions in Africa. The review focuses on African financial systems using the most recent data available. Some of these series end prior to the 2008 global financial crisis, although we provide discussions of short-run impact of the crisis, particularly during 2009. Similar to the rest of the world, African financial systems have been undergoing adjustments and stabilizing from the negative shocks of the global crisis over the last two years, but the review will not cover the adjustment period.

In this section, we present a summary of the African financial systems, highlighting some of the investment opportunities that exist, and then proceed with an in-depth review of the current state of the financial systems of the various sub-groups in Africa. In Section 2, we review the financial systems in North Africa. The financial systems in West Africa are reviewed in Section 3, while those in Central and East Africa are reviewed in Section 4. In Section 5, we examine the financial systems in Southern Africa. We conclude with a brief discussion of the risks that potential investors should be concerned about in Section 6.

The continent as a whole has been the most economically under-developed region of the world but the economies seem to be improving. According to the World Bank (World Development Indicators, March 2010), the 2009 GDP per capita for the continent was \$2554 (down from \$2777 in 2008) and the mean growth rate from 2000 to 2008 was 5.3%. Also, as shown in Table 1, the oil rich countries of Arab North Africa, Gabon and Congo have relatively high GDP per capita. The Central and East African countries have the lowest income per capita. The impressive GDP growth rate outpaced the population growth

\* Corresponding author. Tel.: +1 215 898 3628; fax: +1 215 573 2207.

E-mail addresses: [allenf@wharton.upenn.edu](mailto:allenf@wharton.upenn.edu) (F. Allen),  
[iotchere@sprott.carleton.ca](mailto:iotchere@sprott.carleton.ca) (I. Otchere), [lsenbet@rhsmith.umd.edu](mailto:lsenbet@rhsmith.umd.edu)  
(L.W. Senbet).

<sup>1</sup> Another approach would have been to categorize the continent along linguistic lines – Anglophone, Francophone, and Arab – but the geographic classification gives us more mileage. For a country by country description of Africa's financial system see <http://fic.wharton.upenn.edu/fic/africa/africa.htm>.

Table 1  
GDP per capita of African countries 2009 (current US\$).

North Africa		East and Central Africa	
Algeria	4029	Cameroon	1136
Egypt	2270	Central African Republic	454
Libya	9714	Democratic Rep of Congo	160
Morocco	2811	Congo, Republic of	2601
Sudan	1294	Eritrea	369
Tunisia	3792	Ethiopia	344
Average	3985	Kenya	738
		Tanzania	509
		Uganda	490
West Africa		Southern Africa	
Benin	745	Malawi	326
Côte d'Ivoire	1106	Mozambique	428
Mali	691	Rwanda	506
Senegal	1023	Average	672
Togo	431		
Burkina Faso	517	Zimbabwe	–
Chad	610	Botswana	6064
Gabon	7502	Comoros	833
Niger	352	Namibia	4267
Sierra Leone	341	São Tomé & Príncipe	1184
Gambia, The	430	Seychelles	8688
Ghana	1098	South Africa	5786
Guinea	407	Swaziland	2533
Guinea-Bissau	519	Zambia	985
Nigeria	1118	Average	3793
Average	1126		

Source: WDI.

of about 3%, on average. As shown in Fig. 1, GDP per capita has been growing steadily. In fact, during the pre-crisis period, most African countries began experiencing growth renaissance approaching that in Asian countries during the East Asian miracle. The economic success stories are not accidental. They are payoffs to years of serious economic and financial sector reforms that have taken place since the 1980s. However, the current crisis has begun eroding these gains.

The continent has also been most underdeveloped in terms of finance. In particular, Sub-Saharan African financial systems are least developed even by the standards of other developing regions, based on indicators of financial development. Allen et al. (2009) observe that in the pre-crisis 2007 the liquid liabilities (scaled by GDP) stood at about 30% for Sub-Saharan Africa (SSA), whereas the minimum for the other developing economies was about 4%. When it comes to provision of private credit and financial intermediation, the news is even worse. The average ratio for private credit (scaled by GDP) was only 17% for SSA, whereas the average for the other developing countries

ranged from 32% to 43%. The story is similar for stock market development, as we will discuss more fully later. The discouraging stories on financial development indicators do not quite capture important new developments under way in the African financial systems. As we will see later, over the years, these indicators have improved significantly, along with economic performance. Again, these improvements have been associated with changes in the regulatory and economic environments that SSA has experienced over the recent past.

### 1.1. Banking systems

The banking system in Africa consists of the Central Banks and deposit taking institutions. The Central Banks are technically independent of government control, but in practice they work closely with the Ministries of Finance of their States and help formulate and implement macroeconomic policies of the various governments. The deposit taking institutions are made up of local banks and branches or subsidiaries of foreign banks. Foreign banks have played an important role in banking development in Africa; their share of total African banking has increased significantly as shown in Table 2. The increase can be attributed to the financial sector reforms that these countries have embarked upon, which in turn have led to the opening up of the markets in Africa and the attendant entry of foreign banks. The banking sector in most of the countries is either dominated by state-owned banks or by a few large, sometimes foreign, banks. For example, in Algeria state-owned banks control over 90% of total banking deposits and assets. However, as part of the restructuring program that has been embarked on by the African countries, the banking industry in Africa is undergoing reforms focused on privatization and other forms of restructuring of state-owned banks with the view to improving the quality of the banks.

One common feature of the banking system in Africa is that a large number of banks invest in government securities, primarily treasury bills. This is troublesome since it is reflective of a highly dysfunctional banking intermediation that shuns provision of private credit in favor of safer government securities. The low level financial development in terms of private credit provision that we observed earlier is attributable to this phenomenon. As Fig. 2 shows, credit to the private sector provided by the banking sector as a percentage of GDP has been declining over the years. This phenomenon does not bode well for the African countries. This dysfunctionality in financial intermediation is being increasingly recognized in African policy circles, and various efforts are under way to provide an environment for banks to serve as informed agents and build information capital that is vital for the efficient allocation of resources. Nonetheless, the banking system in Nigeria and the Southern African countries of Malawi, Botswana, South Africa and the Seychelles is relatively well capitalized and dynamic and the banks pursue innovative banking practices. The Seychelles has a highly sophisticated banking system similar to that found in most developed countries.

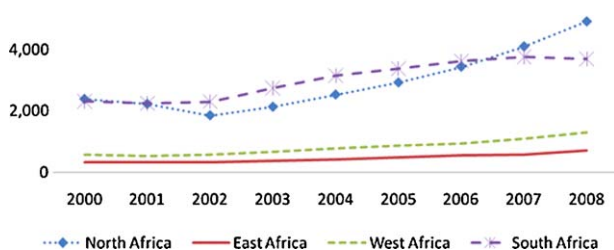


Fig. 1. Average GDP per capita.

Table 2  
Foreign banks as a percentage of total banks by region.

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Eastern Africa	40	44	44	44	43	48	54	56	56
Northern Africa	22	22	26	29	29	29	34	34	37
Southern Africa	48	51	50	51	50	50	51	56	56
Western Africa	43	48	50	51	52	54	54	54	54

Source: Stijn Claessens et al., 2008, Foreign Bank Presence in Developing Countries 1995–2006: Data and Trends, IMF Working Paper.

## 1.2. Insurance sector

The insurance industry in Africa is still in its infancy and is relatively underdeveloped compared to other emerging economies and developed countries. The insurance companies in this region offer property, auto, health, life, casualty, and other types of insurance; however in most countries the auto insurance sector holds the largest portion of the market share. The insurance market in some countries is dominated by nonlife insurance which represents about 85% of the industry premium. Life insurance is not a significant portion of the market, albeit the sector has been the fastest growing sector in the insurance industry. The insurance sector in Africa varies from a monopoly to a very competitive market. Nigeria has a large insurance market with 48 insurance companies operating in the country as of 2008. Although the insurance companies in this area are mostly privatized, the governments in some of these countries still hold significant stakes in the firms.

## 1.3. Stock markets

A particularly important outgrowth of the extensive financial sector reforms in Africa, including policy measures for the development of capital markets, has been a surge of interest in the establishment of stock exchanges, particularly in Sub-Saharan Africa. Stock exchanges have proliferated over the last two decades. There were only 5 stock exchanges in SSA 20 years ago and 3 in North Africa, but now there are about 20 in operation. There has also been a market capitalization boom in Africa, with the exception of the two oldest markets in South Africa and Egypt which came into existence in 1880s. What is also interesting is that SSA witnessed an establishment of a regional stock exchange domiciled in Abidjan, which currently serves the Francophone countries of West Africa. There are, in fact, similar initiatives underway in Southern and Eastern

Africa to consolidate the thinly capitalized markets into regional markets.

### 1.3.1. Depth of African stock markets

African stock markets face serious challenges in terms of depth measured by market capitalization and listing. Except for South Africa and Egypt, African stock markets remain the smallest of any region, both in terms of number of listed companies and market capitalization. The data on market capitalization and listing size are presented in Table 3. The mean market capitalization (as a percentage of GDP) for each of the sub-regions has been increasing steadily. The Southern Africa and Northern Africa markets have relatively higher market capitalization but these figures are driven mainly by the South African and Egyptian markets, respectively. The highest growth has been experienced by the markets in West Africa. The recent financial crisis has however, led to a drop in market capitalization in Africa in 2008. The market capitalization of the largest market—South Africa and Egypt has dropped by about 40% and 50%, respectively. Surprisingly, however the market capitalization of Ghana and Tunisia actually increased in 2008. On the listing front, the number of firms listed on African stock exchanges is small. With the exception of South Africa, Kenya, Botswana, Namibia, Tunisia and Mauritius, market capitalization further decreased in 2009. As of 2009, the mean number of firms listed on the African stock markets was 92. In 2007, the mean was 129 as compared to 911 in Malaysia and 158 in Mexico (Senbet and Otchere, 2010). The number of firms listed has declined in the well-established markets of South Africa, Egypt and Malawi.

### 1.3.2. Liquidity of African stock markets

We employ two standard measures to gauge the liquidity of African stock markets. First, we measure the market's trading activity, relative to the size of the economy, by the total value of shares traded on the exchange scaled by GDP. Second, we mea-

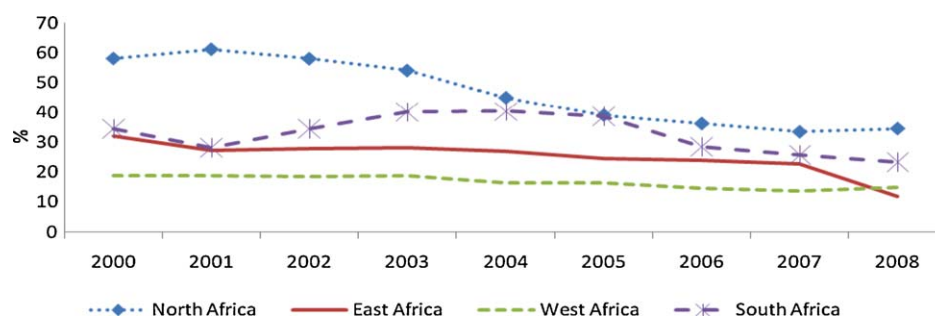


Fig. 2. Average domestic credit provided by the banking sector (% of GDP).

Table 3  
Market capitalization of listed companies (% of GDP).

Region	Country	Market capitalization as a percent of GDP							Country	Number of listed domestic companies						
		2003	2004	2005	2006	2007	2008	2009		2003	2004	2005	2006	2007	2008	2009
Eastern Africa	Kenya	28	24	34	51	50	32	36	Kenya	51	47	47	51	51	53	55
	Tanzania	7	6	4	4	–	6	–	Tanzania	6	6	6	6	7	7	–
	Uganda	1	1	1.12	1.17	–	–	–	Uganda	3	5	5	5	–	6	8
	Average	12	10	13	19	50	19	36	Subtotal	20	19	19	21	29	22	32
Northern Africa	Egypt	33	49	89	87	107	53	48	Egypt	967	792	744	603	435	373	305
	Morocco	26	44	46	75	101	76	69	Morocco	53	52	56	65	74	77	78
	Tunisia	10	9	10	14	15	16	23	Tunisia	46	44	46	48	50	49	49
	Average	23	34	48	59	74	49	47	Subtotal	355	296	284	239	186	166	144
Southern Africa	Botswana	26	26	23	36	48	27	34	Botswana	19	18	18	18	18	19	20
	Malawi	4	6	8	19	–	42	–	Malawi	40	41	42	41	90	41	–
	Mauritius	37	39	41	56	83	40	55	Mauritius	8	8	9	10	9	14	88
	Namibia	6	7	6	7	8	7	9	Namibia	13	13	13	9	9	7	7
	South Africa	161	211	233	277	294	178	246	South Africa	426	403	388	401	422	425	363
	Swaziland	10	10	8	7	7	–	–	Swaziland	5	6	6	6	6	7	5
	Zambia	17	8	14	11	21	–	–	Zambia	12	13	15	14	15	–	–
	Zimbabwe	67	41	70	–	–	–	–	Zimbabwe	81	79	79	80	82	81	94
	Average	41	44	50	59	77	59	86	Subtotal	76	73	71	72	81	85	96
Western Africa	Cote d'Ivoire	12	13	14	24	42	30	20	Cote d'Ivoire	38	39	39	40	38	38	38
	Ghana	19	30	16	25	16	21	16	Ghana	25	29	30	32	32	35	35
	Nigeria	14	16	17	22	52	23	20	Nigeria	200	207	214	202	212	213	214
	Average	15	20	16	24	37	25	21	Subtotal	88	92	94	91	95	95	96

Source: World Development Indicators.

sure “turnover ratio” by the total value of shares traded scaled by the total market capitalization. This indicator measures the market’s overall trading activity relative to the size of the market itself. These indicators are used widely, although they do not directly measure stock market liquidity. The direct indicator of the stock market liquidity would have been the ease with which investors can buy and sell securities at posted prices. However, the two standard measures can be thought of roughly as measures of overall trading activity relative to the size of both the economy and the stock market.

With the exception of the established markets in South Africa and Egypt, stock markets in Africa are thin and illiquid, as shown in Table 4. This is despite rapid growth of the stock exchanges in Africa over the last two decades. As Table 4 shows, the value of stock traded as a percentage of GDP is small, although it has been increasing over the years. The liquidity of the East African markets is abysmally low; in most cases the value of stock traded is less than 1% of GDP. Once again, the well established markets of South Africa and Egypt have relatively high liquidity ratios. Similar results are obtained using the turnover ratio, reflecting minimal trading activity. The added challenge facing these fledgling SSA stock exchanges is concentration of trade in a few stocks and the dominance of a few firms on some stock exchanges. Market dominance is particularly evident in the regional market in Abidjan and the Ghana stock market. Specifically, the Ashanti Goldfields accounts for 90% of the total capitalization of the Ghana stock market, and five companies account for 75% of transactions in Abidjan (Senbet and Otchere, 2010).

What is striking is that the low levels of development indicators for SSA stock markets are dismal even by comparison with other developing countries outside Africa as observed by Allen et al. (2009). Again, this is one area that is getting attention in policy circles in Africa. There is a growing awareness that the mere establishment of stock exchanges is of very limited value unless there is an enabling environment for these markets to perform vital liquidity and information production. The potential impediments to the liquidity of African stock markets include limited trading activity by institutional investors, as well as governments which maintain minority stockholdings. However, as we shall see later, various governments have begun implementing policy measures that foster liquidity of the stock markets.

Among the measures used in fostering depth and liquidity of African stock markets are large scale privatization programs through the stock exchanges (e.g., privatization of Kenya Airways) and regional consolidation of these markets as pioneered by the establishment of a regional stock market domiciled in Abidjan, namely Bourse Régionale des Valeurs Mobilières (BVRM). The BVRM serves as an anchor for the Francophone countries of West Africa—Benin, Burkina Faso, Côte d’Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo. The Abidjan-based market happens to be the only regional stock exchange of its kind in the world, and it is bound to serve as a positive role model for other regions of Africa. Currently similar initiatives are under way in the other regions, with the possibility of the Anglophone countries of West Africa forming a regional stock exchange under the auspices of the Economic Community of West African States (ECOWAS) and countries

in Southern Africa forming a regional stock exchange under the auspices of the Southern African Development Community (SADEC) organization. Like-wise, Eastern African countries, such as Kenya, Tanzania, Uganda, and Rwanda may partner to establish a regional stock exchange.

### 1.3.3. Performance of African stock markets: do they present viable investment opportunities?

The viability of African stock markets as investment opportunities depends on the extent to which they have the potential to improve risk-return tradeoffs facing global investors. The historical track record points to this potential. Despite the challenges associated with liquidity, African stock markets have performed remarkably well, both in terms of absolute returns and on a risk-adjusted basis. The risk adjustment is done using the standard Sharpe ratio that scale average return by volatility. As shown in Table 5, the average annual return for these markets over the past 10 years was 25%. With the exception of 2008, the performance of these markets has been increasing significantly, with the returns on the markets in Egypt and Malawi sometimes exceeding 100%.

In the face of perceived high risks in Africa, it would be prudent to look at the returns on a risk-adjusted basis as well. We estimate risk-adjusted returns for these markets and present the results in Table 6. The performance of the markets looks attractive even after adjusting for standard risk measures. Table 5 shows the performance of African stock markets in absolute as well as risk-adjusted (Sharpe ratio) terms. The other concern that global investors would have is currency fluctuations in Africa, which are typically hard to hedge. Even on this score, African stock markets have performed well. When converted into dollar terms, the results remain impressive – average annual return of 21.8%.<sup>2</sup> (Fig. 3).

Further, we wish to know the extent to which African stock markets are resilient in the wake of global stock market selloffs stemming from the great financial crisis. As expected, the stock markets, which were relatively more integrated into the global financial economy, particularly South Africa and Nigeria got hit hard. The others, while less affected, were not immune since the crisis got transmitted to the less financially integrated economies through shocks in the real sector (e.g., sharp decline in trade and foreign direct investment flows). However, when we perform standard return-risk analysis for the African stock markets, we observe that they have fared better than most other markets around the world. Some markets, surprisingly, generated positive returns in the face of the crisis (e.g., Ghana, Namibia, and Malawi).<sup>3</sup>

<sup>2</sup> Of course, when it comes to Africa, global investors may also be worried about non-standard sources of risk, including those associated with political instability. We will be discussing those sources of risk in the conclusion.

<sup>3</sup> See Senbet and Otchere (2010) for a more complete analysis of the African stock market performance during the crisis period.

Table 4  
Liquidity of African stock markets.

