Financial Services

Into Africa: Investment prospects in the sub-Saharan banking sector*

*connectedthinking

PricewaterhouseCoopers

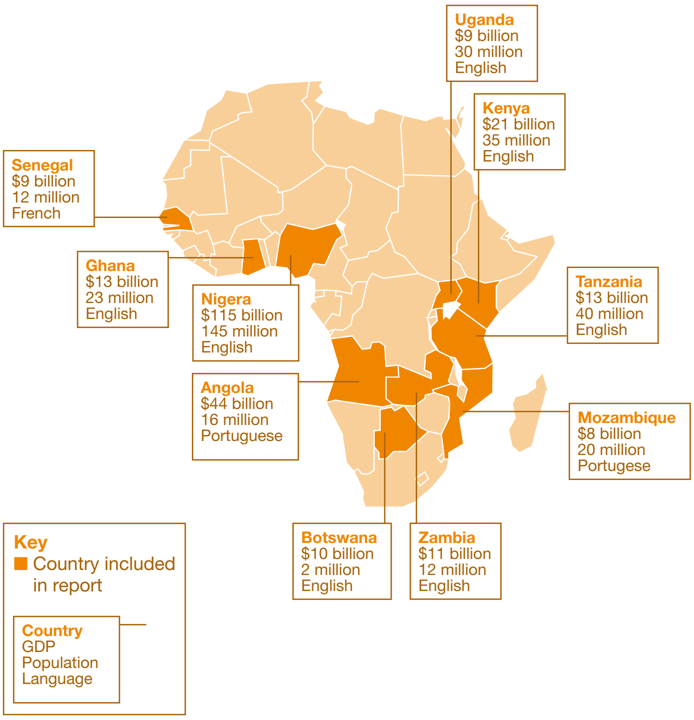
Introduction

Once seen as unpromising and overly risky, sub-Saharan Africa is now one of the world's fastest growing emerging banking markets and an increasingly sought-after investment destination.

Economies are expanding rapidly on the back of soaring oil and mineral prices, while steadily increasing consumer affluence is creating fresh demand for banking services. M&A activity has been growing as groups seek to increase their strategic coverage and tap into this demand.

This flyer, prepared by PricewaterhouseCoopers'[1] professionals from around sub-Saharan Africa, looks at the prospects for investment and development in the region. It focuses in particular on what, after South Africa, are the region's 10 largest economies. South Africa's economic size (more than all 10 featured countries, put together) and advanced market development would make it the subject for a separate report and is therefore not covered directly in this publication.

Countries included in the flyer



Source: International Monetary Fund and CIA World Factbook.

Overview

- Africa's economy set to expand by 6.2% in 2008,[2] buoyed by high commodity prices, along with increasing liberalisation and commercial diversification. Oil producing states are set for especially exceptional growth
- Regional banking markets are expanding rapidly as commerce grows and incomes increase. Banking assets in Nigeria, the largest of our featured countries, are growing at more than 30% per annum (see Figure 2 on page 5)
- In the past, poor infrastructure and limited branch networks have restricted access to banking services, especially in rural areas (most featured countries have barely one branch per 50,000 people – see Figure 5 on page 7). Now, banks are investing in the development of distribution. This includes both new branches and innovative mobile/e-banking strategies that bring hard-to-reach customers into the banking orbit
- While organic development is an option, it can take many years to develop competitive scale. Acquisition may provide faster market entry and development, yet prices can be high
- International groups already have a strong presence in several leading regional markets. Recent acquisitions by leading groups such as Barclays and Standard Bank have heralded the onset of a fresh wave of investment (see Figure 11 on page 12)

1 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.
2 'Economic Report on Africa 2008', published by the United Nations Economic Commission for Africa and the African Union on 2.4.08.

Investment environment

Sub-Saharan Africa is experiencing an economic resurgence.

