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Editorial

Developments in the financial services sector in Africa

Over the past decade, Africa has witnessed an average annual growth rate of about 6% as a result of, among other things, the commodity price boom and significant positive trade figures between China and the continent. The continent is currently going through positive and visible financial services transformation with increasing flow of FDI into the growth sectors including commodities, capital markets and financial services sectors. However, the growth in these sectors is not matched with adequate and sustainable research output that can assist policy makers to make better-informed decisions. This special issue of *Review of Development Finance* focuses on developments in the financial services sector in some African countries. The papers address important issues that aim at deepening our understanding of financial services in Africa.

In the first paper, the authors explore the key issues relating to financial sector policies for enterprise development with special reference to Sub-Saharan Africa (SSA). The role of the formal financial sector, ranging from microfinance institutions, banks, the capital market, and central and development banks, is discussed with respect to enterprise development at all levels, including start-ups, small and medium firms, and large corporates. Specific policy choices for African countries are highlighted, including exploiting the ongoing communications and information technology revolution for payments; in which the M-Pesa system has put SSA in the vanguard, leapfrogging paper based and plastic card based technologies to utilise mobile phones instead. The authors indicate that, this provides a basis for internet-based financial services to be provided by banks in conjunction with telephone companies, or ‘telcos’, taking advantage of lower transactions costs to deliver services such as ‘peer to peer’ lending, ‘crowd (equity) funding’, and ‘invoice discounting’, or ‘factoring’, to small and medium sized enterprises (SMEs). They argue that, in the US and the UK internet based provision of these forms of finance is expanding fast and could be delivered by mobile phones or computers in SSA, with or without bank participation i.e. banking without banks, as such. If they do not want to become dinosaurs, the mainstream banks should enter into partnerships with telcos, rather than trying to block the development of alternative and more efficient payments systems and associated financial services. The authors recommend that, to facilitate the development of banking on the back of mobile digital technology, information on credit standings should be gathered and shared by all market participants, under the supervision of central or development banks, to improve the quality of lending and assure fair competition. The authors suggest that where credit information and available collateral is sparse amongst micro and small enterprises, and lending is costly due to fixed costs effects, micro-finance institutions should be encouraged to enter the market and government backed loan guarantees should be provided to stimulate lending. They recommend that ‘growth enterprises’ require equity or ‘venture’ funding and appropriate tax incentives to providers of risk capital should be put in place. The paper indicates that venture or private equity funders will need to ‘exit’ to realise profits through ‘trade sales’ or stock market ‘initial public offerings’ (IPOs). Larger firms will increasingly seek to issue shares and bonds to raise capital and to facilitate this. Governments via central or development banks must foster the development of capital markets; which take time to earn a reputation for sound regulation and fair dealing and need established government securities markets to provide benchmark interest rates.

The second paper provides some insights on some of the factors that drive interest rate spreads of commercial banks in Kenya. The findings of the study show that bank-specific factors play a significant role in the determination of interest rate spreads, compared to macroeconomic factors such as real economic growth. These include bank size, liquidity risk, credit risk as measured by non-performing loans to total loans ratio, return on average assets, interest income as a ratio of total income and operating costs, all of which are positively associated with higher interest rate spreads except liquidity risk, that is, the ratio of bank’s liquid assets to total assets. On average, larger banks have higher spreads compared to smaller ones. The impact of monetary policy as captured by the policy rate

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is positive but not highly significant. The positive relationship between bank size and interest rate spread is a reflection of the market structure of the banking industry, which is highly skewed with the few large banks accounting for nearly more than one-half of the market share in terms of deposits and loans and advances. The paper indicates that although competition in the banking sector has increased over time, there is still more to be done, especially in terms of addressing market dominance. The authors suggest that efforts to lower interest rate spreads should encompass a mix of both industry-driven and policy-driven strategies. The former could possibly range from diversification of products to investment in efficient and cost-saving technologies.

The third paper extends the finance-growth literature by examining the causal relationship between insurance penetration and economic growth in Ghana. The authors find evidence to support the view that activities in insurance market development leads to economic growth in the long run. The authors find that insurance penetration has a positive long-run relationship with economic growth. Though both life and non-life insurance penetration exhibit positive long-run relationships with economic growth, non-life insurance penetration was found to have had a greater impact on economic growth compared to life insurance penetration. They find that disequilibrium in the short-run model with aggregate insurance penetration was corrected at a faster rate and the speeds of adjustment to long run equilibrium are 65.68% and 51.50% for models with life and non-life insurance penetration respectively. The findings of the study show that unidirectional causality run from aggregate insurance penetration, life and non-life insurance penetration to economic growth to support the ‘supply-leading’ hypothesis. The authors conclude that development of the insurance sector is an important factor in propelling the growth in the real economy. The findings of the study provide policy direction for the development of insurance market in Ghana and emerging economies.