Panel A: stocks traded, total value (% of GDP)														
Region	Country	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Eastern Africa	Kenya	0.81	0.56	0.57	0.37	0.31	0.28	1.40	2.14	2.69	5.78	4.89	4.17	1.65
	Tanzania	–	0.00	0.08	0.44	0.08	0.19	0.19	0.15	0.10	0.08	–	–	–
	Uganda	–	–	–	–	0.00	0.01	0.00	0.00	0.03	0.06	–	–	–
	Average	0.81	0.28	0.33	0.41	0.13	0.16	0.53	0.76	0.94	1.97	4.89	4.17	1.65
Northern Africa	Egypt	7.47	5.93	9.96	11.14	3.99	2.91	3.95	7.11	28.31	44.16	40.68	42.77	28.04
	Morocco	3.14	3.47	6.37	2.95	2.58	1.45	1.39	2.95	6.97	20.57	34.98	25.40	32.38
	Tunisia	1.38	0.95	2.02	3.22	1.58	1.05	0.66	0.80	1.57	1.69	1.86	3.72	3.18
	Average	3.99	3.45	6.12	5.77	2.72	1.80	2.00	3.62	12.28	22.14	25.84	23.96	21.20
Southern Africa	Botswana	1.14	1.35	0.67	0.77	1.08	0.93	1.05	0.51	0.43	0.66	0.89	1.11	0.89
	Mauritius	–	–	–	–	–	–	0.34	0.24	0.28	0.45	–	1.40	3.83
	Malawi	3.08	2.44	1.80	1.69	2.46	1.25	1.89	1.57	2.40	2.14	5.44	4.66	–
	Namibia	0.66	0.38	0.66	0.56	0.22	0.04	0.03	0.27	0.09	0.23	0.26	0.22	0.24
	South Africa	30.05	43.45	54.75	58.32	58.81	71.10	61.69	75.38	82.67	121.23	150.05	145.07	119.76
	Swaziland	0.01	0.01	0.01	0.02	0.77	0.02	0.00	0.00	0.00	0.00	–	–	–
	Zambia	0.20	0.08	0.38	0.25	1.46	0.05	0.25	0.12	0.20	0.21	0.63	–	–
	Zimbabwe	6.40	3.07	3.80	3.77	14.91	11.35	18.18	2.88	9.70	–	–	–	–
Western Africa	Average	5.93	7.25	8.87	9.34	11.39	12.11	10.43	10.12	11.97	17.85	31.45	30.49	31.18
	Cote d'Ivoire	0.20	0.31	0.68	0.32	0.08	0.14	0.18	0.30	0.19	0.62	0.80	1.35	0.58
	Ghana	0.71	0.80	0.32	0.20	0.25	0.18	0.60	0.74	0.63	0.41	0.73	0.93	0.37
	Nigeria	0.36	0.50	0.42	0.57	1.03	0.80	1.27	1.90	1.73	2.42	10.11	9.41	2.71
	Average	0.43	0.54	0.47	0.36	0.45	0.38	0.68	0.98	0.85	1.15	3.88	3.89	1.22
Panel B: stocks traded, turnover ratio (%)														
Eastern Africa	Kenya	0.28	0.28	0.31	3.58	3.40	3.79	7.41	8.15	9.83	14.63	10.60	11.83	4.59
	Tanzania	–	–	3.40	–	2.40	1.85	–	–	2.29	2.10	–	–	–
	Uganda	–	–	–	–	–	–	–	–	3.13	5.22	–	–	–
	Average	0.28	0.28	1.86	3.58	2.90	2.82	7.41	8.15	5.08	7.32	10.60	11.83	4.59
Northern Africa	Egypt, Arab Rep.	53.26	22.28	31.61	34.74	14.20	16.13	13.73	17.31	42.97	54.82	45.60	61.85	60.07
	Morocco	10.20	10.08	17.60	9.22	10.00	10.65	6.45	9.10	15.86	35.26	42.10	31.05	45.73
	Tunisia	1.44	0.89	13.25	23.29	12.60	13.73	7.16	9.16	16.50	14.26	13.30	25.48	16.23
	Average	21.63	11.08	20.82	22.42	12.27	13.50	9.11	11.86	25.11	34.78	33.67	39.46	40.68
Southern Africa	Botswana	0.61	1.13	0.71	4.78	5.60	5.04	4.36	2.30	1.81	2.27	2.20	3.05	2.74
	Mauritius	–	–	–	–	–	13.84	–	–	–	3.49	–	3.92	8.06
	Malawi	3.81	2.86	2.65	5.01	9.30	11.51	6.22	4.45	6.05	4.42	8.00	8.85	–
	Namibia	4.10	2.30	0.60	4.51	3.00	5.18	0.74	4.82	1.50	3.78	3.70	2.84	3.03
	South Africa	29.43	30.38	34.13	33.90	37.40	78.86	44.80	47.37	39.32	48.80	55.00	60.61	57.27
	Swaziland	126.00	–	0.20	–	9.80	6.68	0.03	–	0.01	0.03	–	–	–
	Zambia	2.00	–	4.70	–	20.80	22.47	–	–	1.99	2.11	4.10	–	–
	Zimbabwe	17.10	9.24	12.04	10.77	29.40	19.19	26.14	9.22	15.27	6.19	5.10	–	–
Western Africa	Average	26.15	9.18	7.86	11.79	16.47	20.35	13.71	13.63	9.42	8.89	13.02	15.86	17.77
	Cote d'Ivoire	2.20	4.50	10.81	2.59	0.70	0.72	1.61	2.66	1.41	3.30	2.50	4.08	2.01
	Ghana	5.82	6.49	3.35	1.48	2.60	2.47	4.12	3.24	2.24	2.14	3.90	5.19	1.96
	Nigeria	5.48	5.20	5.07	7.29	10.20	10.65	10.99	13.73	11.46	13.64	28.20	29.30	11.01
	Average	4.50	5.40	6.41	3.79	4.50	4.61	5.57	6.54	5.04	6.36	11.53	12.86	4.99

Source: World Development Indicators.

This table presents data on the liquidity of stock markets in Africa. Panel A shows the trend in the value of stock traded as a percentage of Gross Domestic Product and Panel B presents information on turnover ratio. Turnover is measured as the ratio of value traded to market capitalization. The value traded/GDP ratio measures trading relative to economic activity, whereas turnover ratio measures trading activity relative to size.

Table 5  
Performance of African stock markets\*.

African countries annual stock return (%)													
Region	Country	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	Average	Average exclude 2008
Eastern Africa	Kenya	−22.20	−16.92	−29.18	0.58	100.87	7.60	34.88	42.10	−3.56	−35.33	7.88	12.68
	Tanzania	–	–	–	–	–	–	–	–	–	21.26	21.26	–
	Uganda	–	–	–	–	–	–	–	–	–	−25.07	−25.07	–
	Average	−22.20	−16.92	−29.18	0.58	100.87	7.60	34.88	42.10	−3.56	−13.04	10.11	12.68
Northern Africa	Egypt	43.80	−37.65	−37.95	3.50	152.13	110.98	127.36	11.47	51.85	−55.10	37.04	47.28
	Morocco	−5.20	−19.51	−13.07	−14.87	27.64	13.95	18.76	78.84	42.46	−15.52	11.35	14.33
	Tunisia	74.40	75.87	−30.09	−21.40	20.04	3.72	17.20	39.96	21.12	1.78	20.26	22.31
	Average	37.67	6.24	−27.03	−10.92	66.60	42.88	54.44	43.42	38.48	−22.94	22.88	27.97
Southern Africa	Botswana	47.80	3.87	68.93	1.53	0.23	15.61	23.21	74.07	44.43	−21.38	25.83	31.08
	Mauritius	−6.40	−10.47	−12.61	17.13	37.64	29.33	13.11	49.81	51.94	−35.38	13.41	18.83
	Malawi	–	53.56	−11.51	−31.68	45.91	27.60	55.42	154.80	109.89	25.60	47.73	50.50
	Namibia	48.10	−41.40	−35.87	−20.34	23.83	14.26	7.82	27.06	44.68	19.88	8.80	7.57
	South Africa	57.30	−2.54	25.41	−11.15	11.96	21.85	42.98	37.68	16.23	−25.72	17.40	22.19
	Swaziland	–	–	–	–	–	–	–	11.83	14.98	3.92	10.24	13.40
	Zambia	20.03	56.16	−0.55	10.33	29.04	77.27	61.96	48.17	92.29	−29.08	36.56	43.86
Western Africa	Average	33.37	9.87	5.63	−5.70	24.77	30.99	34.08	57.63	53.49	−8.88	23.52	27.13
	Cote d'Ivoire	−6.80	−18.07	3.61	−4.26	0.81	17.11	28.31	0.27	77.02	−10.68	8.73	10.89
	Ghana	−15.20	16.54	11.42	45.95	154.67	91.32	−29.85	4.97	31.84	58.06	36.97	34.63
	Nigeria	−7.20	54.01	35.16	10.71	65.84	18.46	1.01	37.80	74.73	−45.77	24.48	32.28
	Average	−9.73	17.50	16.73	17.47	73.77	42.30	−0.18	14.34	61.19	0.54	23.39	25.93

\* These returns are calculated from data obtained from Global Stock Market Fact Book, 2008 and in some cases from the stock exchange's website.

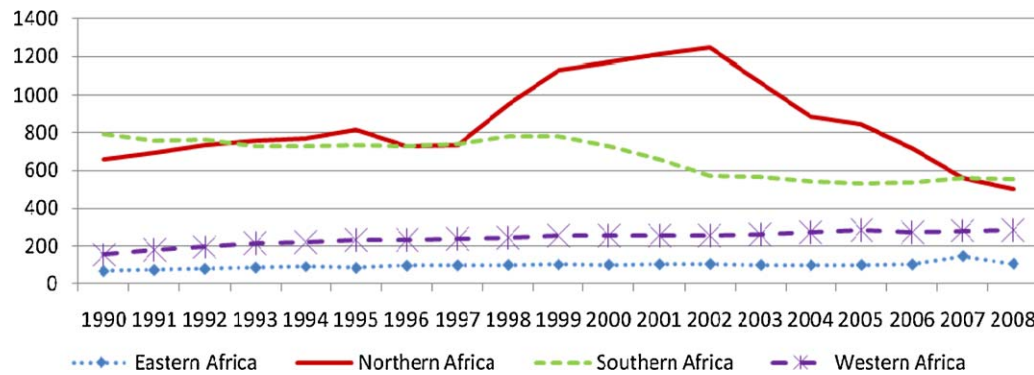


Fig. 3. Listed domestic companies, regional total.

#### 1.3.4. Sectoral investment opportunities in Africa

The foregoing discussion suggests that African stock markets offer viable investment opportunities with the potential to improve risk-return tradeoffs facing global investors. With increasingly integrated economies around the world, Africa offers growth and investment opportunities which currently appear under exploited. Moreover, volatility of the stock markets had been decreasing steadily prior to the global crisis. Fig. 4 depicts the stock return volatility, suggesting that the risk associated with investing in the African stock markets had declined overtime; the exception is Zimbabwe where the risk has increased in recent years. Thus, the recent performance of African stock markets suggests that these markets represent

largely unexploited opportunities for global investors. Going forward, it would be useful to highlight specific sectors that may offer such opportunities. These opportunities can be accessed through private equity channels, and eventually through the stock markets themselves, as more firms in these sectors get listed. These areas, as discussed in Meek (2008) include:

- **Banking:** The regulatory environment pushes banks to seek greater capitalization, which leads to opportunities for private equity firms investing in the financial industry. The deals in banking and insurance are some of the largest in West Africa to date – average deal sizes vary by country but range from \$5 million to about \$30 million.
- **Telecommunication:** The sector has been a popular area for private equity investments in Africa. In the absence of comprehensive fixed line infrastructure, the growth in mobile phone usage has skyrocketed. Africa as a whole has the fastest growing market in the world with 45% growth in subscription. The growth is particularly phenomenal in West Africa as it has experienced 75% subscriber growth.
- **Mining:** Extractive industries continue to provide opportunities for private equity firms operating in Africa. It is expected that there will be many more mining deals as global demand for minerals increases.
- **Privatizations:** With many African countries undergoing a process of selling off state assets, privatizations could provide promise for private equity. Privatization programs will also offer investment opportunities through the stock markets, since there is a growing recognition that state-owned enterprises can be privatized through the stock markets. For instance, Kenya Airways got privatized successfully through the Nairobi Stock Exchange.

Table 6  
Risk-adjusted performance of African stock markets.

Region	Country	Mean return (%)	Sharpe measure
Eastern Africa	Kenya	7.88	−0.01
	Tanzania	21.26	2.47
	Uganda	−25.07	−3.31
	Average	1.36	−0.28
Northern Africa	Egypt	37.04	0.39
	Morocco	11.35	0.16
	Tunisia	20.26	0.42
	Average	22.88	0.32
Southern Africa	Botswana	25.83	0.49
	Mauritius	13.41	0.25
	Malawi	47.73	0.33
	Namibia	8.80	−0.02
	South Africa	17.40	0.31
	Swaziland	10.24	0.20
	Zambia	36.56	0.33
	Average	22.85	0.27
Western Africa	Cote d'Ivoire	8.73	0.14
	Ghana	36.97	0.27
	Nigeria	24.48	0.31
	Average	23.39	0.24

Source: Data used to calculate these returns come from the Global Stock Market Fact book 2008 and International Financial Statistics.

This table shows the Sharpe measure for the African countries. The measure is based on mean stock return and mean risk free (Treasury bill) rates of return from 1999 to 2008. The measure is calculated for the countries for which data are available.

#### 1.3.5. Stock exchange trading systems in Africa

The earlier discussion focussed on the liquidity challenges facing Africa stock markets, but most SSA markets remain operationally inefficient as they use manual trading and clearing systems. The prevalence of manual systems is shown in Table 7, which presents indicators of the African stock market infrastructure. The African stock exchanges that have adopted automated systems include Johannesburg Securities Exchange (JSE), Algerian Stock Exchange, Bourse Regionale des Valeurs

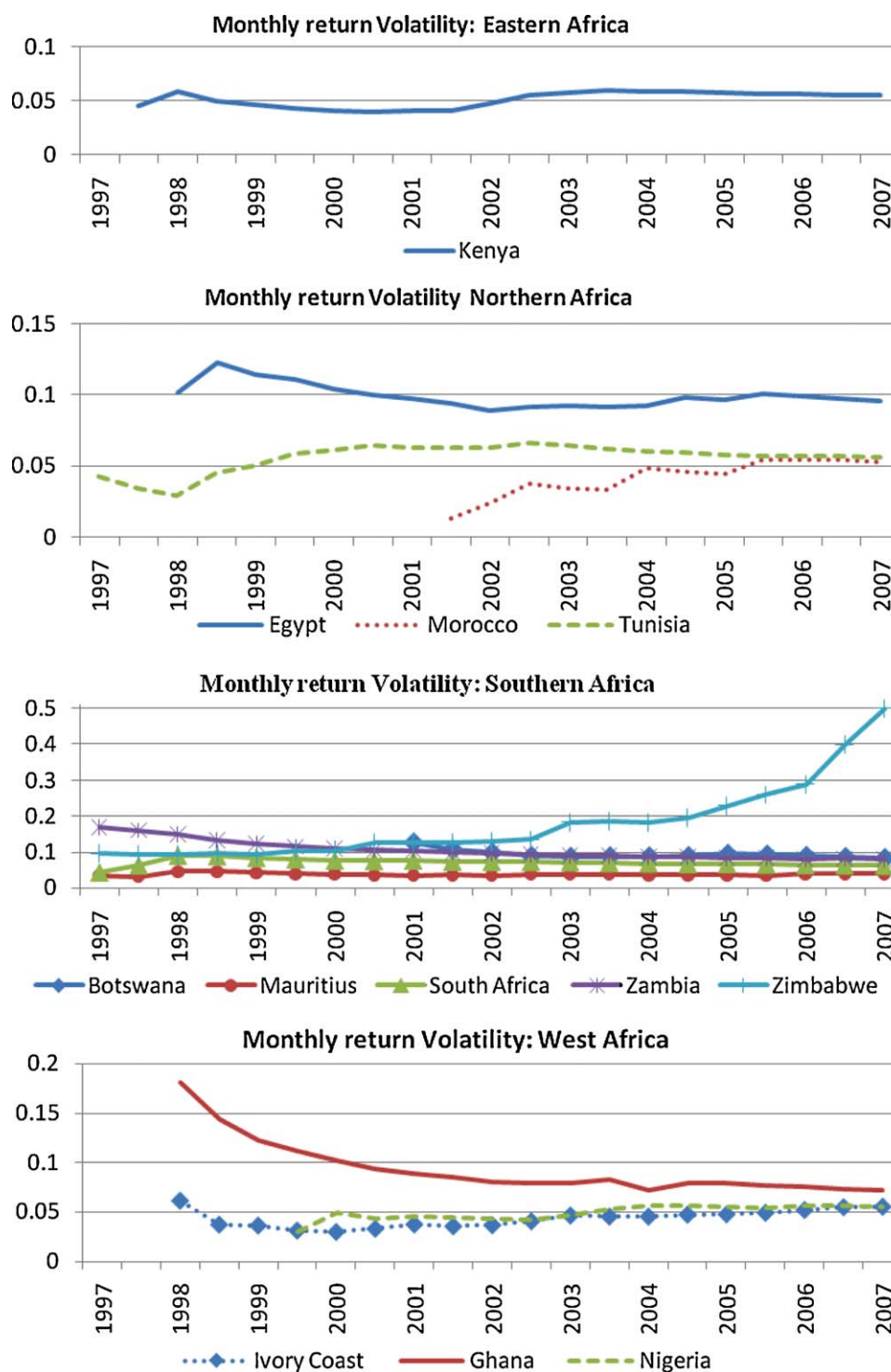


Fig. 4. African stock markets monthly return volatility.

Mobilières (BRVM), the Cairo and Alexandria Stock Exchange (CASE), Stock Exchange Mauritius, Namibia Stock Exchange, Tunis Stock Exchange, Zambian Exchange, and Nigeria Stock Exchange.

The manual systems used by most of the stock exchanges in Africa pose impediments to operational efficiency, as well as liquidity, as they pose bottlenecks in terms of slowing down trad-

ing and information production of the stock market. Therefore, it is important that sub-Saharan African stock exchanges adapt fast to automation and electronic systems. It is encouraging that SSA stock exchanges are gradually adapting to electronic systems. This is particularly important as African stock exchanges contemplate consolidation of regional markets, which would be difficult without automation.

Table 7  
Infrastructural indicators of African stock exchanges<sup>a</sup>.

Country	Clearing and settlement	Foreign participation	Trading system
Algeria	Electronic	Yes	Electronic
Botswana	Manual	Yes	Manual
Cote d'Ivoire	Electronic	Yes	Electronic
Egypt	Electronic	Yes	Electronic
Ghana	Manual	Yes	Manual
Kenya	Manual	Yes	Electronic
Malawi	Manual	Yes	Manual
Mauritius	Electronic	Yes	Electronic
Morocco	Manual	Yes	Electronic
Namibia	Manual	Yes	Electronic
Nigeria	Electronic	Yes	Electronic
South Africa	Electronic	Yes	Electronic
Swaziland	Manual	Yes	Manual
Tanzania	Electronic	Yes	Electronic
Tunisia	Electronic	Yes	Electronic
Uganda	Manual	Yes	Manual
Zambia	Electronic	Yes	Electronic
Zimbabwe	Manual	Yes	Manual

<sup>a</sup> Adapted and updated from Senbet and Otchere (2010).

#### 1.4. Bond markets

A key feature of the financial markets in Africa is the dearth of bond markets for both government and corporate bonds. The bond market is either not well developed or, at best, is at its infancy. None of the markets in North Africa has a secondary bond market. The regional market in French West Africa has a corporate bond market. The maximum maturity of corporate bonds listed on the BVRM is ten years. This is meant to help improve the efficiency of the regional capital markets. In order to list on the BRVM, all bond issues must be guaranteed by an approved financial institution, a development financial institution, a guarantee fund, or the parent company if the issuer is a subsidiary. This might be one of the reasons why most of the corporate issues in the French speaking zone are privately placed and remain unlisted.

Nigeria is the only country in the Anglophone West Africa region with a secondary debt market and a bond index. Federal Government of Nigeria (FGN) Bonds are issued in maturities ranging from 3 to 20 years and can be purchased in both the primary and secondary markets. It launched a sovereign bond index in December, 2006, detailing price information about local currency denominated fixed rate Federal Government of Nigeria Bonds.

Just like in the other parts of Africa, the government bond market in East and Central Africa is not well established. The countries in this region do not have a wide range of treasury bills and bonds, except Kenya which has a variety of maturities to offer, as it has treasury bills and medium to long term treasury bonds. Southern Africa is the only region with a well developed government bond market. Government bond issues in South Africa started in the 1980s when bonds were only issued on demand. Trading in the market which began in 1996 has attracted a lot of interest to the extent that the bond market also has a turnover ratio equivalent to other mature markets. Botswana is one of the few countries with a primary dealership

system in government bonds for both the primary and secondary market.

#### 1.5. Derivative markets

Apart from the markets in South Africa, the derivative market was non-existent in Africa a few years ago. However, due to initiatives undertaken by some governments in the French West Africa regional exchange and Southern Africa, the derivative market in the WAEMU zone is in its infancy while the one in Southern Africa (Namibia, Botswana, Seychelles and South Africa) is thriving. In the WAEMU zone of West Africa, foreign exchange forwards exist with moderate liquidity and maturities extending up to 3–6 months. In Morocco, futures market based on treasury bonds opened in 2008. This is the first attempt to broaden the offering in the Casablanca Stock Exchange. In Botswana, derivatives activity mainly consists of over-the-counter foreign exchange forwards and currency swaps. Both forwards and currency swaps markets are liquid, with terms up to 3-months and 6-months, respectively. Currency swaps are mostly against the USD but can be against any of the major international currencies. The growth in these markets will allow investors to hedge their bets.

#### 1.6. Private equity funds, pension funds and other non-bank financial institutions

Private equity and venture capital are relatively new asset classes in Africa with funds only being established in recent years. In the last twenty years global investors have become enamoured with emerging stock markets, but by comparison Africa has received a scant portion of the capital flows to emerging markets as global equity funds have maintained a low exposure to Africa. However, this situation is changing and the private equity sector is growing. The West African region, especially the Francophone monetary union (WAEMU) region has been attracting a growing number of general partners (GP) due to its stable macroeconomic climate: relatively controlled inflation and foreign exchange risk, favourable investment climate, and trend towards regulation and privatization. The Southern African region has also been home to a number of private equity funds for some time. In Namibia, the non-banking financial institutions market also includes over 500 pension funds and a variety of asset management and unit trust management companies. Most of these institutions in Namibia have strong ownership ties to South Africa (AfDB, 2006).

While some Africa countries have problems in maintaining both political and economic stability, South Africa has capitalized on its stability and economic infrastructure to attract private equity capital. The *Venture Capital and Private Equity Industry Performance Survey* that analyzed South Africa's private equity market from 2006 to 2007 reveals a booming economy with impressive achievements nearly doubling in size from 2006 to 2007. Most notably, South Africa's private equity industry had R86.6 billion under management as of December 2007, compared to December 2006 at R59.3 billion (South Africa Venture Capital Association, 2008). While there is limited private equity

and venture capital in Zambia, the industry is growing with the establishment of the Zambia Venture Capital Fund (ZVCF), Cavmont Group and FMO (the Netherlands Development Finance Company) joint Venture Capital Fund, and Aureos, a foreign private equity firm, with substantial investment made in companies in the country.

### 1.7. Microfinance

Microfinance has a long history in Africa, initially organized in an informal setting. Informal microfinance systems predated the formal microfinance sector. Microfinance has been in existence in the WAEMU countries for almost 30 years and in some of the other countries in Africa. The industry has experienced high growth in recent years and is becoming an important driver in the development of the economies in Africa and continues to play a key role as a grassroots financial tool.