Africa's GDP more than doubled between 2000 and 2006[3] and its economic momentum continues to gather pace. GDP grew by 5.8% in 2007 and is set to increase by 6.2% in 2008.[2] Central Africa has experienced the fastest acceleration in economic expansion,[3] with growth expected to rise from 3.9% in 2006 to 6.3% in 2008, although this generally remains the most underdeveloped of Africa's regions. Of the 10 countries expected to record the fastest GDP growth in the world in 2008, three are from sub-Saharan Africa, including Angola at number one.[4]

The main driver of sub-Saharan Africa's economic resurgence is the rising prices and global surge in demand for oil and minerals, especially from the rapidly developing Asian economies. Angola and Nigeria are major oil exporters and their respective economies are expected to grow by 21%[5] and 7%[6] in 2008 (growth in oil-producing countries has been around 1% ahead of the overall African average[7]). Botswana, Zambia and Mozambique benefit from the export of diamonds, copper and aluminium, respectively.

The resurgence also reflects the increasing development and diversification of the sub-Saharan economies in areas ranging from telecommunications to tourism. Mobile phone penetration in Africa more than doubled between 2001 and 2006 and is now around 25% of the population,[8] paving the way for the rapid development of mobile banking (see page 6).

Sub-Saharan tourism is growing at around 10% per annum (Kenya and Uganda by more than 15% pa), bringing in $24 billion in receipts in 2006 and making this the fastest growing region for tourism in the world.[9] Receipts are still only 3% of the global total and therefore there is considerable room for further growth, although considerable infrastructure development may be needed to achieve the full potential.

Further stimulus for economic expansion is set to come from the fast growth in the region's population (the population of sub-Saharan Africa is projected to grow from around 760 million in 2008 to 1.7 billion in 2050 – one of the fastest regional growth rates in the world[10]), raising demand and ensuring a sustained increase in the supply of available labour.

The region's improving prospects have been underpinned by growing political stability, including the cessation of civil conflicts (notably Angola in 2002) and consolidation of democracy within many parts of the region. Many governments have also instituted more effective macro-economic management and taken steps to open up and improve the efficiency of commercial markets (the region recorded the largest improvement in the pace of reform of the business climate between 2002 and 2006, according to the World Bank[11]). Programmes of reform include the growing liberalisation of the banking sector within many states.

These increasingly buoyant prospects are attracting increasing foreign direct investment (FDI) (see Figure 1 on page 4). China is a key source of investment in the development of oil and mineral extraction and related infrastructure as it seeks to secure supplies of strategic natural resources. Hu Jintao, the President of China, announced preferential credit of some $3 billion during his visit to Africa in 2007.[12]

The Sino-African partnership has now extended to banking following the $5.5 billion acquisition of a 20% stake in Standard Bank by the Industrial and Commercial Bank of China (ICBC).[13] Jacko Maree, Standard Bank Group Chief Executive described the deal as not only a 'vote of confidence' in South Africa, Standard's home market, but Africa as a whole (Standard offers services in 17 African states[14]). 'The partnership establishes a financial services gateway between Africa and China, through an alliance of the largest banks in these regions', said Mr Maree.[15] Africa is now also on the private equity radar, drawing more than $3 billion in investment in 2007, with global emerging market funds deploying around 10% of their portfolios on the continent.[16]

The asset value of banks in our 10 featured countries has increased rapidly on the back of economic expansion (see Figure 2 on page 5), with Nigeria leading the way. Yet, market development is building up from an extremely low base, as measured by the bank asset to GDP ratio in comparison to South Africa (see Figure 3 on page 5). The total bank assets in our 10 featured countries are still less than that of South Africa's Standard Bank ($175 billion[14]).

2 'Economic Report on Africa 2008', published by the United Nations Economic Commission for Africa and the African Union on 2.4.08.
3 'Africa records fastest acceleration of growth in two decades', published by African Development Bank, 14.5.07.
4 Economist Intelligence Unit projection, 19.12.07.
5 Economist Intelligence Unit projection, 4.4.08.
6 Economist Intelligence Unit projection, 5.4.08.
7 'Economic Report on Africa 2007', published by the United Nations Economic Commission for Africa on 4.4.07.
8 World bank 'Africa Development Indicators 2007'.
9 United Nations World Tourism Organisation 'Highlights 2007'.
10 International Union for the Scientific Study of Population, 'Population growth and human welfare in Africa (2006–2009)'.
11 'Accelerating development outcomes in Africa – progress and change in the Africa Action Plan', a report published by the World Bank on 23.4.07.
12 New York Times, 30.1.07.
13 Standard Bank media release, 27.10.07.
14 The Banker, July 2008.
15 Joint presentation by ICBC and Standard Bank to mark the announcement of their strategic partnership, 25.10.07.
16 'Africa: An emerging markets frontier', a report published by the OECD Development Centre on 10.12.07.