The paper on bank finance and export activities of Small and Medium Enterprises (SMEs) seeks to ascertain whether SMEs’ access to bank finance promotes export activities in Ghana. In essence, the study proposes that SMEs with access to bank finance are more likely to be engaged in export activities. The authors indicate that SME access to bank finance may promote their export activities in the sense that such finance is critical to cater for the high fixed costs of exporting, international marketing and branding, and meeting higher quality standards that may be required for entering overseas markets. Banks also provide other value-laden services such as receiving payments, providing letters of credit, forecasts for foreign currencies and opportunities to hedge receipts and payments. that make it easier for an SME to enter the export market. The results of the study support the sunk cost hypothesis since bank finance aids SMEs to overcome the high sunk cost required to export and internationalize. The authors recommend that policy interventions should therefore be directed at reducing the bottlenecks that prevent SMEs from accessing bank funding. These interventions should be holistic and comprehensive in addressing both demand-side and supply-side constraints. Further tackling the institutional weaknesses that financial intermediaries face is suggested as a solution to improve the supply of loans to the SME sector. Priority areas include shortening the time required to enforce contracts. The authors suggest that, government funds to promote the SME sector may be channeled through banks since they can more efficiently administer such funds and charge economic rentals for the funds given out.

The penultimate paper examines the extent to which individuals’ attributes, such as socio-demographic factors, extent of education, income level, ICT inclination and financial discipline, explain access to, and use of bank services in Nigeria. The results of the study show that income level and ICT inclination of individuals have an effect on access to and use of bank services in Nigeria. Moreover, the age of an individual is found to contain explanatory power in the use of bank services. Given the significant effect that age exerts on access to, and use of bank services, the authors propose that policy actions that take cognizance of the ages of the individuals for which such policies are targeted would, on balance, enhance the use of bank services in Nigeria. As the central bank drive towards enhancing financial inclusion through the use of ICT, there is the need for a comprehensive policy, which considers the level of development (education, income and female inclusiveness), in relation to driving financial inclusion in Nigeria.

In the final paper, the authors examine various monetary policy strategies and trends in the key monetary indicators and measures of financial development. In terms of monetary policy outcomes, during the period under review, Ghana recorded its highest growth in M2+ (about 50%) immediately after joining HIPC in 2002. The growth in M2+ in recent years has slowed down with 2012 recording a growth rate of about 24.32%. Inflation, on the other hand, has seen a remarkable improvement averaging around 14.65% within the same period. The authors indicate that there has been steady improvement in the inflation rates, especially in the last three years, enabling Ghana to achieve one of the West African Monetary Zone (WAMZ) convergence criteria of attaining single-digit inflation, albeit briefly. The authors, however, indicate that given the direct relationship between inflation and interest rates, it is puzzling to note that interest rates are still high; particularly lending rates and those real saving rates were negative from 1999 until only recently. The survey touched on several recent developments in the financial sector of Ghana, including but not limited to Universal Banking, Payment System Bill, redenomination of the Ghanaian currency, the Foreign Exchange Act (Act 723) and the new minimum paid-up capital of banks and non-bank financial institutions. These initiatives have contributed to the growth in the banking and non-banking financial subsectors of the economy in terms of their numbers and innovative products and services. The number of banks and non-bank financial institutions has also increased although the degree of competition has not changed significantly with interest rate margins still high. The authors argue that while there have been significant improvements in the monetary indicators it appears the lack of fiscal discipline has eroded some of the gains from the monetary policies and strategies. Thus, maintaining a stable macroeconomic environment that ensures the monetary aggregates are within growth-optimizing limits is fundamental to sound financial sector development. The authors argued that, despite the decline in policy rates and inflation rates during the period under review, lending rates remain high and this is stifling private business. This is compounded by government domestic borrowing from the banking system, thus severely affecting the cost of credit and crowding out the private sector. Policies aimed at reducing governments competing with the private sector for bank credit, and measures aimed at improving financial intermediation and bank competition are thoroughly discussed in the paper.

Content:

Guest Editors:

Joshua Yindenaba Abor
University of Ghana Business School, Legon, Ghana
Paul Alagidede
Wits Business School, University of the Witwatersrand, Johannesburg, South Africa
Matthew Kofi Ocran
Nelson Mandela Metropolitan University, Port Elizabeth, South Africa
Charles K.D. Adjasi
University of Stellenbosch Business School, Cape Town, South Africa