Access to credit by small business is a big problem in Africa, and for this reason the governments have facilitated the establishment of microfinance institutions (MFIs). The providers of these services range from government enterprises to large commercial banks to non-government organizations. These microfinance institutions can help build the foundation of the economy and help increase the GDP of the countries in this region. In Africa, these institutions have been successful in providing financial services to the people who may normally not qualify for loans from the banks and other financial institutions. This is why the MFIs have been popular in this region as many people do not have valuable assets to back their loans, and do not require large loans or have saving accounts which the banks go after. Countries in Africa including Mozambique and Ghana, are experiencing a great deal of growth in the MFI sector in rural and urban areas. With over 45 million loans granted in some countries, the microfinance sector is a booming sector in the continent. The loans provided by the MFIs have had great impact on the agriculture sector. Since the farmers are able to raise capital through the MFIs they can buy tools and other necessary equipment to farm and grow crops and generate income.

This overall favourable development of microfinance, however, masks contrasting structural and qualitative developments, some of which could represent major risks for the sector. Mobilizing funds to the rural area where it is needed most is very difficult for the MFI of this region. High transaction costs cause these firms to operate in urban and semi-urban areas making it hard to reach the rural communities. Consequently, in certain parts of the continent, the microfinance sector comprises many microfinance institutions that are mostly concentrated around big cities. Microfinance in rural areas is not very well represented, and as a result it is very difficult for entrepreneurs in rural areas to undertake small businesses.

### 1.8. Impact of the current financial crisis

While most countries were affected by the recent financial crises, as argued by the African Development Bank, Africa's low level of financial integration ensured that African economies were relatively insulated from the direct impact of the financial

crisis (AfDB, 2009), in part due to the underdeveloped nature of the financial markets. However, African countries, including those which are weakly integrated into the global financial economy, have suffered collateral damage stemming from the global crisis which was rooted in the US. There were stock market sell-offs in the more open economies, such as South Africa and Nigeria. The less open countries got hit as a result of transmission of the crisis through the real sectors, with declining economic performance and interrupting the growth renaissance that the region experienced pre-crisis.

Thus, the current financial and economic crisis has affected the drivers of Africa's recent growth performance. In most of the countries, economic growth slowed noticeably largely because of a decline in export demand. Demand for and prices of commodities produced by the African countries are falling, capital flows are declining, and promised increased aid has not materialized. China's growth has slowed. Although the immediate impact of the crisis were contained, according to the African Development Bank, the medium-term effects are likely to be greater (AfDB, 2009). An extended analysis of the effect of the crisis on Africa is contained in Allen and Giovannetti (2011) and Senbet (2010).

## 2. The state of African financial systems: North Africa region

### 2.1. Introduction

The Arab North African region consists of Algeria, Egypt, Libya, Morocco, Sudan, Tunisia and Western Sahara. The North African countries have followed their own paths to independence heavily influenced by their Muslim heritage. The Arab Islamic conquest reached North Africa in the 6th century and by the 7th century most of the North African countries had fallen to Muslim rule. During the 18th and 19th century, North Africa was colonized by France (Morocco, Algeria and Tunisia), the United Kingdom (Egypt and Sudan), Spain (Western Sahara) and Italy (Libya). The countries gained independence between 1950 and 1970. The population in North Africa is approximately 205 million people (African Economic Outlook, 2009). With a population of 75 million people in 2007, Egypt is the most populous country in the Arab World and the third largest in Africa after Nigeria and Ethiopia, while Libya has the smallest population with 6.16 million people (Business Monitor International: The North Africa Business Forecast Report Q1 2009).

The GDP of the North African region held up well through 2008 with domestic demand, notably investments financed in large part by foreign direct investment (FDI), providing impetus for growth. Economic growth in the region was 5.8% on average in 2008, up from 5.3% in 2007 (AfDB: African Economic Outlook, 2009). The 2008 growth rates reflected strong performances in nearly all the countries of the region. Exceptionally high growth was recorded in Egypt (7.2%), Libya (6.7%), and Sudan (6.8%), while growth in Morocco and Tunisia was around 5%. A sluggish hydrocarbon sector brought GDP growth in Algeria down to 3% (African Economic Outlook, 2009). The most diversified economies of the region, namely, Morocco and

Tunisia, enjoyed economic growth over 2002–2007, with annual real GDP growth averaging 4.8–4.9%. Growth in Morocco and Tunisia has been driven by manufacturing and agricultural exports as well as tourism and remittances ([African Economic Outlook, 2009](#)). Growth in Egypt has been relatively strong, increasing from 7.1% in 2007 to 7.2% in 2008, as investment advanced by more than 30% funded in large part by foreign direct investments (FDI). Egypt has been the largest recipient of FDI in the region, attracting \$13 billion in fiscal 2008, up from \$11 billion in the previous fiscal year ([African Economic Outlook, 2009](#)). Inflation in North Africa is relatively high – 11.7% in Egypt, to 14.3% in Sudan, to 10.4% and to 5% in Tunisia. However, Algeria and Morocco have managed to keep inflation at around 4% (AfDB: [African Economic Outlook, 2009](#)).

The average fiscal balance was equivalent to a surplus of 5.3% of GDP in 2008, up from 3.6% in 2007. The high oil prices resulted in substantial increases in the fiscal balance for the largest oil-exporting countries in the region Algeria (6.8% of GDP, up from 4.8%) and Libya (34.5% of GDP, up from 26.2%). Tunisia, on the other hand, experienced little change in its fiscal deficits in 2008 compared with 2007, while Morocco continued to show a small surplus. Egypt on the other hand saw its fiscal deficit widen to 6.8% of GDP in 2008, up from 5.6% in 2007 ([African Economic Outlook, 2009](#)).

The agriculture sector plays an important role in the North African countries, both for exports and private consumption. In Sudan, this sector remains important, although its economy is primarily based on oil. Sudan has become sub-Saharan Africa's third largest oil producer, only surpassed by Nigeria and Angola. The country's oil exports, which have increased sharply since the completion of the major oil-export pipeline in 1999, account for 70% of total export revenues. The Libyan economy is also dominated by the oil and related industries which consist of 97% of export earnings, 75% of government receipts, and 54% of gross domestic product while agriculture is the second largest industry. In Algeria, the hydrocarbons industry represents 60% of budget revenues, 30% of GDP, and over 95% of export earnings. Once primarily based on agriculture, oil and phosphates, the Tunisian economy has become more diverse, with manufacturing (especially textile and electricals) and tourism sectors playing an increasingly important role in the economy. The services sector accounts for the largest share of GDP (more than 60%), with transport, communications, hotels and catering being particularly important contributors to GDP. In summary, the economies of the North African countries are dominated by natural resources, in particular oil and agriculture; the only exception is Tunisia that has diversified its economy.

## 2.2. Central bank and its role in the economies

Unlike the countries in the French speaking block of West Africa, each country in North Africa has its own Central Bank, which is the primary monetary authority. The Central Bank's primary functions are to protect the value of their currencies and to control inflation and the stability of the economy. They regulate the money supply of their respective countries through open market operations. The Central Banks issue bank notes and

are responsible for managing the foreign exchange market, the official gold reserves, as well as the supervision of the banking system in their respective countries. All the Central Banks use monetary policy to control inflation. The Bank of Sudan strongly adheres to Islamic banking principles and employs Islamic banking instruments to conduct its monetary policy operations. The Moroccan Central Bank, the Bank Al Maghrib (BAM) regulates money supply and demand through 7 day advances, open market operations, repo type transactions, and currency swaps.

The Central Banks of Tunisia (BCT) and Algeria conduct a flexible exchange rate policy. The exchange rates are determined in the interbank foreign exchange market. These Central Banks have adopted an intervention policy with the view to providing liquidity in the market when there is an imbalance of demand and supply of foreign exchange by acting as the main seller and buyer. The Bank of Sudan formally adopted a managed-floating exchange rate regime. However, the exchange rate band for the Sudanese Dinar (SDD) was abandoned in favor of an auction system with direct transactions in the interbank market.

In Egypt, from early 2005 through mid-2007, the Central Bank adopted a managed float policy, managing the exchange rate in a way that ensured stability of the £E/US\$ rate. This approach reflected concerns that greater exchange rate flexibility could lead to a large appreciation – hurting non-hydrocarbon exports and tourism – and that increased volatility could weaken confidence in the interbank foreign exchange market established in December 2004. However, maintaining a stable nominal £E/US\$ exchange rate, akin to a peg, has complicated the conduct of monetary policy and has carried rising sterilization costs. Since mid-2007, the exchange rate has been managed more flexibly, akin to a managed float regime ([IMF, Arabic Republic of Egypt: Selected Issues, December 2007](#)).

In Morocco, the exchange rate regime is a conventional peg based on a basket of currencies consisting of the Euro and the US dollar, with weights of 80% and 20% respectively, broadly reflecting Morocco's trade flows ([Financial System Stability Assessment, IMF, October 2008](#)). Similarly in Libya, the Libyan Dinar (LYD) is pegged to the IMF's Special Drawing Rights (SDR), a basket of currencies consisting of USD, EUR, JPY and GBP. The peg which is LYD 2.80/1 SDR, allows for maximum margins of  $\pm 7.5\%$  around the peg rate. The LYD has been generally stable within a range of LYD 1.22–1.42/1SDR.

All these central banks are technically independent of the government, but in practice they work closely with the Ministry of Finance of their respective countries to formulate and implement macroeconomic policies.

## 2.3. Banking system

The banking system in North Africa is dominated by a few large, sometimes foreign banks. The number of banks in this region ranges from 16 in Libya and Morocco to 39 in Egypt. In Algeria and Egypt, foreign banks account for more than 60% of banking operations. About two-thirds of the banks in Egypt are fully or majority owned by foreign banks, with seven of them only transacting in foreign currency and the remaining being fully licensed to operate in the local currency, the

Egyptian pound (£E). The banking industry in North Africa is undergoing reforms focused on selling state-owned stakes in joint venture banks, privatization and other forms of restructuring of the state-owned banks with the view to improving the quality of the banks. While the restructuring of banks has been quite slow in countries such as Algeria, Libya and Tunisia, it has been successful in Egypt and Morocco. In Morocco, state ownership currently stands at 23% of assets in 2006, down from 40% in 2002 (Financial System Stability Assessment, IMF, October 2008). The “big 3” commercial banks in Morocco – Attijariwafa Bank, Bank Centrale Populaire (BCP) and Bank Marocaine du Commerce Extérieur (BMCE), account for 63.8% of the banking sector assets.

The most ‘liberalized’ market in this region is the Egyptian financial market. Although the Egyptian government successfully privatized the Bank of Alexandria in 2006, the banking industry is still dominated by two large state-owned commercial banks – National Bank of Egypt and Bank Misr. These banks together with the three largest private banks, namely Commercial International Bank (Egypt), National Societe Generale Bank and Bank of Alexandria represent approximately half of the Egyptian banking system assets and deposits (HSBC Global Research, March 2009).

In Algeria the banking sector is dominated by state-owned banks. The state-owned banks control over 90% of total banking deposits and assets, with the two largest state-owned banks – The Bank Extérieure d’Algérie (BEA) and Bank Nationale d’Algérie (BNA) holding half of the banking sector total assets, while the 14 private banks which are subsidiaries of international banks fully owned by foreign capital hold about 10% of the assets and deposits. Similarly, the Tunisian banking sector is dominated by three state-owned banks, namely Societe Tunisienne de Bank, Bank Nationale Agricole and Bank de l’Habitat, which accounts for about 50% of market share in assets (Oxford Business Group Report: Tunisia 2008). Libya’s banking system is dominated by five banks which are owned in full or in part by the Libyan Government – Jamahiriya Bank, Wahda Bank, Sahara Bank, Umma Bank and the National Commercial Bank. These banks constitute almost 90% of Libya’s banking sector assets. The financial liberalization policies adopted by the government have resulted in the partial privatization of the Wahda Bank and Sahara Bank in 2007 and 2008. However, the financial liberalization and banking privatization initiative has been slow to take effect in Libya.

Different interest rate regimes adopted by the countries in the region have resulted in different interest rate spreads in the region. As Table 8 indicates, Morocco recorded the highest interest spread from 2002 to 2006 of about 8–9%, while interest rate spreads in Algeria and Egypt were at the 6 percentage point throughout 2004–2006. Interest spread is kept fixed at 3% in Sudan whereas in Tunisia, lending rates are freely set by the individual banks, except for sight accounts and deposit for a period of less than 3 months where a ceiling of 2% is in place.

Moroccan, Egyptian, Algerian and Libyan banks get most of their funding from deposits, which account for approximately 69–83% of their liability base, but banks in this region use the deposits differently. Libyan banks reinvest most of their funds

Table 8  
Interest Rates (period averages, %).

	2002	2003	2004	2005	2006	2007	2008	2009		2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Morocco</b>									<b>Algeria</b>									
Lending rate	13.1	12.6	11.5	11.5	11.9	–	–	–	Lending rate	8.5	8	8	8	8	8	8	8	8
Deposit rate	4.1	3.7	3.5	3.5	3.7	3.7	3.9	3.8	Deposit rate	5.3	5.3	2.5	2.5	1.8	1.8	1.8	1.8	1.8
Money-market rate	3	3.2	2.4	2.8	2.6	3.3	3.4	3.3	Money-market rate	3.1	1.9	1.1	2	2.3	3.1	3.3	3.7	3.7
Interest spread	9	8.9	8	8	8.2	–	–	–	Interest spread	3.2	2.7	5.5	6.2	6.2	6.2	6.2	6.2	6.2
<b>Egypt</b>									<b>Libya</b>									
Lending rate	13.5	13.4	13.1	12.6	12.5	12.3	12	–	Lending rate	7	6.1	6.1	6.3	6	–	–	–	–
Deposit rate	8.2	7.7	7.2	6	6.1	6.6	6.5	–	Deposit rate	3	2.1	2.1	2.5	2.5	2.5	2.5	–	–
Money-market rate	6.9	10.1	8.6	9.5	6.9	11.4	9.8	–	Money-market rate	4	4	4	4	4	–	–	–	–
Interest spread	5.3	5.7	5.9	6.6	6.4	0.9	5.5	–	Interest spread	4	4	4	3.8	3.5	–	–	–	–
<b>Tunisia</b>									<b>Sudan</b>									
Lending rate	–	–	–	–	–	–	–	–	Lending rate	11.2	11	11.4	11.8	11.7	–	–	–	–
Deposit rate	3.5	3	3	3	3.3	–	–	–	Deposit rate	8.2	8	8.4	8.8	8.7	–	–	–	–
Money-market rate	5.1	5	5	5.1	5.2	5.2	4.3	4.4	Interest spread	3	3	3	3	3	–	–	–	–
Interest spread	–	–	–	–	–	–	–	–										

Source: IMF, International Financial Statistics (2010).

with the Central Bank of Libya in the form of demand and time deposits, while Egyptian banks use the funds to increase their lending facilities. Also, the loan/deposit ratio has been consistently declining in Algeria (69.2% in 2007), Libya (23% in 2008) and Egypt (53% in 2008). This indicates that the Libyan banking system in particular and the Egyptian banking sector to some extent can withstand further loan growth without jeopardizing their liquidity position. In Morocco, credit to the private sector has been increasing rapidly, growing by almost 30% in 2007.<sup>4</sup> In Egypt, the private sector accounted for about 92.5% of total credit facilities available in 2006/07; this represents a growth of 4.5% from the previous year's rate. In contrast, bank credit to the private and public sector is almost equal in Algeria.

While some of the countries in this region have some form of deposit insurance programs, coverage varies widely. For example, the deposit insurance system in Algeria covers up to 600,000AD (approx. \$9230) per depositor and in Morocco, the deposit guarantee fund compensates up to a maximum of 80,000DH (approx. \$11,000) per customer.

#### 2.4. Insurance companies and other financial institutions

The insurance industry in the North African countries is still in infancy and is relatively underdeveloped compared to other emerging economies and developed countries. Consequently, the insurance sector plays a very small role in the economies. The insurance industry is also highly concentrated. In Algeria, there are 16 insurance companies but the three public companies hold approximately 80% of the market share; similarly in Morocco, the top three players out of 17 insurance companies own more than 50% of market share (*Financial System Stability Assessment*, IMF, October 2008). In Libya, the state-owned Libya Insurance Company accounts for about 40% of the market (*Middle East Insurance Review* July 2007, ARIG), and the top five players in Tunisia owns 91% of market share (Tunisia 2008, Oxford Business Group).

The Moroccan insurance sector is the largest in region and the second largest in Africa, with approximately USD\$12.9 million in assets in 2007. Premiums represent about 3% of the country's GDP, amounting to only \$65 per capita (*Financial System Stability Assessment*, IMF, October 2008). While in Algeria, insurance companies account for less than 3% of total financial system assets, the insurance density in the country stands well below that of the neighbouring countries (Tunisia and Morocco). The life insurance segment has been the fastest growing sector in the insurance industry. This is especially true in Tunisia where the sector has grown by more than 23% between 2006 and 2007 (Oxford Business Group Report: Tunisia 2008,). In Morocco, this sector grew at an annual rate of 26.7% in 2006 (Oxford Business Group Report: Emerging Morocco 2007) and in Egypt the sector grew by 35.8% from 2007 to 2008 (The Egyptian Insurance Supervisory Authority). While Libya has recently deregulated its insurance sector, life insurance is practically nonexistent in the country.

In terms of other financial institutions, there are 62 investments funds in Tunisia – 23 of them are mutual funds. More than 91% of their funds are invested in fixed income instruments because many investors lost their investments during the market downturn in the 1990s, and as a result many of them prefer the security of fixed income funds (The Report: Tunisia 2008, Oxford Business Group). In Morocco, the mutual fund sector is modest in size accounting for about 11% of total financial system assets.

#### 2.5. Government bond markets

There is a significant variation in the level of development of the (government) bond market in this region. For example, Libya does not have a government bond market. Since the market for Islamic instruments is in its infancy, the market for government securities remains shallow in Sudan. However, the markets in Egypt, Morocco and Tunisia are fairly well-developed, with the markets dominated by government bonds with relatively long maturity periods. In the primary market, Treasury bonds account for 90% and 85% of bond issues in 2006 in Morocco and Tunisia respectively (The African Financial Market Initiatives, African Development Bank), and 90% in Egypt in 2008. Tunisia has multiple forms of government bonds, namely transferable Treasury bond (BTC), short-term Treasury bonds (BTCT), long-term Treasury bonds (BTA) and bonds negotiable on the stock exchange (BTNB). While secondary bond market trading remains virtually nonexistent in North Africa, Algeria, Egypt and Tunisia have bonds listed on the respective stock exchanges. Egypt, Morocco and Tunisia are the only countries in the region to have Moody's and S&P investment grade ratings.

In Algeria, the financial market is dominated by the bond market comprising 14 listed Treasury bond issues, with an outstanding value of around AD145bn (\$2.2bn). Government Treasury bonds are traded through six authorized intermediaries, made up of representatives of the six public banks. Treasury bonds issued with maturity dates greater than five years have been listed on the Algiers bourse since the beginning of 2008 (*Emerging Algeria*, 2008). Egypt's government bond market has developed rapidly. Since 2001 the government has issued Egyptian pound denominated bonds and foreign currency denominated bonds including a series of Eurobonds (*Daily News Egypt*, 2007). Treasury bonds are issued through a public auction. Since there are no primary dealers in Egypt, government bonds are traded on the Cairo & Alexandria Stock Exchange (CASE).

#### 2.6. Stock markets

This region is home to one of the oldest stock markets in Africa, the Egyptian stock market. In general, the level of stock market development in this region varies significantly. The Khartoum Stock Exchange in Sudan and the Algerian Stock Exchange (ASE) are very small, with total market capitalization of US\$ 3.4 million and US\$ 97 million respectively. There are currently only two companies listed on the ASE. Therefore, the stock market plays a minor role in the financing of the firms

<sup>4</sup> A Disequilibrium Approach, IMF Working Paper, March 2009.

in these countries. Tunisia and Morocco on the other hand have relatively better developed equity markets, with total market capitalization of TND 8301 billion (*Bourse de Tunis Report, 2008*) and US\$65.6 billion respectively, in 2008. There are currently 51 companies listed on the Tunis Stock Exchange (TSE) with total trading volume in the TSE in 2007 of TND 1744 billion (approx. US\$1.221 billion). Local ownership of the TSE stands at 72% as of 2007 (*Bourse des Valeurs Mobilières de Tunisie*). Trading volume as a fraction of market capitalization is 26.72% on the TSE.

There are 77 firms listed on the Casablanca Stock Exchange (CSE) in Morocco. Total trading volume in the Casablanca Stock market in 2008 was MAD 217.7 billion (approx. US\$25.6 billion). The CSE places no restrictions on foreign ownership of Moroccan companies. There is, however, a very low rate of foreign investment in the CSE, and the ratio of local to foreign investment is estimated to be 19:1 (*Magharebia, Global Economic Crisis Triggers Bear Market in Morocco, 2008*). Turnover is very much higher in the CSE compared to the TSE. Trading volume as a fraction of capitalization is 40.9% on the CSE, while trading volume as a fraction of GDP is 158.4%.