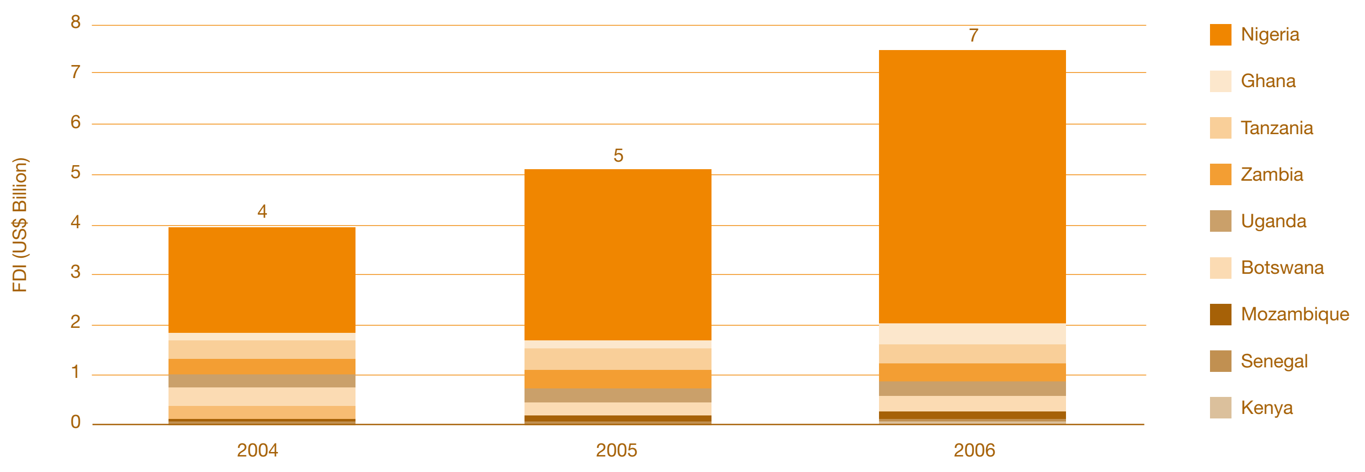
While the still largely untapped potential is evident, sub-Saharan Africa faces considerable economic risks and challenges. While diversifying, many countries are vulnerable to any sustained fall in the price of commodities, although demand is likely to remain robust as Asian manufacturing continues to expand. Inflationary pressures could also continue to mount, especially in large oil exporting countries – more than half of Africa's countries have inflation of more than 5% pa (more than 60% of Africa's oil producers have inflation of more than 5% pa).[17]

Political stability remains fragile, as the contested elections in Kenya, Nigeria and Zimbabwe attest. Corruption remains a concern. Of our 10 featured countries, five scored less than three out of 10 in the latest Transparency International Corruption Perception Index and three between three and four (Ghana, Senegal and Tanzania).[18] The notable exception is Botswana, which at 5.4 is ahead of South Africa and several EU states. In recent years, a number of high-profile cases have also highlighted the risk of fraud, both of and within the banking sector, ranging from the sale of bank details retrieved from recycled computers[19] to allegations of collusion in money laundering by corrupt officials.[20]

Poor infrastructure can raise production costs and make it harder to reach customers. Businesses can be further hampered by high tariffs, red tape, cumbersome tax systems and arbitrary decisions by officials.

Sub-Saharan Africa also continues to grapple with the impact of climatic volatility and health issues, including HIV/AIDS (22.5 million people in the region live with the virus,[21] although prevention campaigns and anti-retroviral treatment are beginning to slow down the increasing incidence). These issues inhibit development, especially among the poorest sections of the population. For banks and other employers, there is also the high potential cost of healthcare and sick leave.

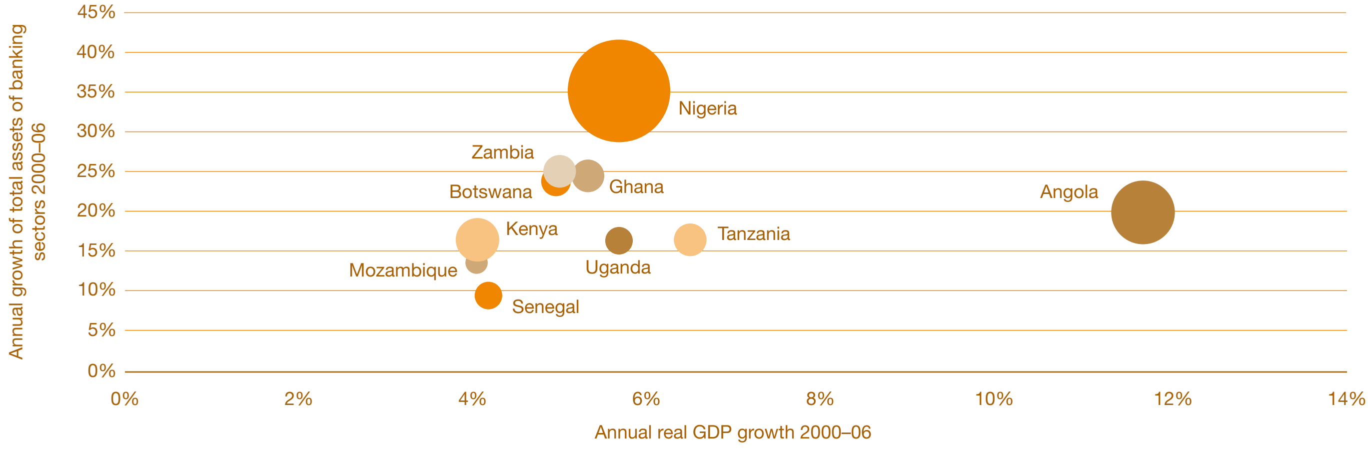
Figure 1 – Foreign direct investment, 2003–2006



Source: CIA World Factbook.

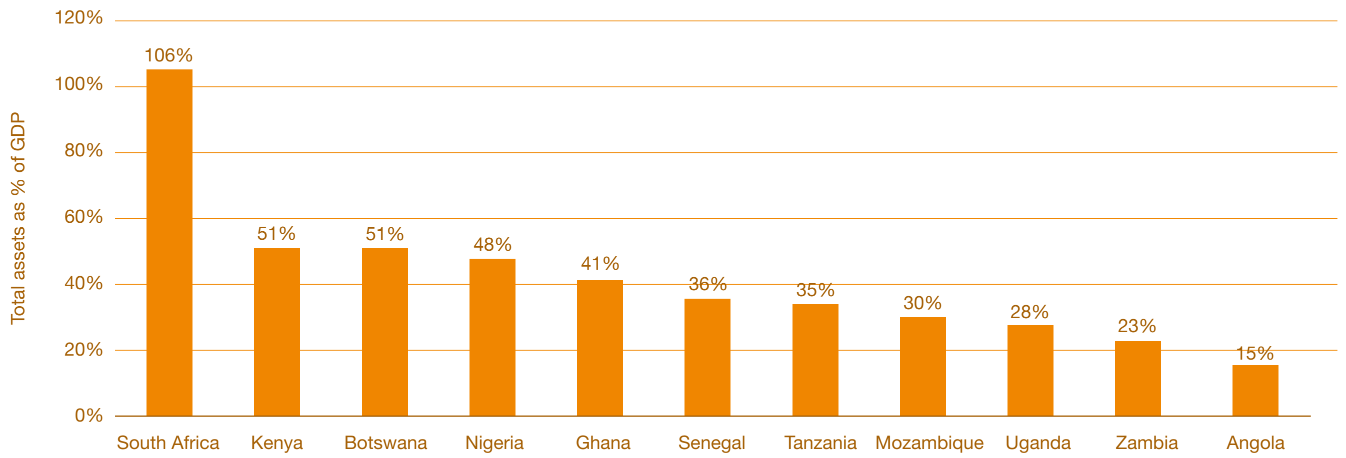
17 'Economic Report on Africa 2008', published by the United Nations Economic Commission for Africa and the African Union on 2.4.08.
18 Transparency International 'Corruption Perception Index 2007'.
19 'UK bank details sold in Nigeria', BBC News Online, 14.8.06.
20 Global Insight, 17.12.07.
21 UNAIDS (www.unaids.org), 4.4.08.