The Egyptian Stock Exchange referred to as the Cairo and Alexandria Stock Exchange (CASE) is one of the oldest stock exchanges in the world. In Egypt, de-listed and low-liquidity securities are traded in the over-the-counter (OTC) Market. More recently, a market for trading in the stocks of growing small and medium enterprises – NILEX, similar to AIMs market in London was established in October 2007. It is the first of its kind in the region with 5 companies listed on the NILEX. In recent years, the number of firms listed on the CASE has dropped from 435 in 2007 to 373 in 2008 (a drop of 15%). Despite this decline, the liquidity of the market improved, with the ratio of traded companies to total listed companies increasing from 77.5% in 2007 to 86.1% in 2008. The stock markets in Morocco, Egypt and Tunisia are moderately concentrated; the top five listed companies comprise approximately 30.5% of total market capitalization of the Casablanca Stock Exchange (CSE), 36.1% of Cairo and Alexandria Stock Exchange and 46% of the TSE. Unlike other stock markets in Africa, the stock exchanges in both Morocco and Tunisia use automated electronic quote driven system (NSC) during trading sessions. The Egyptian stock market, meanwhile, is in the process of transitioning to a fully automated trading system.

Like most stock markets in the world which are substantially integrated into the global financial economy, the stock market in Egypt got hit by the global financial crisis. Total market capitalization plunged substantially in 2008 by 38.3% from £E 768 billion in 2007 to £E 474 billion in 2008. As shown in Fig. 5a and b, the Egyptian and Moroccan stock markets, as represented by the CASE30 Index and MASI respectively, dropped sharply during 2008, recording all time single year loss of 56.4% and 13.5% respectively. The Egyptian government succeeded in privatizing 53 companies with a total consideration of £E13.6 billion during 2006/07. Since 2007, the government has been shying away from using IPOs to privatize companies due to the decline in the market indicators. The Tunisian government considers the stock market as the primary vehicle of its privatization program. Thus

far, 209 public and semi-public companies have been ceded, generating \$4.6 billion for the government. Most of the firms that have been privatized are in the tourism, services, commercial, and building materials sectors (*Tunisia: Privatization's progress, Sept, 2008*). In Morocco, as of 2005, twenty-seven manufacturing firms and eighteen hotels had been sold since privatization began in 1993. The asset sales occurred through open tender, public issues, trade sales and the stock exchange.

## 2.7. Other financial markets (bonds and derivatives)

Like most other regions of Africa, the corporate bond market is virtually non-existent. The majority of the bonds issued in the Moroccan, Tunisian and Egyptian fixed income market are government securities. The biggest corporate bond issue in Egypt in 2008 was the El-Ezz Steel Rebars' £E11 million issue. In Morocco, non-government securities account for less than 5% of total debt outstanding and stood at MAD10.7 billion in 2006 and consist primarily of Commercial Paper issued by non-financial companies (*AfDB, 2006*).

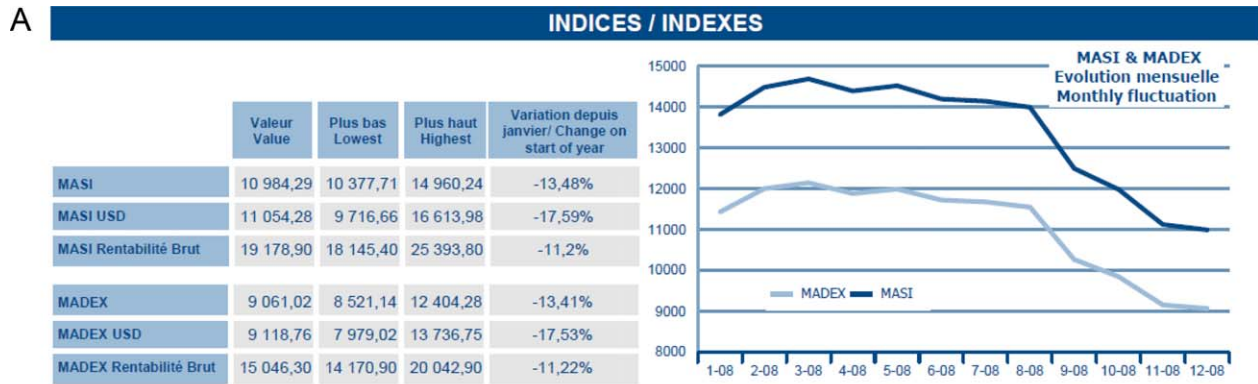
Similarly in Tunisia, the share of non-government debt issues remains small compared to total market issuance. Over 42% of outstanding issues are from banks (TND299 million), 45% from leasing companies (TND315 million), 7% from the tourism sector (TND50 million), and 1.6% from the factoring sector (TND11 million). The Algerian corporate market is significantly larger than that in other countries at the periphery of the Eurozone and the stock of corporate bonds has increased slightly in 2007, from DA150 billion to DA170 billion, all in private placements (*Loko, 2008*). The largest bond issuer in Algeria is Sonelgaz with half of its bonds issued in the seven-eleven year segment (*Loko, 2008*). In Morocco, futures market based on treasury bonds opened in 2008. This is the first attempt to broaden the offering in the Casablanca Stock Exchange.

## 2.8. Other types of finance

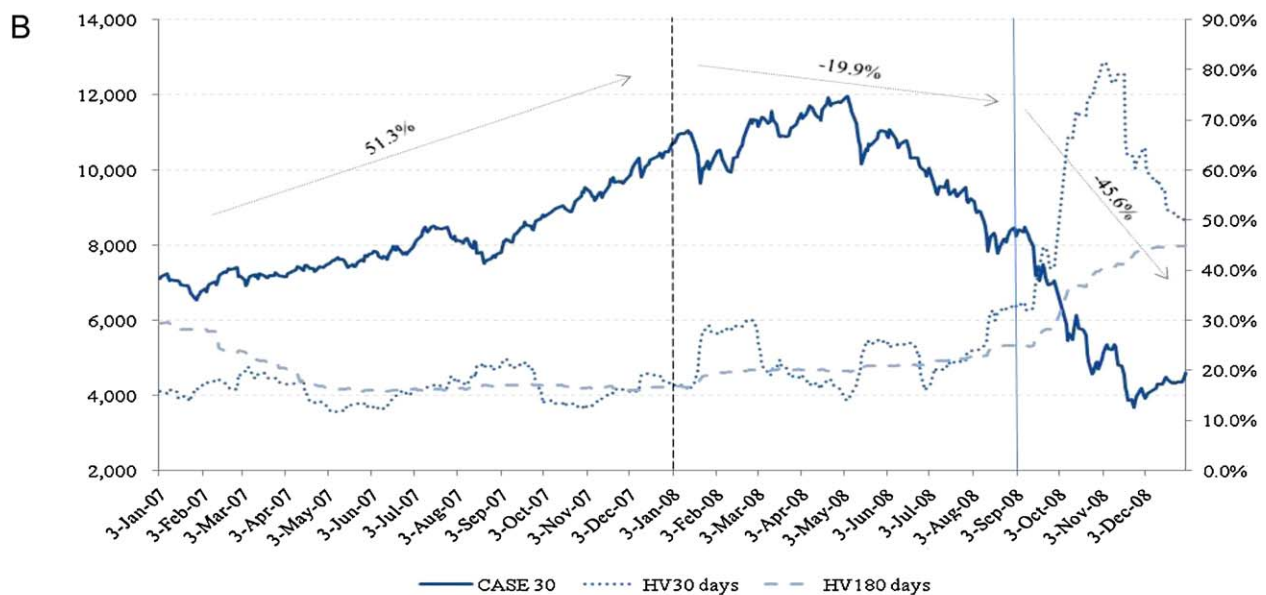
### 2.8.1. Microfinance

Unlike other regions of Africa, microfinance and microcredit sectors are not well-developed in Algeria. The only programs currently available are governmental programs, administered through public institutions such as the Social Development Agency, ANSEJ and FNRDA. The Tunisian Solidarity Bank (BTS), a government bank, was established in 1997 to promote micro-enterprise, and currently sponsors microfinance associations throughout the country. The organization provides loans of up to \$9500 with a maximum interest rate of 5%. The largest private provider of microfinance in Tunisia is an NGO, ENDA Inter-Arabe. Other microfinance providers include foreign governments and international organizations (e.g., Agence Française de Développement, the World Bank, and the African Development Bank).

In Morocco, there are currently ten incorporated microfinance institutions (MFIs). There are many restrictions that have been imposed on these institutions. For example, MFIs are only allowed to lend for productive activities and cannot mobilize savings. Furthermore, there is a ceiling on loan sizes currently



Source: Bourse de Casablanca Annual Report 2008



Source: Mubasher and Global Research

Fig. 5. (a) Casablanca stock exchange, CSE (Morocco) index performance. Source: Bourse de Casablanca Annual Report 2008. (b) Cairo and Alexandra stock exchange, CASE Index Performance. Source: Mubasher and Global Research.

set at about \$3000. However, MFIs have broad permission to innovate both in mobilizing capital and in lending methodology. While the micro finance sector is not well established in Egypt, the government has implemented a nationwide tri-level (Micro, Meso and Macro level) strategy to promote the development of microfinance in Egypt.

### 2.8.2. Private equity

Private equity as an industry does not currently exist in Algeria. Tunisia, on the other hand, has been a recipient of private equity investments from both Tunisian firms and international firms investing in the country. The Tunisian Private Equity Association (ATIC) supports venture capital and private equity associations in Tunisia. Major Tunisian private equity firms include Tuninvest Financial Group (TFG) and Financiere Tunisienne (FT). International private equity firms investing in Tunisia include Emerging Capital Partners (US), IIB (UAE), Global

Investment House (Kuwait), and Actis (UK). In Morocco, there are four Morocco focused funds, namely Capital Invest, Fond Capital Morocco, Attijari Invest and Maroc Invest; and three multi-country funds, Fond Capital North Africa, Emerging Capital Partners and Veolia Water Maroc.

### 2.8.3. Informal finance

Despite recent developments in micro finance, informal money lending is fairly common in the region but is poorly documented. Various parties are believed to grant loans to individuals at interest rates of as much as 7.5% per month in Tunisia. There are also a number of financing mechanisms and institutions available to entrepreneurs in Tunisia. These include the National fund to promote handicrafts and small trades (FONAPRAM), the incentive system for innovation in information technologies (RITI), capital risk investment companies (SICAR), the bank to finance small businesses (BFPME), and the National Guarantee Fund (FNG).

### 3. The state of African financial systems: West Africa

All the countries in West Africa are part of the Economic Community of West African States or ECOWAS whose mission is to promote economic integration. However, the West African region is also made up of two distinct linguistic zones, namely French Speaking and English Speaking West Africa. These linguistic blocks constitute the main economic groups in the region.

#### 3.1. French speaking West Africa

The French speaking block comprises Niger, Benin, Côte d'Ivoire, Mali, Senegal, Togo, Burkina Faso, Chad and Gabon. The combined GDP of these countries is \$75.947 USD billion in 2007 and a per capita GDP of \$913 USD according to 2008 estimates (IMF, 2009). Of the above countries, Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal, and Togo form the West African Economic and Monetary Union (WAEMU) whose aim is to promote economic integration among the member countries.

##### 3.1.1. Central bank

The countries in the French West Africa zone have a common central bank, namely the Central Bank of West African States (BCEAO) which is located in Dakar, Senegal. The Central Bank is the only entity authorized to issue currency throughout the WAEMU member States. The Central Bank is overseen by a Governor, Board of Directors and National Credit Committees and is under the overall supervision and control of the Council of Ministers. The Governor is appointed by the Council of Ministers for a renewable six-year term. The bank has two Deputy Governors who are appointed by the Board of Directors, for a renewable five-year term. Each member state has two directors on the Board. The Central Bank takes an active part in discussions with partners of the CFA zone regarding the reform of insurance, social security provisions, savings mobilization, business law, regional training centers, and the Franc Zone Monitoring Office (Observatoire Economique de la Zone Franc), which monitors economic trends.

The West African Economic and Monetary Union (UEMOA) financial markets are administered through the following institutions:

- The Conference of Heads of State, which decides on the accession of new members.
- The Council of Ministers, which defines, among others, the monetary and credit policy of the Union to safeguard the value of the CFA Franc.
- The UEMOA Commission, as delegated by the Council of Ministers, is in charge of the day-to-day administration of the Union.
- The Central Bank of West African States (BCEAO) controls the Banking Commission responsible for overseeing and supervising banks and financial institutions.

- Micro-finance institutions are governed by separate laws, the PARMEC (Projet d'Appui à la Réglementation des Mutuelles d'Epargne et de Crédit) Law.

The common currency of the region, the CAF Franc, is not traded on the foreign exchange markets but is fully convertible into Euros, with the convertibility guaranteed by the French Treasury through a special operations account at the Bank de France. This arrangement effectively offers practically unlimited overdraft facilities and allows the CFA states to avoid short-term balance of payments constraints. In return, the Central Bank of West African States (BCEAO) is required to deposit 65% of its foreign exchange reserves at the Bank de France. Buying and selling rates of the Euro are fixed at XOF 655.957/1 Euro, and the rates of other currencies are determined on the basis of the Euro rate on the foreign exchange market. Payments and transfers of capital within the UEMOA zone and France are unrestricted as are current account transactions, but capital flows to the countries outside the WAEMU are subject to verification based on the submission of supporting documentation.

##### 3.1.2. Banking and insurance systems

The region has about 90 credit institutions, 70 banks and 20 financial institutions, with Ivory Coast having the largest number of banks (16) followed by Senegal (10). The WAEMU banking system is concentrated, with 19 large banks holding the major market share of 62.7%; 24 are of medium size and hold 27.6% market share while the remaining 9.7% market share is held by 27 small banks.

The main economic union, the West African Economic and Monetary Union (UEMOA), established in January 1994, is made up of eight West African countries (Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal, Togo, and Guinea-Bissau), which are members of the Franc Zone and use the CFA Franc as the common currency. Branches and subsidiaries of foreign or regional banks play an important role in financial intermediation in UEMOA. In fact, eight banks (including Société Générale, BNP Paribas, Credit Lyonnais, Citibank, Bank of Africa, Ecobank, and Financial B.C.) dominate the UEMOA banking system with relatively wide national networks. The countries in the region have established a common financial market (WEAMU) for the banks and institutions operating in the member countries. Banks that have been granted a licence to operate in one of the countries can operate in any of the other countries without further administrative formalities. Cross-border borrowing and lending is therefore enhanced. Also, companies can seek financing in any of the eight countries but most firms tend to stay in their home countries where they typically have a comparative advantage.

In Niger, 2/3 of banks are owned by foreigners; in Benin, as of December 2007, 74.5% of the banking system was owned by foreign investors, 20.3% by nationals and 5.2% by the government. Half of the twelve banks are 100% owned by private nationals and foreign investors. The top three banks – BOA-Benin, Ecobank and Société Générale de Banques au Benin (a subsidiary of the French Société Générale) – are predominantly foreign owned. In Côte d'Ivoire, ownership of banks

is more evenly distributed among foreign investors who hold a 46.6% stake, private nationals with a 33.4% stake and the government with 20%. In Mali, foreign investors play a major role in the financial sector with 62.8% ownership of the banks. Private nationals hold 23.2% and the government holds 14.0%. Foreign investors have a particularly strong ownership interest in the banking sector in Senegal. Foreign ownership represents 70.0% of the total ownership stake in the Senegalese banks while private nationals and the Government hold 24.1% and 6.0% respectively. Thirteen of the banks are majority owned by foreign investors. In Togo, foreign investors own 50.9% of the banking system, private nationals own 30.5% and the government owns 18.5% of the assets. In Chad, there are seven banks that are currently operating in the country, most of them have undergone internal reforms to reduce the volume of non-performing loans and improve lending practices.

### 3.1.3. Insurance sector

The insurance sector is regulated and supervised by the Inter-African Conference of Insurance Markets (CIMA), which was established in July 1992 in Yaoundé (Republic of Cameroon). CIMA covers the following countries: Benin, Burkina Faso, Cameroon, Central African Republic, the Comoros, Côte d'Ivoire, Gabon, Equatorial Guinea, Guinea Bissau, Mali, Niger, Senegal, Chad and Togo. The regulatory body of the CIMA is the Regional Commission of Insurance Control (CRCA) and the Council of Ministers is its highest body. The total portfolio of the WAEMU CIMA zone is dominated by the non-life insurance sector. Some form of deposit insurance is provided by BAEC, a regional deposit insurance fund that was created in 1994.

### 3.1.4. Government bond market

Like in other parts of the continent, the bond market in this region is not well developed. Each country in the region carries out its own borrowing according to its needs. Benin's government has been issuing Treasury bills and bonds to fund its deficit. At the end of December 2006, the government had CFA 25.4 billion outstanding in Treasury bills. In 2007, the government raised XOF 40 billion from CAA-Benin at 6% fixed rate and a 2012 maturity. The benchmark issuer in the WAEMU zone is the West African Development Bank (BOAD), a regional multi-lateral bank. Since 1999, the Bank has accounted for about 22% of all public debt issues in the market (roughly CFA 102 billion). In the absence of a government yield curve, BOAD bonds are used as benchmarks. Corporate bonds have to be guaranteed before they can be listed. This partly explains why most of the corporate issues in the WAEMU zone are privately placed and remain unlisted.

In Cote d'Ivoire the government mainly funds itself by borrowing from the central bank. However, in 2006, the government opted for the bond market to fund its deficit. Overall, the use of the debt capital market by corporations in Cote d'Ivoire is very limited. Mali's government has used Treasury bills to fund its deficit in the past but is yet to issue a bond on the BRVM. As of December 2006, the government had no outstanding Treasury bills. The Government of Burkina Faso has used Treasury bills and bonds to fund its deficit. As of December 2006, the Gov-

ernment had CFA 20.5 billion outstanding in Treasury bills and CFA 8.3 billion outstanding on a bond issued in March 2003. At the same time, three outstanding corporate (telecommunication companies) bonds from Burkina Faso and one outstanding corporate bond from Mali were listed on the BVRM.

### 3.1.5. Stock market

The regional exchange for the eight members of UEMOA is the Bourse régionale des valeurs mobilières (BRVM), the only regional stock exchange in Africa. The BRVM started operating in September 1998. It is located in Abidjan and has a branch in each capital city of the other member states of the Union. The BRVM is a private corporation with start-up capital assets of about 2.9 billion CFAF, 13.50% of which come from WAEMU and the rest from brokerage firms, chambers of commerce and industry, sub-regional institutions and other private individuals.

The exchange is responsible for the listing of securities on the bourse, securities quotations, publication of market prices and information, and promotion and development of the securities exchange. Its main role is to pool and process stock market orders transmitted by brokerage firms that are authorized to negotiate securities quoted on the BRVM. Securities traded on the BRVM are cleared through the central clearing and depository house known as *Dépositaire Central Bank de Règlement* (DC/BR) which guarantees the settlement of each transaction and draws on a special guarantee fund in cases of default. As of 30 June 2009, there were only 10 firms listed on the BVRM. In 2007 the BRVM had a total of 20 bond issues worth \$467 million dollars. The maximum maturity of corporate bonds listed on the BVRM is ten years. In order to list on the BRVM, all bond issues must be guaranteed by an approved financial institution, a development financial institution, or a guarantee fund.

*3.1.5.1. Privatization and stock market development.* The governments in this region have been trying to develop the stock market through financial liberalization and privatization. In Niger, since mid-2000, the government has moved to privatize infrastructure companies including SONITEL, the state-owned telecommunications company; SNE, the country's largest water company; Nigelec, a large electricity utility and Sonidep, an oil products company. Chinese firm ZTE outbid FranceTelecom and Sonatel for SONITEL, acquiring 51% ownership through a consortium with a Libyan company. Efforts to accelerate the restructuring of these companies would help provide financial resources for the companies' future growth. Due to the buy-and-hold attitude of most investors, the secondary market in the WAEMU zone is fairly illiquid. The derivative market in the WAEMU zone is also in its infancy. Foreign exchange forwards exist with moderate liquidity and maturities of 3–6 months.

### 3.1.6. Private equity

The WEAMU region has been attracting growing numbers of general partners (GP) due to its stable macroeconomic climate: relatively controlled inflation and foreign exchange risk, favourable investment climate, and initiatives aimed at deregulation and privatization. Active funds in the WAEMU region include: Cauris Management's US\$15 million fund which is

headquartered in Togo; Phoenix Capital Management's US\$100 million fund located in Côte d'Ivoire office, and Advanced Finance & Investment Group which has assets of about US\$200 million. The French West African market can be divided into several tiers of opportunity:

- Cote d'Ivoire and Senegal are generally regarded as good markets with political stability and relatively easy entry;
- Togo and Benin are good markets but there are significant barriers to entry into these markets;
- Although the private equity markets in Mali, Niger and Burkina Faso are developing, they should not be discounted because of their potential.