Figure 2 – GDP growth vs banking asset growth (bubble size = GDP 2006)



Source: PricewaterhouseCoopers analysis.

Figure 3 – Total banking assets as percentage of GDP (2006)



Source: Finscope and PricewaterhouseCoopers analysis.

Market Environment

The banking sector is growing rapidly, albeit from a low base.

Penetration

Apart from Botswana, the penetration of banking in our featured countries is low in comparison to the more developed South Africa (see Figure 4 on page 7), indicating the potential for growth as incomes increase in the wake of rapid economic growth. At present, many people still rely on micro-credit or informal lending and have no bank account in what remain largely cash-based societies, even among relatively wealthy citizens.

Low penetration is partly a result of income levels, although an increasingly affluent urban middle class is now emerging. The low proportion of people with bank accounts also reflects infrastructure problems that have resulted in the limited development of branch networks, especially within remote rural areas. Few countries are served by more than two branches per 100,000 people (see Figure 5 on page 7).

The potential size of the bankable population can be estimated by looking at the number of people who can afford financial services (the Finmark Trust, a think-tank, sets a benchmark of 2% of income for affordable banking[22]). By this reckoning, there are between 40 and 60 million potentially bankable customers in sub-Saharan Africa.

Branch expansion to tap into this potential is accelerating, both through the development of fixed and mobile offices. In Nigeria, for example, local banks taking part in a 2007 PricewaterhouseCoopers survey estimated that the number of branches would double by 2010 and automated teller machines (ATMs) increase from less than 2,000 to more than 5,000.[23] In Ghana, Barclays is targeting more than 150 branches by the end of 2008, an increase of 100% from 2006.[24]

Further distribution potential is coming from the rapidly increasing take-up of mobile phones. A number of mobile providers have established alliances to facilitate payments, withdrawals and money transfers via short message service (SMS). Services are available to people, even if they do not have a formal bank account. A pioneering example is M-PESA, a joint venture between Kenyan mobile phone operator Safaricom and Vodafone, with worldwide remittances facilitated by Citibank.[25]

E-banking also offers considerable potential. In 2006, more than 20 of Nigeria's banks issued InterSwitch debit cards, which enable users to undertake e-payments and other online transactions. More than two million cards are now in circulation.[23]

Demand

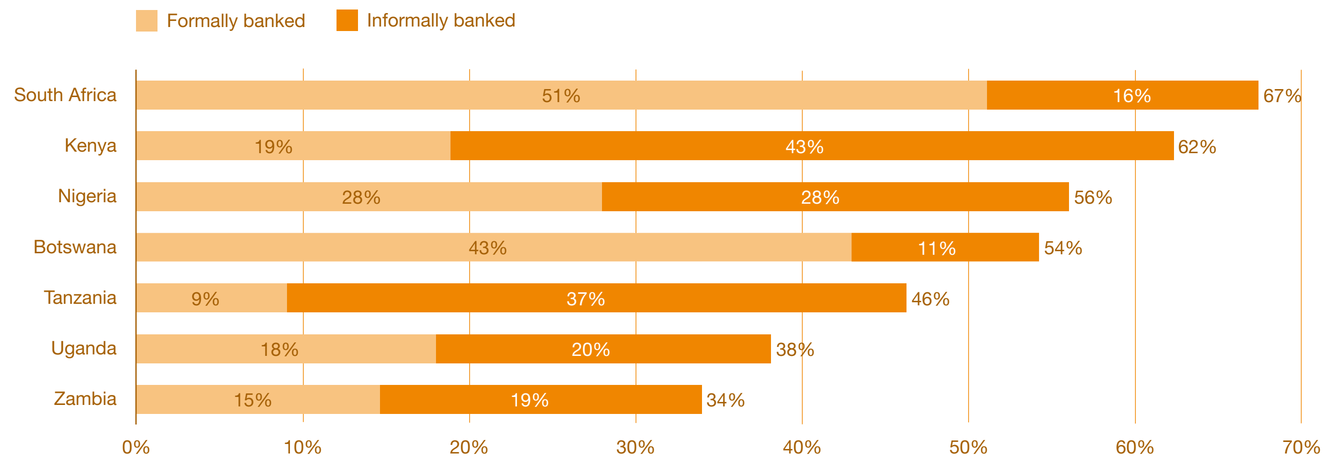
Although retail banking services were until recently quite limited across sub-Saharan Africa, local banks are now responding to increasing consumer demand. As incomes rise, consumers are seeking to move away from reliance on cash to the greater security and convenience of a bank account. A nascent market in mortgages and consumer loans is also developing. The untapped potential is indicated by the fact that the credit to GDP ratio is 18% in Africa, compared to some 30% in South Asia; in Angola it is less than 5%.[26] A further source of demand is international money transfer. Remittances to and within sub-Saharan Africa reached $30 billion in 2007.[27]