The following sectors are, or will be, important sectors with regards to private equity:

- **Banking:** The regulatory environment pushes banks to seek capitalization, and this creates opportunities for private equity firms investing in the financial industry. The largest deals in banking and insurance are some of the largest in West Africa to date – average deal sizes vary by country but range from \$5 million to about \$30 million.
- **Telecommunication:** The sector has been a popular area for private equity investments in the WAEMU region. In the absence of comprehensive fixed line infrastructure, the growth in mobile phone usage has skyrocketed. Africa as a whole has the fastest growing market in the world at 45% but the growth in West Africa is phenomenal as the region has experienced about 75% subscriber growth in West Africa.
- **Mining:** Extractive industries continue to provide opportunities for private equity firms operating in the WAEMU region. There will be many more mining deals as global demand increases.
- **Privatizations:** With many WAEMU countries undergoing a process of selling off state assets, privatizations provide significant promise for private equity. Privatizations may also provide opportunities to investors in the stock market, as some of these entities get privatized through the stock exchange.

### 3.1.7. Microfinance

Microfinance has been in existence in the WAEMU countries for over 30 years in Benin, Burkina, Cote d'Ivoire and Togo, and over 10 years in Mali, Niger and Senegal. The industry has experienced high growth in recent years and is becoming an important driver in the development of the economies in this region. Unlike many central banks in Africa, the Central Bank of French West Africa (BCEAO) has closely monitored the microfinance sector since the beginning of the 1990s through a databank on microfinance called Decentralized Financial Systems (DFS) monograph. The data provide a measure of access to, and offer of, financial services in BCEAO countries and the financial performance of the institutions. Statistics relating to the sector are publicly available and provide recent and reliable financial and economic information to assist in decision-making.

Microfinance continues to play a key role as a grassroots financial tool, with close to 400 institutions offering approximately 3000 points of service. The sector has a surplus of CFAF 25–30 billion deposited with the banking system. About 3.8 million customers or individual beneficiaries, including about 90,000 groups, can obtain financing or deposit their funds through microfinance institutions. In addition, over 430,000 loans are granted annually (AfDB, 2008). This overall favourable performance however, masks contrasting structural and qualitative developments, some of which could represent major risks for the sector. In certain parts of the sub-region, e.g., Gabon, the sector comprises many microfinance institutions that are mostly concentrated around big cities. Microfinance in rural areas is not very well represented, and as a result it is very difficult for entrepreneurs in rural areas to establish small businesses.

### 3.1.8. Impact of current financial crisis

The countries in this region, like most countries in Africa, have been affected by the global economic crisis and their growth rates are likely to be affected in the foreseeable future. This could have a detrimental effect on efforts to reduce poverty. Remittances are expected to dwindle. Demand for commodity exports, and therefore prices of exports which will in turn affect the external current account deficit and reserves WAEMU countries (Mueller et al., 2009).

## 3.2. English speaking West Africa

All the countries in West Africa are part of the Economic Community of West African States (ECOWAS) whose mission is to promote economic integration in the sub-region. The English speaking countries in West Africa consist of Sierra Leone, Gambia, Ghana, Liberia and Nigeria. The combined GDP of these countries is \$189.321 USD billion as of 2007<sup>5</sup> and a per capita GDP of 1308 USD.<sup>6</sup> The GDP growth rate for these countries ranges from 3.33% for Guinea Bissau to 7.16% for Ghana according to 2008 data.<sup>7</sup> Unlike the French speaking countries in West Africa, the English speaking countries do not have a single monetary union.

### 3.2.1. Central bank and its role in the economy

Since the English speaking countries do not have a single monetary union, each country has its own central bank and its own policies. In Sierra Leone, the central bank, the Bank of Sierra Leone (BSL), regulates and supervises the activities of commercial banks and other financial institutions to ensure the health of the financial system is sound. It is the banker and adviser to the Government on financial and economic matters and maintains the external and internal value of the national currency, the Leone. The BSL implements the monetary policy of

<sup>5</sup> <http://www.imf.org/external/pubs/ft/weo/2009/01/weodata/weorept>.

<sup>6</sup> Calculated from data obtained from <https://www.cia.gov/library/publications/the-world-factbook/index.html>.

<sup>7</sup> <http://www.imf.org/external/pubs/ft/weo/2009/01/weodata/weoselco.aspx?>

the government and its objective is to achieve a low and stable rate of inflation consistent with sustained economic growth and financial stability.

The Central Bank of The Gambia is responsible for providing banking services to the government and commercial banks. It is also responsible for managing the payment and settlement system of the country. The Bank has different departments that are responsible for the different aspects of the Central Bank's mandate. Whereas the Economic Research Department is responsible for providing the Bank with the economic analysis necessary to conduct monetary policy, the Open Market Operations Unit plans and executes the Bank's operations in the money market to ensure that interest rates are in line with the Bank's policy position. Its operational contact with money market participants enables it to contribute to the monetary policy formulation process in the Bank as well as contribute to the development of a money market. In addition, it manages the issue and redemption of the domestic debt of The Gambia. The Foreign Department is responsible, jointly with the Financial Supervision Department, for evaluating applications from potential foreign exchange bureaus. The Microfinance Department serves in a similar capacity to the Financial Supervision Department; however, it focuses on the microfinance sector.

In Ghana, the Central Bank has the dual role of maintaining price stability and supporting the general economic policy of the Government and promoting economic growth and the effective and efficient operation of the banking and credit systems in the country.<sup>8</sup> Under the Bank of Ghana Act (Act 612), the governing body of the Bank is the Board of Directors. The Board consists of the Governor as Chairman, the First and Second Deputy Governors, and nine Directors, one of them is a representative of the Ministry of Finance and Economic Planning. The members of the Board of Directors are appointed by the President of Ghana in consultation with the Council of State. All the members of the Board, other than the Governor and the two deputies, hold office for a three-year period, but are eligible for re-appointment. The responsibilities of the Board involves formulating policies necessary for the achievement of stability in general level of prices, as well as effective and efficient banking and credit systems in the country. The Board, in consultation with the Minister, formulates exchange rate policy. Ghana operates a Managed floating regime with no pre-determined path for the exchange rate but it is anchored by a monetary policy framework based on inflation targeting. The Bank attempts to influence the exchange rate without having a specific exchange rate path or target. Indicators for managing the rate are broadly judgmental (e.g., balance of payments position, international reserves, and parallel market developments), and adjustments may not be automatic.<sup>9</sup>

The Central Bank of Nigeria (CBN) has a Board of Directors consisting of the Governor, four deputy governors and five non-executive directors. The Bank has the overall control and administration of the monetary and financial sector policies of the Federal Government. The Board of Directors is responsible

for the policy and general administration of the affairs of the bank. In order to facilitate the attainment of price stability and to support the economic policy of the Federal Government of Nigeria, the Monetary Policy Committee (the MPC) has been charged with the responsibility of formulating monetary and credit policy, issuing currency, maintaining external reserves to safeguard the international value of the legal tender currency, promoting monetary and price stability and a sound financial system in Nigeria and providing economic and financial advice to the Federal Government. The MPC meets on the first Tuesday of alternate months (once in a month) to set the interest rate called the Monetary Policy Rate (MPR). This operating target rate was introduced in 2006 to achieve a stable value of the domestic currency through stability in short-term interest rates around it. The MPR serves as an indicative rate for transactions in the inter-bank money market as well as other interest rates in the money market transactions.

### 3.2.2. Banking and insurance systems

Due to the absence of a monetary union, each country in the English speaking region has its own system. However, it should be mentioned that Sierra Leone, Gambia, Ghana, Guinea and Nigeria are part of the West African Monetary Zone (WAMZ) that plans to introduce a common currency, the Eco by 2015. The WAMZ was formed in 2000 with the mission to establish a strong stable currency to rival the CFA franc, whose exchange rate is tied to the euro and is guaranteed by the French Treasury. The eventual goal is for the CFA franc and Eco to merge, giving all of West Africa a single stable currency. The establishment of a common currency will be the forerunner of a common central bank. However, several of the WAMZ's countries suffer from weak currencies and chronic budget deficits.

In Sierra Leone, the financial system consists mainly of the banking and insurance sectors, each having a separate regulatory authority and supervisory body. The banking sector consists of eight commercial banks, 4 community banks, 2 discount houses and 51 foreign exchange bureaux; all of which are under the supervision of the central bank. Community banks primarily service the rural areas and provide micro-finance loans. The minimum capital requirements for all licensed financial institutions have been increased to ensure a safer and stable financial system. For example, the minimum paid-up capital for banks has been increased from SLL 800 mm to SLL 15 billion on a graduated basis. The Sierra Leone Insurance Commission regulates the insurance sector. There are nine registered insurance companies. Supervision of the sector is carried out by the Commissioner of Insurance, an outfit within the Department of Finance.

Gambia's financial system is dominated by commercial banking. There are currently 10 commercial banks, and almost all of them are majority-owned by foreign financial institutions. The largest commercial bank is a locally incorporated subsidiary of the UK-based Standard Chartered Bank and is 25% Gambian-owned. Gambia's commercial banks offer a variety of banking services, including trade finance and credit, dealings in foreign exchange and equity participation and deposits. The Banking Office is responsible for providing banking services to the government and commercial banks. It is also responsible

<sup>8</sup> <http://www.bog.gov.gh/>.

<sup>9</sup> <http://www.imf.org/external/>.

for managing the payment and settlement system for the country. Currently, it plays an important role in the development of a cross-border payment system for the West African Monetary Zone. The insurance sector is small in terms of assets, but it is growing. In a bid to improve the efficiency of the financial system in the Gambia, the Central Bank was empowered by the 1997 Constitution to assume the regulation and supervision of insurance institutions. Presently there are 11 insurance companies operating in The Gambia.

The Ghanaian banking industry can be split into 3 distinct areas, namely, the Central Bank, Commercial/Universal Banks and Rural/Community Banks. There are 25 registered banks in Ghana as at 2009 with the minimum capitalization expected to total over GH¢935 million by the end of 2009. Barclays Bank, Standard Chartered Bank and Ghana Commercial Bank (a privatized bank) have the most market share but competition from foreign banks, mainly from Nigeria, has reduced the market share of these three banks. The new regulation of the central bank – the Bank of Ghana – requires banks operating in the country to have a stated capital of not less than GH¢60 million (about US\$43 million). Rural banks play an important role in the economy. The idea of rural banking was conceived some 32 years ago by the Bank of Ghana with the aim of broadening and deepening financial intermediation in the rural areas and with the specific mandate of serving the special needs of the rural population. There are currently 129 rural banks in the country serving the rural communities. The ARB Apex Bank Ltd. is the mini Central Bank regulating the Rural/Community Banks (RCBs).

Ghana currently does not have a deposit insurance program in place. Rather, the central bank uses capital adequacy regulations to ensure the protection of funds deposited at the banks. Banks are required to keep 9% of their assets in primary reserves of cash lodged at the Bank of Ghana, and a further 35% in secondary reserves of government securities. Primary reserves receive no interest, while secondary reserves receive only the going market rate. The banks pass on the cost of these regulatory constraints on their liquid assets through high lending rates to consumers (borrowers). But various bodies have called on the government to seriously consider the use of Deposit Insurance as an alternative mechanism for satisfying at least part of capital adequacy rules, in order to generate some relief for the more striving banks, a move that would lower lending rates for the consumers.

The biggest obstacle to implementing an explicit deposit insurance scheme, apart from the technical challenges of creating a new sensitive institution from scratch, is the issue of “moral hazard” i.e. the notion that an insurance scheme could interfere with traditional restraints and weaken incentives for prudence and caution on the part of depositors and banks alike. The exact technical attributes of any deposit insurance program may influence what types of hazards emerge.

Ghana’s insurance industry is regulated and supervised by the National Insurance Commission. By the end of 2008, the industry was made of 18 Non-Life Insurance companies, 16 Life Insurance companies, 2 Reinsurance Companies, 36 Insurance Broking companies, one reinsurance broking company, and one loss adjusting company. Insurance companies are allowed to

use Reinsurance companies outside Ghana. In 2007 reinsurance premiums paid to overseas companies were about \$5 million.

As compared to other countries in the sub-region, Guinea has a small financial system. The country’s financial system is dominated by banks. As of 2006, there were 7 commercial banks, 5 micro lending institutions and 4 insurance companies. Given the supply constraints, loan rates tend to be high and long-term loans are difficult to obtain. There are seven commercial banks in Guinea, including the Bank Internationale pour le commerce et l’industrie de la Guinée (BICIGUI); the Societe Generale des Banques en Guinee (SGBG); the Unione Internationale des Banques en Guinee (UIBG); La Bank Populaire Maroco-Guinéenne (BPMG), Ecobank Guinée and the International Commercial Bank de Guinée (ICBG), which was launched in Conakry in early November 1996. All these banks have French or US participation. The government has offered for sale to the general public shares in the BICIGUI bank. The bank controls roughly 45% of the country’s banking resources, supplying one-third of all credits to the private sector and up to 60% of those awarded for international trade. In December 2006, seven commercial banks were operating in the country. Banking services are largely concentrated in the capital, Conakry. Branches and subsidiaries of foreign or regional banks play an important role in financial intermediation in Guinea.

Nigeria, the largest economy in West Africa, has a more developed banking system. Banks have been active in the Nigerian economy since the late 1800s when Nigeria’s first bank, the African Banking Corporation, was established in 1892. The Central Bank of Nigeria (CBN), the banking regulator, began operations in 1959 following the passage of the 1958 Central Bank Act. Since 2004, Nigeria’s banking industry has been transformed by the Central Bank recapitalization program which has reduced the number of banks from 89 to 24, increased branch penetration and the industry’s balance-sheets fourfold. Of the 24 banks licensed to operate in Nigeria, 21 are publicly traded banks. The total assets of the banking sector rose by 55.37% to ₦ 10.47 trillion in 2007 from ₦ 6.74 trillion in 2006, a significant rise demonstrating the effects of consolidation on the banking system. The ownership of banks, apart from banks that are foreign owned, is broad-based with direct and indirect government ownership limited to 10%. However, unlike in other emerging markets, foreign ownership of banks is not very high as Nigeria appears reluctant to give up pieces of its banking system. Foreign ownership currently is limited to Citigroup (Nigeria International Bank), Standard Chartered Bank of Nigeria, Stanbic IBTC and Ecobank Nigeria, a subsidiary of Togo domiciled Ecobank Transnational Incorporated.

The Nigerian Deposit Insurance Corporation (NDIC) was established in 1988 (under the direct control of the Central Bank of Nigeria) to carry out the supervision, examination and liquidation of banks. The practice and implementation of the Deposit Insurance Scheme (DIS) in Nigeria is based largely on the US model. Though the NDIC has the mandate to insure deposits of all deposit taking financial institutions in the country, currently it only insures deposits in conventional banks with steps being taken to insure deposits of other financial institutions such as Mortgage Institutions. The NDIC insures all deposit liabilities

of licensed banks and other financial institutions with insurance premium equal to a flat rate of 0.9375% or 15/16 of 1% of deposit liabilities and insures deposits of up to N50,000 per depositor. Plans are afoot to revise the insurable deposit to N200,000. As of 2008, there were 48 insurance companies operating in Nigeria. Of these, 25 were non-life insurers, 19 were composite and the remaining four were life insurers. This market structure largely reflects the dominance of nonlife insurance which represents about 85% of the industry premium. Notably, more than half (26) of Nigeria's insurance companies were publicly quoted in 2008, with only 22 privately owned.

### 3.2.3. Government bond market

In Sierra Leone, the Central Bank issues government securities up to a maturity of one year through primary market dealers which consist of commercial banks and discount houses. Treasury bills are sold in weekly auctions to discount houses, banks and other public agencies. A total amount of SLL 433 m was outstanding as of December 2006. Treasury bearer bonds (TBB) with a 12 month maturity are issued in the primary market in monthly auctions, with coupons paid on a quarterly basis. A total of SLL 137 m worth of TTBs was outstanding as of December 2006. At the end of 2006, holdings by commercial banks of outstanding government securities were 41.6%, 43.9% for non-banks and 14.5% for the central bank. Bonds can be sold to primary market agents, institutions, retail, or the central bank. In 2006, an amount of SLL 254 billion in treasury bills had been purchased in the secondary market. There has been no non-government debt issuance to date. The secondary trading of treasury bills is undertaken on a small scale.

The Central Bank of Gambia issues securities on behalf of the government. Treasury bills are primarily used to conduct open-market operations. They are issued on a weekly basis, or as may be determined by the Central Bank, with maturities of 91, 182, and 364 days. Treasury bonds are normally issued every three years with a 3-year maturity. Since 2002, the frequency of the auction has increased. The Central Bank of Gambia has replaced the bi-weekly auction for Treasury bills with a weekly auction, an indication of the growing importance of this market. The Bank sells the bills through multiple-price auctions where successful competitive bidders are awarded Treasury bills at a yield that equals the price bid they submit, and those with non-competitive bids are awarded the securities at the weighted average clearing price. There are six approved primary dealers in government bills auctions. The secondary trading of treasury bills is undertaken on a small scale.

In Ghana, the bond market is nascent, and there has been a conscious effort on the part of the Bank of Ghana (BoG) and the Ministry of Finance and Economic Planning (MoFEP) to effect a change by promoting bond market development. The government is the main issuer of debt securities. As of March 2009, total outstanding government securities stood at GHS 3440 mn (USD 2529 mn) comprising mostly of short term bills, and to a smaller extent notes and longer term bonds. Bonds listed on the local exchange consist of longer-dated government securities (maturities of two years and above) and a few corporate bonds (including issues under HFC Bank shelf registration program

and Standard Chartered Bank MTN Programme). The Bank of Ghana holds weekly auctions on Fridays for the sale of BoG Treasury bills and bonds to 17 primary dealers, known as Government Securities Dealers. There is no set issuance calendar for the longer-term Treasury bonds. Issuance of Treasury bills is via a multiple price auction while Treasury bonds are issued via a uniform price auction.

Nigeria is the only country in the sub-region with a secondary debt market and a bond index. In 2000, the Debt Management Office (DMO) was established to centrally consolidate the management of Nigeria's Debt. Prior to its establishment, management of the country's debt was decentralized in an uncoordinated and inefficient manner. In 2006, the Debt Management Office of Nigeria (DMO) created a secondary debt market. This was done by the creation of the Primary Dealers/Market Maker (PMDD) system. There are currently 19 PMDDs in Nigeria and their primary function is to create liquidity in the Federal Government of Nigeria (FGN) Bonds. The bonds are issued in maturities ranging from 3 to 20 years and can be purchased in both the primary and secondary markets. Access Bank, as a licensed PDMM, has been playing a leading role in disseminating data on the government bond market. It launched a sovereign bond index in December, 2006, detailing price information about local currency denominated fixed rate Federal Government of Nigeria Bonds. In order to qualify for inclusion in the index, a bond must be publicly issued through the Debt Management Office (DMO) and traded under the PDMM trading guidelines.

### 3.2.4. Stock markets

The stock markets in English Speaking West Africa are at various stages of development. The Gambia does not have a stock exchange although a few local equities are traded over the counter. In Sierra Leone, there is no stock exchange. The Government is currently working towards the establishment of a formal capital market. The Sierra Leone Stock Exchange Technical Committee was created to establish a legal framework to structure and regulate the future domestic capital market.

The Ghana Stock Exchange (GSE) started operations in 1990. As of March 2009, the GSE had 31 listed companies, with a market capitalization of approximately GHS 14.54bln (USD 10.6bn). The GSE sets the rules and regulations for companies and other entities seeking to be listed on the GSE. The GSE is governed by a Council (Board of Directors) with representation from licensed dealing members, listed companies, banks, insurance companies and other persons of the Ghanaian finance and public service sectors. The All Share Index of the Ghana Stock Exchange has grown at a 10-year compounded annual growth rate of 30.6% while the 10-year average annual return is 37%. The manufacturing, brewery and banking sectors dominate the exchange. The market is characterized by high concentration. The top 10 firms by capitalization represent 95% of the total market cap. The top 3 firms represent 81% of total market cap. It is important to note that the two largest listings are multinational corporations that are simultaneously listed in other stock markets (namely Ashanti Goldfields Ltd. and Ecobank Transnational), hence their relatively large capitalization compared to the other listed companies. In 2008, 546 million shares worth

GHC 381 million traded on the exchange, an increase of 90% and 170% in volume and value respectively over those of 2007.

The Nigerian stock market, the most liquid stock market in West Africa, was established in 1960 as the Lagos Stock Exchange. In December 1977 it became The Stock Exchange has eight branches located in Lagos (opened in 1961); Kaduna branch (established in 1978); Port Harcourt (in 1980); Kano (in 1989); Onitsha (in 1990); Ibadan (in 1990); Abuja (in 1999); Yola (in 2002); and Benin (in 2005). Currently, there are 276 securities listed on The Exchange, made up of 17 Government Stocks, 50 Industrial Loans (Debenture/Preference Stocks) and 209 Equity/Ordinary Shares of Companies, with a total market capitalization of 2.23 trillion naira. Many of the listed companies have foreign/multinational affiliations and represent a cross-section of the economy, ranging from agriculture through manufacturing to services.