Stock market expansion is creating increasing demand for broking services, much of which is met by banking groups. In Nigeria, for example, banks control around two-thirds of trading activity by value.[28] Economic growth is also driving the expansion and development of corporate banking, particularly in the areas of project finance and letters of credit.

Overall, however, both retail and corporate banking are at a relatively early stage of development, offering international groups the opportunity to leverage both their expertise and capital. Brand and reputation rather than personal relationships tend to be the determining factors in choosing a provider, which could give strongly branded international groups an advantage in entering and developing their presence. Importantly, their brand and reputation could also help to attract the best staff at a time when competition for qualified personnel is increasing.

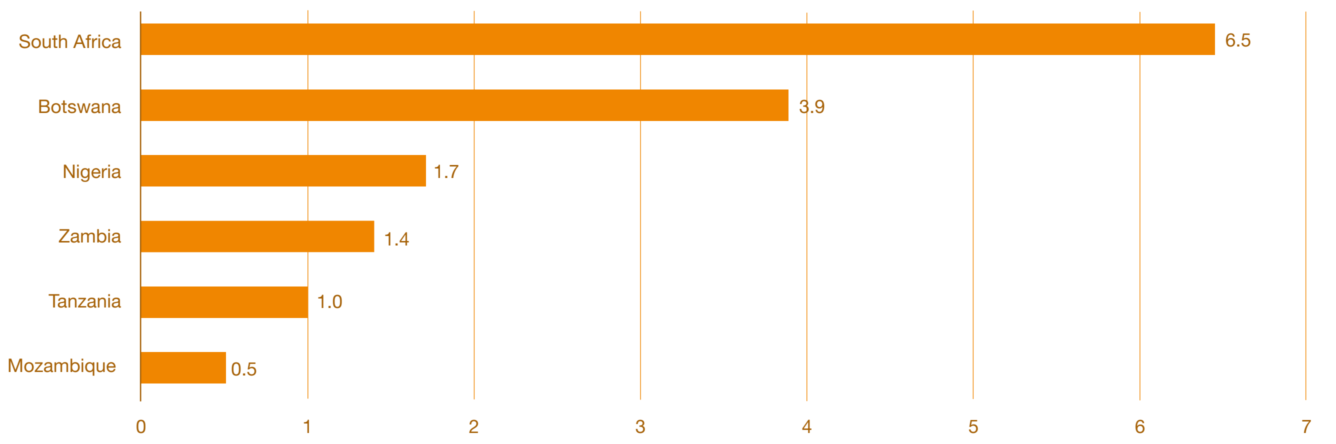
22 Finmark Trust (www.finmarktrust.org.za).
23 'Initial perspectives on strategic and emerging banking issues in key African markets', a survey report published by PricewaterhouseCoopers on 26.6.07.
24 PricewaterhouseCoopers analysis.
25 Citibank media release, 12.2.07.
26 Economist, 15.11.07.
27 International Fund for Agricultural Development 'Remittance Forum', updated 1.4.08.
28 Global Banking News, 7.12.08.

Figure 4 – Financially served adult population 2006



Source: Finmark Trust and PricewaterhouseCoopers analysis.

Figure 5 – Number of bank branches per 100,000 people



Source: PricewaterhouseCoopers analysis.

Number of banks

The high number of banks operating in each country reflects the relative fragmentation of these markets (see Figure 6), although the top end of the market is often more concentrated. The impact of regulatory developments and increasing competition could begin to reduce the number of banks, as has already proved the case in Nigeria.