With the abrogation of the Exchange Control Act 1995, foreigners can now participate in the Nigerian capital market both as operators and investors. There are no limits to the percentage of foreign holding in any company registered in the country. In terms of performance, prior to the onset of the global financial crisis, the NSE All Share Index had been one of the best performing stock markets on the continent. As a consequence of the financial crises, its market capitalization fell 44% in 2008 from \$82.7bn in 2007. The total market value of the 301 securities listed on the Exchange dropped in value by 28.1% from N13.295 trillion to N9.563 trillion at the end of 2008. The decline in market capitalization resulted mainly from price depreciations of equity values, the delisting of 19 companies and the maturing of outstanding bonds. The Nigerian Stock Exchange (NSE) All Share Index was one of the worst-performing equity markets in Sub Saharan Africa (SSA) in 2008 falling 43% in local currency and 50% in dollars. Total market turnover was \$19.6bn in 2008, an increase of 24% over the prior year (\$15.8bn in 2007). The Nigerian stock market remains the third largest in Africa, behind South Africa and Egypt.

The three stock exchanges in the West African region, namely, the Nigerian Stock Exchange, Ghana Stock Exchange and the BRVM in Cote d'Ivoire are in ongoing harmonization talks to establish uniform rules, regulations and operational procedures. The aim is to allow free access to investors and issuers across the three markets. In addition, the GSE has signed Memoranda of Understanding with the Kenyan Stock Exchange and the Nigerian Stock Exchange for cross-border listing of securities quoted on their markets. The first success was the simultaneous listing of Ecobank Transnational listed on the Nigerian Stock Exchange, the Ghana Stock Exchange and the BVRM in Cote d'Ivoire.

### 3.2.5. Microfinance

The region has a long history of microfinance. In The Gambia, microfinance started in the early 1970s with the creation of the Indigenous Business Advisory Services (IBAS), a government agency established mainly to bring support to the indigenous micro-enterprises. Since then, the sector has experienced substantial growth as a result of support from the government and donors agencies (including Agence Française de Développe-

ment, International Fund for Agricultural Development and Women's World Banking). Despite its early beginning, the microfinance sector in the Gambia is still very limited as measured by its penetration rate of less than 17% and is very focused on rural women. As of June 2005, there were around 120 microfinance practitioners with a loan portfolio of 7.9 million USD for 232,000 clients.

The Gambian microfinance sector is served by four different types of microfinance intermediaries which offer credit facilities and savings mobilization-Wholesalers (VISACAs, the village savings and credit associations); Retailer non bank financial institutions; Projects in support of rural microfinance; and Commercial banks. In recent years, many new competitors (e.g., New Reliance Services and Access) have entered the Gambian microfinance sector. They are mainly bank affiliates that focus mainly on urban clients. The main microfinance network institution in the country is The Gambian Microfinance Network (GAMFINET) whose capacity needs to be strengthened to better serve MFIs in terms of external support and improve the coordination and monitoring mechanisms. In 2001, The Central Bank of The Gambia (which regulates and supervises microfinance institutions) initiated new policies to boost the sector and limit risks by establishing prudential requirements. Among the measures put in place is the requirement that borrowers have at least 30% of their loan amount in their savings balance.

Like in other parts of this region, micro finance in Nigeria and Ghana has a long history, initially organized in an informal setting. Informal microfinance systems predated the formal microfinance sector. There are two main forms of informal finance in these countries: (a) Moneylender/Pawnbroker: Individuals who extend credit, usually with excessively high interest rates. Unpaid loans may result in the surrender of land, assets, or a form of indentured servitude on behalf of the debtor. (b) Informal Savings and Credit (Esusu): These informal microfinance associations (often referred to as rotating savings and credit associations or *RoSCAs*) are operated by various ethnic groups both in urban and rural locations and resemble savings and loan institutions which provide benefits to members only. The association works by mandating that all members contribute to a pooled fund periodically. The pooled funds are then partially or entirely distributed to a member in rotation once the funds reach a certain amount.

In recent years, Nigeria's microfinance industry has grown significantly due largely to the growing informal business sector and the reluctance of banks and other existing financial institutions to fund these emerging small businesses. However, the Nigerian formal microfinance industry is still in its infancy, serving 1 million of the estimated 40 million people the industry could be serving (Mohammed and Hasan, 2008). As of 2001, there were 161 registered microfinance institutions (MFIs) with outstanding loans worth N649.6 million and savings of N99.4 million (Anyanwu, 2004). The major providers of microfinance capital include commercial banks and development finance institutions (DFI) such as the Nigerian Industrial Development Bank (NIDB). The DFIs have been largely unsuccessful due principally to the government's severe reduction in funding to these institutions.

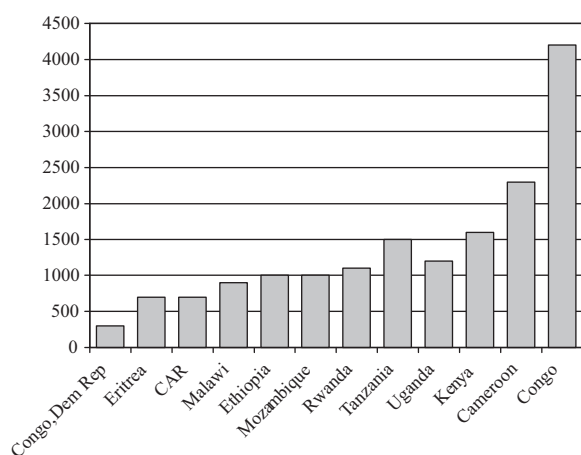


Fig. 6. GDP per capita in US\$, 2010. Source: CIA Factbook

### 3.2.6. Private equity

Despite the growth potential, the underserved markets, and vast resources, the private equity investment in the region is limited. Some of the key challenges facing private equity investors include inability to liquidate/exit from investments, and limited access to debt funding. Other risks include foreign exchange risks, including currency devaluation, political instability, and operational challenges of working in some of the countries, in particular, Nigeria. A number of private equity transactions are in the financial and telecom sectors due to the underserved markets and high growth potentials. Key private equity firms in the Nigerian market are African Capital Alliance, Actis, Emerging Capital Partners, Helios Investment Partners and Travant Capital.

## 4. The state of African financial systems: East and Central Africa

### 4.1. Introduction

For the purpose of this review, the East and Central African region includes Eritrea, Democratic Republic of Congo, Central African Republic, Kenya, Congo, Mozambique, Malawi, Tanzania, Uganda, Rwanda, Ethiopia, and Cameroon. These countries cover an area of about 7,719,400 sq. km with a total population of approximately 335 million people. All of the countries in this region, apart from Ethiopia have had a colonial past, with most of them gaining independence in the 1960s aside from Mozambique and Eritrea which gained independence in 1975 and 1991.

As Fig. 6 shows, the GDP per capita (2010) of the countries in the region varies significantly, with the Democratic Republic of Congo having the lowest per capita income of \$300 and Congo with an income per capita of about \$4200. Despite having the smallest GDP per capita, most of the countries have a relatively high growth rate ranging from 6% to 8.5%. Some of these economies are among the fastest growing economies in the world. Central African Republic, Congo, Kenya, and Cameroon are the only countries in the region with growth of less than 4%.

East and Central Africa is rich in natural resources and valuable minerals. The main components of the GDP of these countries are mining, forests, and agriculture. One exception is Congo where the oil sector accounts for 52% of the GDP. These countries have not yet taken full advantage of the natural resources as most of them have poor infrastructure and face severe political instability. Mozambique and Cameroon suffer from unemployment of 21% and 30% respectively. Inflation is high in most of these countries, usually greater than 8% except Central African Republic, Congo, and Cameroon which have low inflation of 1%, 2.6%, and 2%.

### 4.2. Central bank and its role in the economy

Each country in the region created a central bank shortly after independence in order to have full control over their financial markets. The governments run the central banks independently except for the countries in the Bank des Etats de l'Afrique Centrale (BEAC) region, consisting of Cameroon, Central African Republic, and Congo who share a common central bank located in Cameroon.<sup>10</sup> The currency is the CFA Franc and it is pegged to the Euro. One thing worth mentioning is that the three countries in the BEAC also have the lowest inflation. The BEAC and the central bank of Eritrea are the only central banks which have pegged currencies. The central bank of Eritrea has pegged the currency to the USD, while the CFA used by the BAEC bloc is pegged to the Euro. Most of the other countries have floating currencies. While the central banks of this region are all different and unique in their own ways their missions are very similar – to maintain price stability. Most of the countries in this region suffer from high inflation, so maintaining stability in the currency and money supply is the central bank's number one priority. In this regard, some of the central banks in this region set their interest rates to fight inflation. For example, the central bank of Mozambique, using interest rate policy and other tools, has been very effective at maintaining price stability as they have lowered inflation from approximately 15% in 2001 to 5% 2007.

### 4.3. Deposit-taking institutions

The banking system is different in all of the countries, although there are many similarities. The chart below shows some of the differences. As Table 9 shows, the number of banks in this region varies from 4 in Congo to over 45 in Kenya. A small group of banks, primarily foreign banks, dominate the market. In 5 of the 12 countries, 4–6 banks hold a large portion of the banking market. Eritrea and Ethiopia are the only countries to have an all domestic banking system in this group; the rest of the countries are open to foreign banks. Kenya is the only country to have a more complex banking system with 43 commercial banks, 2 mortgage finance companies, and 120 foreign exchange bureaus as of 31st December 2008. Deposits

<sup>10</sup> The union includes three other countries namely Chad, Gabon, and Equatorial Guinea which are (for the purpose of this review) not included in this sub-group.

Table 9  
Status of banks in selected African countries.

	# of banks	Ownership		Privatization
		Foreign	Domestic	
Eritrea	4		All	Partial
DR of Congo	18	8	10	No info
CAR	4	Half foreign half domestic		Partial
Kenya	45	A mix of the two		Full
Congo	4	Half foreign half domestic		No info
Mozambique	7	Mostly foreign		No info
Malawi	10	Mostly domestic		No info
Tanzania	22	Mostly foreign		Full
Uganda	15	Mostly foreign		Full
Rwanda	11	Mostly foreign		Full
Ethiopia	11		All	No info
Cameroon	10			Full

from consumers seem to be the main source of funds for the banks in this region. Since depositing funds into bank accounts is not too popular in many of these countries, the banking sector is not running at its full potential. The main sources of investments for banks in the region are loans to the private sector and the provision of funding to the government. In some countries, the primary function of the banks is to provide funding for the government.

A key feature of the banking system in this region is that after gaining independence, most of the countries established their own local banks. Like other state-owned enterprises, the performance of these banks has been abysmal. Therefore, as part of the structural adjustment program that most of these countries have undertaken with prodding and financial support from the IMF and the World Bank, countries such as Kenya, Tanzania, Uganda, Rwanda, and Cameroon have privatized their banks. While others are in the process of privatizing, some countries still have government run banks. It seems that as the country's financial system matures the trend towards privatization may continue. Interest rate spreads range from 3.34% to 17.5%. The high bank spreads are symptomatic of the instability in the macroeconomic environment and the weak financial system. The interest spread is where the bank makes its money and covers the risk it takes on by lending money. The wider spreads reflect the risk a bank is taking or the monopolistic nature of the banking sector in the region.

#### 4.4. Insurance companies

The insurance sector in this region varies from a monopoly to 43 licensed companies. The insurance companies in this area are mostly privatized; however the governments in some of these countries still hold stakes in the firms. Eritrea has only one insurance company, a partially privatized insurance company with the government owning 63% of the company. The insurance sector in the area is regulated and supervised by a regional body, the Conference Internationale des Marchés d'Assurances (CIMA). CIMA was established in 1992 in Yaoundé (Republic of Cameroon) by Benin, Burkina, Cameroon, Central Africa, the Comoros, Ivory Coast, Gabon, Equatorial Guinea, Guinea Bis-

sau, Mali, Niger, Senegal, Chad and Togo. The regulatory body of the CIMA is the Regional Commission of Insurance Control (CRCA). Other countries in the region have a variety of private and state owned insurance companies and are monitored by local legislative bodies. The insurance companies in this region offer property, auto, health, life, casualty, and other types of insurance, with the auto insurance sector holding the largest market share. Life insurance is not a significant portion of the market but the sector is growing in certain regions, particularly in Cameroon.

Deposit insurance is available for the most parts of the region except Rwanda, Ethiopia, and Malawi (which is currently contemplating setting up a deposit insurance scheme). The governments either have created institutions to provide deposit insurance, contract it out to foreign companies, or have their own form of deposit insurance. The countries in this region have all been affected by wars, corruption, unstable economies, lack of property rights, civil war, and government instability. As a result, many businesses avoid the region; as a consequence, there is a dearth of foreign portfolio investment.<sup>11</sup>

#### 4.5. Government bond markets

The government bond market in this region is not well established. The countries do not have a wide range of Treasury bills and bonds. They either have an emphasis on short term Treasury bills or a few long term bonds. For example, investors in the Democratic Republic of Congo only have 3 maturities to choose from, namely 7 days, 14 days, and 28 days and these short term government Treasury bills are the only government investment instruments available.

Kenya on the other hand has a wide range of maturities to offer, as it has Treasury bills and medium to long term Treasury bonds. The Kenyan government bond markets are one of the more established bond markets in the region. Tanzania also has an established capital market but it remains shallow. However, the government is working very hard to increase efficiency and absorptive capacity of its domestic credit market for Treasury bills and bond issuance. At the moment the Tanzanian government bond market is short term focused but the government is contemplating issuing new longer term Treasury bonds. Cameroon is the only country to not have Treasury bills and only issues zero coupon bonds.

Uganda, which has been improving its securities market slowly over time, also has Treasury bills and Treasury bonds. One of the ways the government attempts to promote improvement in the market is through its primary dealer ranking system which was introduced in 2005 by the Bank of Uganda. The winner of this prestigious award is announced every month. It is a catalyst for stimulating secondary market trading of government securities. The Ugandan secondary market provides a wide

<sup>11</sup> While data on other financial institutions are not readily available for most of the countries, Malawi, Mozambique, Ethiopia, and Cameroon have other financial institutions such as reinsurance companies, venture capital, private equity firms, leasing companies, and industrial banking firms that operate in the economies.

range of short term, mid range, and long term investments. While most of the countries in the region have interest rate of 7% to 12%, the Democratic Republic of Congo has interest rates on government securities ranging from 33% to 65%.

#### 4.6. Stock markets

The stock markets in this region are not well established as many countries either do not have a stock exchange or have recently established a stock market. Stock exchanges do not exist in Eritrea, Democratic Republic of Congo, Central African Republic, and Ethiopia. This is a bit of a problem for these countries as not only can individuals not invest money in the domestic market except perhaps through Treasury bills, the government also has more of a difficulty privatizing state owned enterprises through share issue privatization. While most of the businesses in Ethiopia are state owned, the government is promoting private ownership and loosening its grip on state owned assets. The percentage of firms owned by the government has reduced from 94% to 70% in just 8 years. Although this is a great improvement, more needs to be done in creating a competitive marketplace. The private sector has proven to be much more stable and more profitable during this time period. The establishment of a stock exchange where companies can raise more capital and become publicly traded firms will be a step in the right direction.

Like the bond market, Kenya has the most well established stock market among the countries in this region. Having been established in 1954, the Nairobi Stock Exchange (NSE) is the oldest and most active stock exchange in Eastern and Central Africa. The Stock Exchange was established with the help of the British in the 1920s as an informal market for the Europeans. In 1954 the market was formalized through incorporation, and later in 1963, Africans were allowed to participate in the trading. At the moment it is the 4th largest exchange in Africa in terms of volume and the 5th largest in terms of market capitalization. The Nairobi Stock Exchange is also the only stock exchange in the region to have an index. Rwanda is the newest country in the region to set up a stock market. The exchange which was established by the Capital Market Advisory Council in January 2008 started as an over the counter (OTC) market. It opened with two Treasury bonds of 5 billion Rwandan Francs each. The two Treasury bonds had an interest rate of 8% each, and were to mature after two years. Once the exchange is fully operational as a publicly traded exchange, the government intends to privatize 6 state-owned companies by the end of this fiscal year.

The stock markets in this region have not gained full momentum yet and will need some more time to do so. Most of the countries have received help with the creation and maintenance of their stock market. Organizations, such as the World Bank, the African Stock Exchange Association, Capital Markets Advisory Council (CMAC), and East African Securities Exchanges Association (EASEA) have provided financial and advisory support for the establishment of stock exchanges in this region. Moreover, to provide support to the fledgling stock markets in the region, the African Stock Exchange Association was incorporated in 1993 in Kenya, with the aim of providing a formal framework for the mutual cooperation of stock exchanges in the

sub-region. Its functions include the exchange of information and assistance in the development of member exchanges.

African markets are characterized by problems of low liquidity (Senbet and Otchere, 2010).<sup>12</sup> In this regard it is encouraging to note that attempts are being made by some governments in the region to enhance the liquidity of the fledgling markets. In Tanzania for example, the Ministry of Finance has provided many incentives to investors and issuers. For issuers the government has reduced corporate tax from 30% to 25% for a period of three years in cases where the issuer has issued at least 35% of the issued shares held by the public. The reduced rate is applicable for five years starting from the listing date. Another measure introduced is tax deductibility of all Initial Public Offering (IPO) costs. Even though it is a one-time incentive, it will encourage firms to list on the exchange. Also, withholding tax on investment income made by Collective Investment Schemes (CIS) is the final tax as investors in CIS do not pay income tax on the distributions by CIS. For investors, incentives include a zero capital gain tax as opposed to 10% for unlisted companies, Zero stamp duty on transactions executed on the Dar es Salaam Stock Exchange (DSE) compared to 6% for unlisted companies, and withholding tax of 5% on dividend income as opposed to 10% for unlisted companies.

#### 4.7. Other financial markets

The countries in this region do not have bond markets apart from the primary government bond and Treasury bill markets. This could be due to instability in the private sector or the lack of large corporations that have the capacity to issue bonds.

##### 4.7.1. Microfinance

Access to credit by small businesses is a big problem in this region, and for this reason the governments of these countries have set up microfinance institutions (MFIs). These institutions have been successful in providing financial services to the people who may normally not qualify for loans from banks and other financial institutions. This is why the MFIs have been popular in this region as many people do not have valuable assets to back their loans, and do not require large loans or saving accounts which the banks usually go after. The providers of these services range from government enterprises to large commercial banks to non-government organizations.

Mozambique has been experiencing a great deal of growth in the MFI sector in the rural and urban areas. With over 45 million loans and 8 different institutions the microfinance sector is a booming sector in the country. The loans provided by the MFIs have had a great impact on the agriculture sector. Since the farmers are able to raise capital through the MFIs they can buy tools and other necessary equipment to farm and grow crops and generate income. Congo has increased the number of MFI branches from 69 in 2001 to 86 in 2007 and at the moment this sector contributes about 1.1% of the GDP of Congo (IMF, 2009).

<sup>12</sup> Senbet and Otchere (2010), African Stock Markets: Ingredients for Development and Capacity Building, IMF/African Institute.

These microfinance institutions can help build the foundation of the economy and help increase the GDP of the countries in this region. This is why much emphasis is placed on MFIs and we are seeing high growth in this sector. However, mobilizing funds to the rural area where it is needed most is very difficult for the MFIs. High transaction cost makes it difficult to reach the rural communities. Consequently, they tend to operate in urban and semi urban areas.

#### 4.7.2. Informal finance

Informal finance is another key method of raising capital for the poor or people without bank accounts. Informal finance (which is a bottom up approach of raising and disbursing funds) is a key method of raising capital in Cameroon as the majority of the population raise capital through the informal finance sector. In the Democratic Republic of Congo, informal mechanisms such as savings schemes called “daddy cards” and ROSCAs are common.

Private equity investment is limited in this region, even though a few countries including The Democratic Republic of Congo, Kenya, and Mozambique have attracted private equity investment. The IFC, which is playing a leading role in this area, has launched a \$500 million SME venture in Democratic Republic of Congo and a \$12 million SME venture in Mozambique. Other larger international funds, such as Sanlam of South Africa, are increasingly active in agriculture and natural resource related investments. However, due to high interest rates and erratic currency fluctuations, the development of private equity as a significant force in the economy has been limited in Mozambique.

### 5. The state of African financial systems: Southern Africa

For the purpose of this study, Southern Africa is made up of Botswana, Comoros, Namibia, Sao Tome Principe, Seychelles, South Africa, Swaziland, Zambia and Zimbabwe. The inflation rate for these countries ranges from 8.79% for Botswana to 11.37% for Sao Tome Principe according to 2008 estimates.<sup>13</sup> Unlike the countries in West Africa, South African states do not have a single Monetary Union governing all of them. Each country operates differently and has its own characteristics and attributes.

#### 5.1. Central bank and its role in the economy

The objective of monetary policy in Botswana is to achieve a sustainable, low and predictable level of inflation, which contributes towards the broader national objective of sustainable economic development. The Bank’s monetary policy goal is to achieve 3–6% medium term price stability objective. In this regard, the Bank pursues its monetary policy objective in support of the broader national objectives of economic diversification and export competitiveness. Controlling inflation helps

Botswana to maintain competitiveness and stability in the real exchange rate and avoid the need for a devaluation of the Pula. In controlling inflation, the Bank uses interest rates and open market operations to influence aggregate demand.<sup>14</sup>

Since the introduction of the pula in 1976, Botswana has adopted a fixed but adjustable peg system. Initially, the pula was pegged to the US dollar. In an attempt to mitigate the susceptibility to volatility of an independent float and the straitjacket of a fixed exchange rate, Botswana, like several other developing countries, has chosen an intermediate exchange rate regime which enables it to benefit from the positive aspects of the two extreme exchange rate mechanisms. Significantly, in a situation where there is a large inflow of diamond revenues, a free float might lead to an appreciation of the currency to levels that would make non-diamond production unprofitable (the so-called “Dutch disease”), which would be inconsistent with the country’s development and diversification objectives.

Bank des Comoros, the central bank of Comoros, regulates and supervises the financial sector. It also manages foreign exchange controls, and capital transfer needs of various government agencies. The Comorian Franc (KMF) is pegged to the Euro at KMF 491.96775/1 EUR. Exchange rates are officially quoted on the basis of the fixed rate of the Comorian Franc for the Euro and the Paris exchange rate for other currencies. The Comoros has an arrangement with the French Treasury through an Operations Account. With the exception of transactions relating to gold, the country’s exchange control measures do not apply to France or to other countries whose banks or currency issues are linked to the French Treasury by an Operations Account (i.e. WAEMU and CEMAC). Forward cover against exchange rate risk is authorized by the central bank and is provided to traders for up to three months by a commercial bank that is authorized to conduct such transactions.

The Central Bank of Namibia serves as the State’s principle instrument to control the money supply, the currency and the institutions of finance, and to perform all other functions ordinarily performed by a central bank. The ultimate goal of monetary policy in Namibia is to ensure price stability in the interest of sustainable growth and development. The government maintains a one-to-one peg of the Namibian dollar to the South African Rand and therefore monetary policy decisions are dictated by the peg. The Central Bank of Namibia can influence monetary policy to some degree despite the peg by using capital controls and requirements on banking and other financial institutions. Namibia can maintain a Repo rate that is different from South Africa’s Repo rate and thereby better manage domestically induced inflation.<sup>15</sup> The central Bank uses the call account facility, seven day repurchase transactions, and Bank of Namibia bills to achieve its policy objectives.

In the Seychelles, the role of the Central bank is to promote price stability and to maintain both the domestic and external value of the currency. All legal controls on the purchase and

<sup>13</sup> <http://www.afdb.org/en/countries/>.

<sup>14</sup> Central Bank: Bank of Botswana (<http://www.bankofbotswana.bw/index.php?sectid=402>).

<sup>15</sup> Bank of Namibia (2009).

sale of foreign currency in the Seychelles have been removed as of November 2009.<sup>16</sup> This has allowed the rupee to float freely against other currencies. But as the free market takes on the role of establishing the exchange rate, the Central Bank is able to use other monetary instruments to direct the course of Seychelles' economy.<sup>17</sup> As an independent statutory body, the Bank is granted autonomy by the Central Bank Act of 2004 to operate freely from any political influence.

In South Africa the mission of the central bank, known as the **South African Reserve Bank**, is to achieve and maintain price stability in the South African economy, bank supervision, as well as management of official gold and foreign exchange reserves.<sup>18</sup> The Bank is governed by a fourteen-member Board of Directors including one governor and two deputy governors, all of whom are responsible for the day-to-day affairs of the Bank and are appointed to five-year terms by the President of South Africa. Eleven additional directors are elected by the stakeholders of the Bank for three-year terms. The **South African Reserve Bank** conducts monetary policy within an inflation targeting framework of 3–6% on a continuous basis. The South African Rand (ZAR) is the official currency of South Africa. Prior to February 1983, and between September 1985 and March 1995, the South African Reserve Bank maintained a dual exchange rate for the rand, consisting of the Commercial and Financial Rand. The Commercial Rand was a managed float and applied to all current transactions, while the financial rand floated freely and applied to local sale or redemption proceeds of South African securities and other South African investments owned by non residents. Since March 13, 1995, South Africa has moved to a single currency by abolishing the Financial Rand. The South African Reserve Bank has a floating exchange rate policy with no exchange rate targets.

The **Central Bank of Swaziland (CBS)** was established as the monetary authority in 1974 to monitor, regulate and develop Swaziland's financial infrastructure.<sup>19</sup> The core responsibilities of the CBS include issuing the national currency, advising the government, managing the country's official reserves, and dealing in the foreign exchange markets both spot and forwards markets. The monetary arrangement between South Africa and Swaziland, which dates back to when both countries used British Sterling as their currency, was formalized in December 1974 with the signing of the Rand Monetary Area (RMA) Agreement which became the Common Monetary Area (CMA) in 1986. The signatories are South Africa, Swaziland, Lesotho and Namibia. The CMA provides for the free flow of funds between the four member countries with no exchange controls. To facilitate the smooth implementation of the CMA agreement, member countries hold regular consultations with a view to reconciling their respective interests in the event of a member country deciding to formulate, modify and implement its monetary policies.

While the monetary agreement frees Swaziland from the need to make decisions concerning monetary and exchange rate policies, and thus allows the country to concentrate efforts on more pressing and immediate fiscal tasks, it severely limits the country's ability to formulate or influence monetary policy or respond to shocks affecting the country as its monetary policy is highly influenced by the South African Reserve Bank. Membership of a currency union with full integration and a fixed exchange rate regime precludes monetary policy independence. It is therefore essential to note that in terms of tools available to effect price stability, the Central Bank of Swaziland has limited powers to influence price movements. Membership of the CMA is characterized by the free flow of capital between member states. Swaziland's interest rates are traditionally more or less on par with those of South Africa. Despite tracking the South African interest rate structure, Swaziland's interest rate management is largely through moral suasion, where the Central Bank encourages the local banking sector to lend to the private sector. The Swazi Lilangeni (SZL) is pegged 1 to 1 to the South African Rand (ZAR). South African bank notes, but not coins, are legal tender in Swaziland.

The central purpose of the Bank of Zambia (BoZ) is to formulate and implement monetary policies to ensure price and financial stability. The Bank of Zambia licenses regulates and supervises commercial banks, the non-bank financial sector and micro-finance institutions. The Bank's main objective in monetary policy is to maintain low inflation levels. In this regard, the BOZ monitors inflationary pressures and adopts appropriate measures to keep reserve money in line with the targets. The managed floating exchange rate regime has served the economy well, hence the Bank intends to continue with its intervention policy of correcting transitory overshooting of the exchange rate and meeting its international reserve targets. Recognizing the challenges associated with the management of increased foreign currency inflows to monetary policy and competitiveness, the Bank uses foreign exchange sales to mop up excess liquidity generated by the increased inflows from the booming mining sector and donor support. While the banking sector appears sound, the Central Bank intends to strengthen supervision and broaden the availability of financial services. Regarding the capital market, the government intends to introduce measures to develop an active secondary market in government securities.

In Zimbabwe, the Reserve Bank has, as its primary goal, the maintenance of the internal and external value of the Zimbabwean currency. In this regard, the Bank is responsible for the formulation and implementation of monetary policy, directed at ensuring low and stable inflation levels. Up until 1994, the Reserve Bank held the bulk of the country's gold and foreign assets with authorized dealers (i.e. commercial and merchant banks) retaining small amounts as working balances. As part of the overall macro-economic reform program introduced in 1991, Exchange Controls have gradually been liberalized with authorized dealers having assumed the role of custodian of the country's foreign exchange resources since 1994 (Reserve Bank of Swaziland).

<sup>16</sup> Speech of Governor of Central Bank of Seychelles, October 31 2008.

<sup>17</sup> *Seychelles Nation Online*. "New challenges for a new generation: the Central Bank at 30." 11.30.2008. <http://www.nation.sc/index.php?art=14257>.

<sup>18</sup> The South African Reserve Bank (SARB): <http://www.reservebank.co.za/>.

<sup>19</sup> <http://www.centralbank.org.sz/>.

## 5.2. Banking and insurance systems

Botswana has one of the most elaborate banking and insurance systems in Africa. The non-bank financial sector is active, with over 100 private pension funds and 32 insurance companies. The financial system of Comoros is small and concentrated in the banking sector and it comprises Bank des Comoros (the central bank), one commercial bank (Bank pour l'Industrie et le Commerce des Comores) and one development bank (Bank de Développement des Comores). It is the government's intention to increase competition in the banking sector and it has granted a license to the Bank de la Reunion to operate in the country. Access to credit for entrepreneurial activities in Comoros is hindered by the small and underdeveloped financial sector. Overall, the financial system lacks an effective regulatory framework that can facilitate dynamic business investment. Two of the country's three islands, Anjouan and Moheli, have developed an offshore financial services sector as a means to finance government spending. Comoros has a small insurance sector.

Namibia's financial sector is robust and well-developed compared to most of its neighbours' but it is closely aligned with the state. Commercial banks, on average, are well capitalized at 15% of risk weighted assets.<sup>20</sup> The sector also benefits from a high savings rate relative to other emerging economies. This high savings rate is rooted in the priority that the government and mining companies have placed on pensions and insurance cover. However, the financial sector focuses on state-related business, a small number of large companies, and high-income households. Ten of the largest depositors represent a third of the total corporate liabilities while personal mortgages represent 37.7% of loans outstanding (Business Monitor International, 2008). Namibia's banking industry has grown significantly since independence in 1990 with seven banks currently operating in the country.

In Sao Tome and Principe, the financial system is small and underdeveloped. There are seven private commercial banks, five of which were opened between 2005 and 2007. The largest and oldest bank is Banco Internacional de Sao Tome e Principe which is a subsidiary of Portugal's government-owned Caixa General de Depósitos. It had a monopoly on commercial banking until a change in the banking law in 2003 led to the entry of other banks. Four of the private commercial banks are foreign owned, such as the Cameroonian subsidiary bank, Afriland First Bank Sao Tome e Principe. The focus of economic reform since the early 1990s has been widespread privatization. The government encourages private participation in the management of quasi-government corporations and banks. Credit facilities for businesses are very limited. Medium and longer-term financing is difficult to obtain from commercial banks in Sao Tome and Principe. Interested investors generally try to locate offshore sources of funding as local interest rates are very high.

Over 37 years, the banking sector in Seychelles has changed significantly as institutions have responded to the rapid development of the economy. With a population of just over 80,000,

Seychelles is served by six commercial banks. All the commercial banks are regulated by the Central Bank and are required to renew their licenses annually. Barclays was the first bank to open a branch in Seychelles in the late 1950s. Prior to that time, banking was effectively handled by the local trading company Temoljees. Under the Savings Bank Act, the bank's lending activity was limited to small amounts for individuals but, under the Financial Institutions Act, it is free to provide working capital for corporate clients. Seychelles has a highly sophisticated banking system similar to that found in most developed countries, with most Seychellois having access to their own bank account, automatic teller machines, credit and debit cards. All types of account are available including current, fixed deposits, call deposits, savings schemes, loan accounts, and all major credit cards are represented.

The South African Banking system comprises of the South Africa Reserve Bank; 55 locally controlled banks; 5 mutual banks; 12 foreign-controlled banks; and 9 branches and 60 representative offices of foreign banks. South Africa's "Big Four" local banks, namely Absa, First National Bank (a division of First Rand National Bank), Standard Bank and Nedbank provide retail and investment banking services in competition with a wide range of niche commercial banks. Notably, South African banks have been excluded from corporate banking due to more aggressive pricing at European, Malaysian and U.S. banks operating in South Africa. In recent years, credit rating agencies such as Fitch and Standard & Poor's, concerned about South Africa's growth potential and macroeconomic stability, have downgraded the country's external credit rating outlook from 'stable' to 'negative'. Therefore, the country's open economy and financial markets could be more heavily exposed to the economic downturn than initially anticipated. According to Business Monitor's 2009 Insurance Report,<sup>21</sup> total premiums in South Africa rose by an estimated 13% to ZAR 259,087 million. Non-life premiums rose by 15% to ZAR 61,612 mn, while life premiums rose by 13% to ZAR 197,475 mn. These premiums are forecast to grow significantly.

Swaziland's banking system has become shallower. Private sector lending, money supply, and bank deposits as a percentage of GDP have all declined since 1995. There are four authorized commercial banks in the country. The commercial banking system has largely concentrated on export financing while under serving a large portion of the adult population. This limited access to financing has reduced the amount of growth-enhancing investment projects in the country. As an added strain on the banking system, the nonbank financial institutions (NBFIs) that developed to fill the financial need have been inadequately regulated and supervised. The growth of the NBFIs in Swaziland has been affected by a combination of a relatively small financial sector and the high costs associated with using formal banking services.

Access to banking services is generally not available to certain segments of the population such as those living in rural

<sup>20</sup> As defined by the Basel Core Principles internationally recognized standard.

<sup>21</sup> Business Monitor International South Africa Insurance Report Q1 2009, ISSN: 1750-5763.

areas or those without steady incomes. The NBFIs such as savings and credit cooperatives (SCCOs) and microfinance institutions have focused on these groups. Since 2008 the number of NBFIs has grown significantly as they attempt to take advantage of the liquidity surge from the requirement that all insurance and retirement funds must increase their holdings of domestic assets from 10 to 30% of total assets through 2009. At the end of 2007, there were 266 NBFIs in Swaziland. As in many developing countries, the main line of insurance business is compulsory motor insurance, which is often subject to regulation and attracts low premiums. In Swaziland, the oldest and also the largest insurance company, the Royal Insurance Company, is 40% government owned. The company had monopoly in the industry until November 2006 when the Registrar of Insurance and Retirement Funds was founded and the Insurance Act was established to open the market to competition. The insurance sector comprises 5 licensed Insurers, 9 Insurance Brokers, 18 Insurance Agents, 3 Retirement Funds and 1 Fund Administrator. All these firms are locally owned.

Zambia's financial sector is relatively small and is dominated by banks. The sector, however, has one of the most liberal banking regimes in Southern Africa. The sector has experienced significant privatizations in recent years. Zambia's banking sector consisted of 12 operational commercial banks as at December 2006, including several foreign-controlled banks. Concentration is high, with the five largest banks controlling the bulk of the assets. The Zambia National Commercial Bank, the only state bank and the country's largest domestic bank, which was privatized in 2006, controls 24% of the retail banking market. There is no formal deposit insurance system in Zambia.

The country's largest insurance company, Zambian State Insurance Corporation (ZSIC) was established with the view to providing low cost insurance to indigenous Zambians. It is wholly owned by the Government of the Republic of Zambia. The Corporation is partner to some of the world's most reputable and strongest re-insurance companies. The Zambia State Insurance Corporation has the broadest distribution network among all the other insurance companies in Zambia. Besides maintaining a healthy business relationship with insurance broking firms, the Corporation procures business through independent contractors (agents) and branches. Currently, there are 17 branches, district and franchise offices covering all the nine provincial centers in Zambia. Like the banking sector, the insurance sector has undergone restructuring involving the partial privatization of the State Insurance Company and the emergence of five private insurance firms. However, the privatization efforts for the state-owned insurance corporation have temporarily stalled.

The political problems facing Zimbabwe have affected every fabric of the society. As of January 2009 the banking sector consisted of 28 banking institutions that are supervised by the Reserve Bank of Zimbabwe (RBZ). Since February 2009, insurance companies and pension funds have had the ability to transact in either local or foreign currency given the devaluation of the local currency. Similar to the banking industry, the insurance and pension sectors have received inadequate oversight and this has led to illegal transitions, indiscipline, and disre-

gard for rules and regulations. Studies have shown that most pension funds and insurance companies do not comply with the minimum prescribed asset requirements of 35% and 30% respectively (Zimbabwe Ministry of Finance, 2009).<sup>22</sup>

### 5.3. Government bond markets

The primary bond market in this region is relatively well-established compared to other parts of Africa. In Botswana, the primary bond issues are managed by the Bank of Botswana on behalf of the government. The first government bond was issued on March 26, 2003. The main objective of the government issues is to help develop local capital markets by adding to the choice of available financial instruments and establishing a relatively risk-free yield curve to serve as a benchmark for other bond issues. Six primary counterparties have been appointed by the Bank of Botswana to participate in auctions. In addition to government bonds, the government of Botswana also issues Treasury bills. There is a primary dealership system in government bonds for both the primary and secondary market. Government debt instruments consist of Bank of Botswana Certificates (BOBC) and government bonds. Government bonds are auctioned and traded on a yield-to-maturity basis and can be bought and sold through the BSE primary dealers. However, the market is illiquid as investors are typically of buy-and-hold types. The Bank of Botswana invests in some of these issues to help promote the liquidity of the market. Government bonds have maturities of 2 years, 5 years, and 12 years, whereas Bank of Botswana Certificates have maturities of 14-, 91- and 364-days.

The Bank of Namibia issues both Treasury bills and internally registered stock (IRS) by open tender for maturities that exceed 12 months. The Central Bank facilitates communication and trading between market participants by providing a secondary bond market website. The site is not a trading platform but provides a forum where participants can obtain current market information. The latest available figures show that the turnover on Namibia's bond market is US \$180 M with a yield curve of 1–17 years (Gruebel, 2009). In the Seychelles, Treasury bills are auctioned on a weekly basis and are open for public tender. Bids for Treasury bills must be made in multiples of SR 5000.

Government bond issues in South Africa started in the 1980s when bonds were only issued on demand. The South African Revenue Bank was the principal underwriter of those bonds. The Bond Market Association (BMA) which was formed to self-regulate the market was granted an exchange license in 1996 and was converted into the Bond Exchange of South Africa (BESA). Trading in the market which began in 1996 has attracted a lot of interest to the extent that the bond market has a turnover ratio equivalent to that of other mature markets. In 2005 the Bank for International Settlement (BIS) reported that South Africa's government bond market was the sixth most liquid market in the world behind Canada, Chile, Poland, Taiwan and the United States. More recently, according

<sup>22</sup> Ministry of Finance Budget Statement, 2009.

to the Bond Exchange of Africa's 2007 market performance, "turnover on the bond exchange reached a record R13.8 trillion, with R13 trillion in trades occurring in government bonds. Although government bonds have always dominated the bond market, in recent years more companies are issuing bonds. Before 2007, government bonds accounted for about 60% of all bonds issued. At the end of 2007 companies had actually issued more bonds than the government, which makes for a less volatile market.

The Swazi government has enjoyed a net creditor position for a long time (up until 1993/94). For this reason, there has not been a need to sell securities for financing. However, there are some small amounts of both Treasury bills (E40 million) and bonds (E30 million) that have been issued regularly purely for the purpose of enhancing the money market. The Treasury bills are auctioned on a weekly and monthly basis. Each issue has been oversubscribed.

The Bank of Zambia currently offers debt instruments on behalf of the Government of Zambia on a competitive and non-competitive basis. Treasury bills with maturities of 28, 91, 182, 273, and 364 days are available to individuals on a weekly basis and to corporate institutions on an auction basis. Government bonds, with maturities ranging from 2 years to 15 years, are auctioned every 4–6 weeks, depending on the borrowing needs of the government. All primary and secondary trading of government bonds takes place at the Lusaka Stock Exchange. Supported by the yield curve established by the government, several corporations from various sectors have successfully accessed the capital markets. In October 2000, Farmers House, Plc launched the first flotation and listing of corporate bonds on the LuSE in which US\$1 million was raised. It is important to note that local institutional involvement played a very important role in the success of the issue by taking up over 85% of the offer.

In Zimbabwe, Treasury bills are issued for maturities of 91 days, 182 days, 365 days, and 728 days and treasury bonds with 2- and 3-year maturities. In 2005, a 5-year inflation indexed bond was launched. The primary market operates via a multiple price system in which both competitive and non-competitive bids are accepted. Private sector companies do not issue debt in the Zimbabwean bond market perhaps due to the hostile political and economic environment. Short-term government securities are traded over the-counter (OTC), and banks and other primary market dealers actively trade these instruments. Trades are settled on the basis of T + 2. Government domestic debt has continued to grow, closing at \$59 sextillion in January 2009, with outstanding Treasury Bills accounting for 94% of this amount (Reserve Bank of Zimbabwe, 2009).<sup>23</sup>

#### 5.4. Stock markets

The stock markets in Southern Africa are relatively new, except the South African stock market. The Botswana stock exchange (BSE) was established in 1989 and became a sepa-

rate legal entity in November 1995. The market capitalization of the BSE grew from 254 million pula in 1989 to 534 184.66 million pula in 2006, then dropped to 313966.31 million pula in 2008 because of the financial crisis but has since improved to 374,537.22 million pula in 2009. The number of securities (shares and fixed income) listed in the BSE rose from 5 in 1989 to 56 in 2006 and 64 as of February 2010 (Botswana Stock Exchange, 2010). In 1989, the only market performance index was the Botswana Share Market index (BSI) and it was set at 100. However, as the market developed and diversified in terms of domestic companies and dual foreign companies listed on the exchange, the need for additional markets indicators arose. Three distinct indices were introduced to reflect the market's diversity namely domestic company index (DCI), foreign company index (FCI) and the all company index (ACI). As of the end of 2006 the DCI recorded 6195.45 points, while the FCI hit 1777.30 points and the ACI 1914.18 points. In 2001 the BSE introduced a Venture Capital Board dedicated to companies looking for start-up capital.

With the introduction of the Central Securities Depository (CSD), the settlement cycle has been reduced to T + 3. In conforming to international standards and to reduce settlement risk, the CSD intends to commence work on implementing an Automated Trading System (ATS). This will be a welcome development and will support the BSE's marketing initiatives by making it easy for both Botswana and Foreign investors to trade on the BSE. In addition, the BSE Act of 1994 is being reviewed in order to set up an appropriate operational and regulatory legal framework in an effort to align it with International Best Practices and cater for innovations in financial markets around the world.

The Namibian Stock Exchange (NSX), established in 1992 to support the country's independence from South Africa, is a weighted market capitalization index that includes both single and dual listed companies. The dual listed companies are traded on both the Namibian and Johannesburg Stock Exchanges. There are thirty-six companies listed on the NSX. The NSX is a computerized trading system that matches buy and sell orders. This system is integrated with the Johannesburg Stock Exchange and has data managed by servers in Johannesburg. Ordinary and preference shares, rights, options and debt are all traded on the exchange. Participants are charged a minimum of N\$ 15 per equity transaction plus a sliding commission scale. NSX listings are predominantly South African owned and the NSX is heavily influenced by activity on the Johannesburg Stock Exchange. The NSX is continuously pursuing integration and coordination efforts with exchanges in other African countries, and especially with the Johannesburg Stock Exchange in South Africa.

The South African stock market, based in Johannesburg is Africa's premier exchange and the most sophisticated exchange comparable to exchanges in developed countries. It has operated as a market place for the trading of financial products for nearly 120 years. During this period, the Johannesburg Stock Exchange (JSE) has evolved from a traditional floor based equities trading market to a modern securities exchange providing fully electronic trading, clearing and settlement in securities, financial and agricultural derivatives and other associated instruments and

<sup>23</sup> RBZ Weekly Economic Highlights, week ending January 2009.

has extensive surveillance capabilities. The JSE is also a major provider of financial information. Trade is carried out using an upgraded technology system—the London Stock Exchange's TradElect™. The average daily number of trades in 2007 was 46,216, compared with 31,899 in 2006, and a record number of trades, totalling 99,959, occurred on the futures close-out on 20 December 2007.

In the Seychelles, the Securities Act of 2007 provides the legal framework for the setting up of a stock exchange. With a long history of international business the new regulatory system for a fair and transparent securities market extends the scope and appeal of Seychelles. The Act encourages overseas and local securities dealers to trade in foreign and Seychelles securities. A number of overseas companies and mutual funds have expressed interest in obtaining quotations on the exchange. The Swaziland Stock Exchange (SSX), which was established in 1991, is regulated by a Committee consisting of two representatives from licensed stockbrokers, one representative from the Central Bank who acts as chairperson, one representative from the listed companies, a representative from institutional investors and a representative from Transfer Secretaries. An interesting feature of this exchange is that it uses a different method of computing the SSX All Share Index and by extension, market capitalization and involves the utilization of bid (buy) and offer (sell) prices in compiling the market indices.

In Zambia, the Lusaka Stock Exchange (LuSE) was established in 1993 with technical assistance from the World Bank and the International Finance Corporation, and was officially opened on February 21, 1994. In addition to supporting financial and capital market development, the LuSE was created to attract foreign investment and facilitate the divestiture of state ownership in state-owned enterprises. However, the privatization process in Zambia has not been without its challenges, and there has been significant speculation regarding the financial viability of some of these companies. This has contributed greatly to the shallow market depth of the LuSE. As of November 2008, the LuSE migrated over to an automated trading system from a manual system in which orders were matched as they were faxed or delivered to the exchange by brokers. The exchange now operates an electronic clearing and settlement process, with trade-for-trade netting and settlement three days after the trade (T+3). In addition, there is an electronic depository facility operated by LuSE Central Share Depository.

The Zambian securities market is a “unified market” in which securities of public companies that are not listed are also quoted and traded on a second-tier market within the LuSE. Most listed companies are former state enterprises that have undergone privatization. However, recent listings by companies such as the Zambia National Commercial Bank, Celtel, and the Copperbelt Energy Company have led to a significant increase in trading volume. Currently, there are 20 companies traded on the LuSE, with the top five companies representing over 77% of the total market capitalization.

The Zimbabwe Stock Exchange is a small but active stock market in Africa. It was established in 1896 and has been open to foreign investment since 1993. It has about a dozen mem-

bers and over 65 listed securities (Zimbabwe Stock Exchange, 2009). There are two indices, the Zimbabwe Industrial Index and the Zimbabwe Mining Index.<sup>24</sup> Companies may not allow more than 40% of their ownership (traded after 1993) to be foreign and no single overseas shareholder can possess more than 10%. Those bringing in funds through a registered commercial bank are now allowed to repatriate their income and sale proceeds free of charge, but taxes of 15% on dividends and 10% on capital gains are levied on individuals.<sup>25</sup> Prior to 2008, the ZSE was outperforming exchanges in the South African region, but the political situation and the high inflation rate have affected the performance of the stock exchange. Since the beginning of 2009, trades have been conducted exclusively in US dollars.

### 5.5. Other types of finance

The financial markets in Southern Africa have a variety of financial products including corporate bonds and derivatives. In Botswana, commercial banks have been able to launch convertible bonds and do account for the proceeds as capital required for reserves, and also to raise long-term resources, thereby allowing them to offer longer-term lending products. Derivatives activity mainly consists of over-the-counter foreign exchange forwards and currency swaps. Both forwards and currency swaps markets are liquid, with terms up to 3-months and 6-months respectively. Currency swaps are mostly against the USD but can be against any of the major international currencies. In Namibia, the non-banking financial institutions market also includes over 500 pension funds and a variety of asset management and unit trust management companies. These institutions provide savings options largely to the private sector in order for firms to meet government regulations that require employee benefits for savings. Most institutions have strong ownership ties to South Africa (AfDB, 2006). Private equity and venture capital are relatively new asset classes in Namibia with funds only being established in recent years. The main private equity institutions include Stimulus Private Equity, NedCapital, and NIB which is 15% owned by the IFC. The Development Bank of Namibia has also recently established a private equity fund focused on small-to-medium enterprises (SMEs). Given the large size of Namibia's pension fund market, private equity has significant potential for growth. However, at present, it remains a relatively new asset class.

While some African countries have problems in maintaining both political and economic stability, South Africa has capitalized on its stability and economic infrastructure to attract private equity capital. The Venture Capital and Private Equity Industry Performance Survey that analyzed South Africa's private equity market from 2006 to 2007 reveals a booming economy with impressive achievements nearly doubling in size from 2006 to 2007. Most notably, South Africa's private equity industry

<sup>24</sup> <http://www.mbendi.com/land/af/zi/p0005.htm#20>.

<sup>25</sup> <http://finance.mapsofworld.com/stock-market/zimbabwe-stock-exchange.html>.

holds R86.6 billion under management as of December 31, 2007, compared to December 31, 2006 at R59.3 billion.

The informal financial sector in Zambia is more popular than the formal sector because of low transaction costs, and flexibility and speed with which services are provided. There are a variety of arrangements, rooted in the social fabric of the society through which Zambians gain access to capital. There is limited private equity and venture capital in Zambia. Zambia Venture Capital Fund (ZVCF) was the first venture fund to be established in the country in 1996, with a fund size of US\$7.5 million, which increased to US\$12.5 million in 1997. The second fund was established as a joint venture between the Cavmont Group and FMO (the Netherlands Development Finance Company), with a fund base of US\$2.0 million. In 2006, Aureos, a foreign private equity firm, completed a US\$4.35 million investment in Golden Lay Farms, the largest table egg producer in Zambia's Copperbelt region.

### 5.6. Microfinance

Namibia has a significant and growing micro-finance industry with well over 100 micro-finance institutions (MFIs) of various types. In 2008, the Development Bank of Namibia launched its Microfinance support network that provided low cost loans to organizations that support development activities. The program has made US\$ 4.2 million available to existing microfinance institutions to enable them to extend their reach within the country (NEWS WIRE, 2008). This program is expected to accelerate the development and penetration of micro-finance institutions throughout Namibia and to further reduce the market for informal loan sharks and other informal money lending entities.

The South African credit granting industry is highly dualistic. On the one hand, there exists a plethora of financial and credit products aimed at the middle-upper income groups. At the opposite end, as much as 50% of low income individuals remain unbanked. The micro lending sector therefore, in most cases, becomes the primary source of access to credit for this category of borrowers. In terms of total consumer credit extension (USD 51.7 billion), South Africa's micro finance market is relatively small (USD 2 billion). Because micro loans are relatively small (i.e. under USD 1430 per customer), the sector's sphere of influence and coverage in the country however, is considerable. Today there are approximately 3 million borrowers, 1,400 registered micro lenders with a branch outreach of 7,000 outlets in all of South Africa's nine provinces. As regulators of the South African micro lending industry, the Micro Finance Regulatory Council (MFRC) has a dual mandate in ensuring the sustainability of the industry in providing access to finance for lower income individuals as well as ensuring consumer protection.

In Swaziland, the only form of financing for a number of the rural poor is through microfinance institutions that may be organized at the local level. While banks charge an average annual interest of prime rate of 13.5% plus 10%, micro lenders on the other hand charge an average annual interest of 30% (Allafrica,

2009).<sup>26</sup> MFIs in Zambia are very small by African standards. As of 2006, MFIs were only serving 50,000 customers, representing 0.005% of Zambia's population (Association of Micro-finance Institutions of Zambia). Total assets under management do not represent more than 2% of those of banking institutions. Due to their low volume of operations and high operating costs, MFIs grant loans at higher interest rates than those offered by commercial banks. Therefore, most borrowers only take out short-term loans (one month) from MFI's to meet family needs, or in the case of small businesses, short-term liquidity needs.

## 6. Conclusion

African financial systems, particularly those in Sub-Saharan Africa with the exception of South Africa, are dominated by traditional banking and informal finance. However, as a result of extensive and economic reforms that have taken place over the last two decades, there have been marked improvements in banking development, as well as emergence of non-bank finance, particularly in the form of stock markets which have proliferated across Africa. While the challenges facing these markets, in terms of liquidity and depth, are immense, they have experienced improvement both in capitalization (size) and trading activity. These improvements have been in response to improvements in regulatory and economic environments that the region has experienced over the recent past. Accompanying these stock market developments is their performance record in recent years, and the available data indicates the markets have performed well both on an absolute and risk-adjusted basis.

In view of the thinness and illiquidity of African stock markets, which pose a serious hindrance against financial globalization of Africa, there is now growing efforts for regional cooperation for consolidations of these markets. Thus, regionalization of African stock markets should enhance mobilization of both domestic and global financial resources to fund regional companies, while injecting more liquidity into the markets. Regional stock exchanges are being contemplated along linguistic lines. A pioneer in this regard is the Abidjan-based Bourse Régionale des Valeurs Mobilières (BVRM) formed in 1998 to serve the Francophone countries of West Africa. The Anglophone countries of West Africa are also contemplating forming a regional stock exchange under the umbrella of the ECOWAS. Moreover, the Southern African Development Community (SADEC) stock exchanges are taking initiatives for the formation of a regional stock exchange to serve the Southern region. The Eastern region countries, such as Kenya, Tanzania, Uganda, and Rwanda are also natural partners for organizing a regional stock exchange.

The banking sector in most of the countries is either dominated by state-owned banks or by a few large, sometimes foreign banks. However, as part of the restructuring program that has been embarked upon by the African countries, the banking industry in Africa is undergoing reforms focused on privatization and other forms of restructuring of the state-owned banks with

<sup>26</sup> <http://allafrica.com/>.

the view to improving the quality of the banks. One common feature of the banking system in Africa is that a large number of the banks invest in government securities, primarily Treasury bills. The banking systems in Nigeria and the Southern African countries of Malawi, Botswana, South Africa and the Seychelles are relatively well capitalized and dynamic and the banks pursue innovative banking practices. The Seychelles has a highly sophisticated banking system similar to that found in most developed countries.

While the financial crisis led to a drop in market capitalization of the markets in Africa in 2008, the market capitalizations of some African countries continue to improve. The stock markets in Africa present attractive investment opportunities despite the challenges they have faced relating to low capitalization and liquidity. With the exception of 2008, the performance of these markets has been increasing significantly, with the returns in some of the markets exceeding 100%. While the crisis of 2008 has tempered the returns that the African stock markets generated, the performance of the market was better than what most other markets realized, with the markets in Ghana, Namibia and Malawi surprisingly realizing positive returns even in the face of the worst global financial crisis for many years. The performance remains strong and attractive even after adjusting for standard risk measures. With the deepening policy commitment to the equity sector and Africa's growing integration into the global financial economy, African stock markets offer a potential for attractive and globally competitive risk-return tradeoffs.

A key feature of the financial markets in Africa is the dearth of markets for both government and corporate bonds. The bond market is either not well developed or at best, it is in its infancy. There are pockets of areas, such as Nigeria, French West Africa, and the Southern African region that have secondary bond markets. Apart from the markets in South Africa, the derivative markets were non-existent until a few years ago. However, due to initiatives undertaken by some governments in the French West Africa regional exchange and Southern Africa, the derivative market in the WAEMU zone is in its infancy while the ones in Southern Africa (Namibia, Botswana, Seychelles and South Africa) are thriving.

Private equity and venture capital is growing in Africa especially in those countries with a stable macroeconomic climate: relatively controlled inflation and foreign exchange risk, favourable investment climate, and trend towards regulation and privatization. The micro finance industry, which has a long history in Africa, has experienced high growth in recent years and is becoming an important driver in the development of the economies in the region and continues to play a key role as a grassroots financial tool. Access to credit by small businesses is a big problem in this region, and for this reason the governments of these countries have set up microfinance institutions (MFIs).

In closing, while we recognize that African stock markets have performed impressively when adjusted for standard measures of risk, such as the Sharpe ratio, it would be prudent to mention a couple of non-standard sources of risk which are particularly relevant in the context of Africa. These risk factors largely arise from instabilities in the economic and political sys-

tems, as well as fluctuations in the values of African currencies which are difficult to hedge.

### 6.1. Macro-economic and political instability

There have been episodes of high macro-economic and political instabilities in Africa that contribute to high volatilities in the financial markets. The "tail case" is Zimbabwe. This is particularly worrisome in view of the prevailing evidence that stability, such as low and predictable rates of inflation, contributes to stock market stability (e.g., Garcia and Liu, 1999). Political risk is often associated with lack of quality institutions, such as law and order and democratic accountability which lead to increased risk premium in the stock market. Further, investors would be concerned about a source of political risk stemming from the odds of adverse changes in government policies. Unfortunately, the African continent is filled with a litany of cases of abrupt changes in government policies and political climate. These abrupt changes have adverse consequences on the development and performance of stock markets.<sup>27</sup> The popular uprisings in Tunisia, Egypt and Libya in early 2011 are other examples of political instability.

### 6.2. African currency fluctuations

High levels of currency value fluctuations are endemic to African economies, creating an impediment to foreign investment in the region. These currency fluctuations can induce an important risk factor in the African stock market scene. In fact, there is evidence that currency depreciation has an adverse impact on the performance of African stock markets (Senbet and Otchere, 2006). Unlike hard currencies, African currencies are readily hedged, and there is a dearth of hedging mechanisms through derivative markets (forward, futures, and options). Of course, one could mitigate currency risk through holdings of export-oriented companies listed on the stock exchanges. In particular, those with exposure to hard currency exports may be targeted, since they substantially hedging against local currency fluctuation.

### Acknowledgements

We are grateful to the Nomura Institute of Capital Markets Research Center for Financial Policy at the University of Maryland and the Wharton Financial Institutions Center for financial support. We thank the Wharton MBA students that participated in the Independent Study Course on Africa's Financial Systems in the spring semester of 2009. Without their extensive efforts we could not have completed this project. We are also very grateful to Patricia Reiter who provided excellent research assistance.

<sup>27</sup> Consider the dramatic price swing in the Zimbabwe stock market in the wake of the government land reform policy. The Zimbabwe market, which rose by a whopping 90% in 1996, moved down by more than 50% during the final quarter of 1997 (Gopinath, 1998).

## References

- allafrica.com, Swaziland (2009), <http://allafrica.com>.
- Allen, F., Carletti, E., Cull, R., Qian, J., Senbet, L., 2009. The African Financial Development Gap, University of Maryland/University of Pennsylvania working paper, September 2009.
- Allen, F., Giovannetti, G., 2011. The effects of the financial crisis on sub-Saharan Africa. *Review of Development Finance* 1, 1–27.
- African Development Bank, 2006, 2007, 2008, 2009, African Economic Outlook. <http://www.afdb.org/en/countries/>.
- African Development Bank, 2009, Impact of the Global Financial and Economic Crisis on Africa, <http://www.afdb.org/en/countries/>.
- African Development Bank, 2006. Namibia Country Portfolio Performance Review. African Development Bank.
- Anyanwu, C.M., 2004. Microfinance Institutions in Nigeria. Paper Presented at the Gs4 Workshop on “Constraints to Growth in Sub – Saharan Africa, Pretoria, South Africa”, Nov. 29th – 30th.
- Arab Insurance Group, 2007, Middle East Insurance Review, July.
- Bank of Botswana. <http://www.bankofbotswana.bw/index.php?sectid=402>.
- Bank of Ghana <http://www.bog.gov.gh/>.
- Bank of Namibia <http://www.bon.com.na/>.
- Business Monitor International, 2009. North Africa Business Forecast Report Q1.
- Business Monitor International, 2009. South Africa Insurance Report Q1, ISSN: 1750-5763.
- Business Monitor International, 2008, Namibia Mining Report Q3.
- Botswana Stock Exchange website. <http://www.bse.co.bw/>.
- Bourse de Tunis Report, 2008.
- Central Bank of Seychelles Governor’s Speech, October 31, 2008.
- Central Bank of Swaziland <http://www.centralbank.org.sz/>.
- Daily News Egypt, 2007.
- Garcia, V.F., Liu, L., 1999. Macroeconomic determinants of stock market development. *Journal of Applied Economics*, 29–59.
- Gopinath, D., 1998. Taking the road less traveled. *Institutional Investor*, 173–174.
- Grubel, G., 2009, Stimulating the corporate debt market in Namibia, Bond Exchange of South Africa.
- HSBC, 2009, Global Research, March.
- International Monetary Fund, 2009, World Economic Outlook Database.
- International Monetary Fund, 2008. Financial System Stability Assessment, IMF, October.
- International Monetary Fund, 2007. Arabic Republic of Egypt: Selected Issues, December.
- International Monetary Fund, 2007. International Financial Statistics.
- Loko, G.S., 2008. International monetary fund: Algeria.
- Magharebia, 2008. Global economic crisis triggers bear market in Morocco.
- Mohammed, A.D. and Z. Hasan., 2008. Microfinance in Nigeria and the Prospects of Introducing its Islamic there in the Light of Selected Muslim Countries’ Experience. Munich Personal RePEc Archive (MPRA). MPRA Paper No. 8287: 1–19.
- Mueller, J., Yackovlev, I., Weisfeld, H., 2009. The global financial crisis: impact on WAEMU member countries and policy options, IMF Staff Position Note, July 2, 2009. <https://imf.org/external/pubs/ft/spn/2009/spn0916.pdf>.
- NEWS WIRE (2008): Namibia: Development Bank Namibia Launches Micro-finance Framework, Nov 3, [www.microcapital.org/news-wire](http://www.microcapital.org/news-wire).
- Oxford Business Group, 2008. The Report: Emerging Algeria.
- Oxford Business Group, 2008. The Report Tunisia—Privatization’s progress, September.
- Oxford Business Group, 2007. Report: Emerging Morocco.
- Reserve Bank of Zimbabwe, 2009. RBZ Weekly Economic Highlights, week ending Jan 2009 <http://www.rbz.co.zw/pdfs/wkly/09January2009.pdf>.
- Seychelles Nation Online, 2008. New challenges for a new generation: the Central Bank at 30. 11.30.2008. <http://www.nation.sc/index.php?art=14257>.
- Senbet, L., forthcoming. Financial Sector Policy Reforms in the Post-Financial Crisis Era: Africa Focus, African Development Bank Volume on Financial Crisis.
- Senbet, L., Otchere, I., 2010. In: Marc, Q., Genevieve, V., Palgrave (Eds.), *African Stock Markets: Ingredients for Development and Capacity Building*, in *African Finance in the 21st Century*. Macmillan Publishing.
- Senbet, L., Otchere, I., 2006, Financial sector reforms in Africa: perspectives on issues and policies in annual World Bank conference on development economics: growth and integration, pp. 81–119.
- South African Reserve Bank. <http://www.reservebank.co.za/>.
- South Africa Venture Capital Association, 2008. The South African Private Equity Confidence Survey – Deloitte.
- Stijn Claessens, Van Horen, N., Gurcanlar, T., Mercado, J., 2008. Foreign Bank Presence in Developing Countries 1995–2006: Data and Trends, IMF Working Paper.
- Venture Capital and Private Equity Industry Performance Survey, 2006–2007.
- Meek, V., 2008, West Africa gets exciting, *Emerging Private Equity* emerging Private Equity’s July/August.
- Zimbabwe Ministry of Finance, 2009, Budget Statement, 2009.
- Zimbabwe Stock Exchange, 2009. <http://finance.mapsofworld.com/stock-market/zimbabwe-stock-exchange.html>.