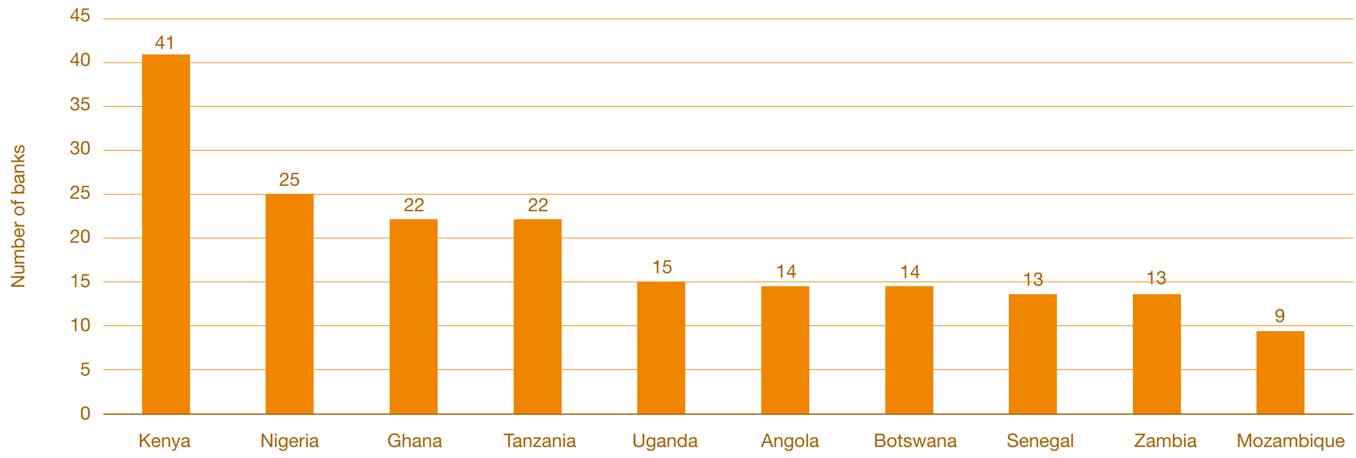
Regulation and liberalisation

Banking sectors are benefiting from market reform. Nigeria led the way by raising the minimum capital requirement to $200 million, leading to rapid consolidation (from more than 80 banks to some 25 in 2007).[29] Streamlined, better capitalised and with more extensive reach, Nigerian banks have been able to enhance their services and are in a better position to compete and meet customer demands, while seeking to develop their international presence, both within the region and overseas. Other states may follow Nigeria's lead, though at present their minimum capital requirement is generally below $10 million.

As Figure 7 (on page 9) highlights, South African and Nigerian institutions now dominate the list of largest banking groups based in the sub-Saharan region (certain international groups such as Barclays and Standard Chartered also have a strong presence).' In all of the countries featured, a legal framework for the financial sector (including banking law) is or is in the process of being put in place (eg Zambia). All, apart from Uganda, Zambia and Mozambique, have moved to IFRS. Moreover, state holdings and restrictions on foreign investment are limited, especially in comparison to many emerging markets in Asia. However, as Figure 8 (on page 10) highlights, the degree of commercial freedom within the banking sector varies. In Kenya, no person is permitted to hold more than 25% of a bank's capital. In Uganda, no individual or corporate body controlled by a single individual can own more than a 49% stake in a financial institution. In Angola, foreign investment was until recently restricted to a few Portuguese groups, although the market is now gradually opening its doors.

As Figure 9 (on page 10) highlights, profitability in 2006 was relatively healthy, considering that quite a number of banks had recently listed and were still putting their newly raised funds to work. The relatively low return on equity (ROE) in Nigeria and Kenya reflects a significant injection of new equity capital through IPO and private placements. In terms of asset, deposit and profitability growth, the performance is more impressive. Assets in the Kenyan banking sector grew by 20% in 2007, deposits by 18% and profits by 34%,[30] for example.

Figure 6 – Number of commercial banks, 2006



Source: PricewaterhouseCoopers analysis.

29 'Initial perspectives on strategic and emerging banking issues in key African markets', a survey report published by PricewaterhouseCoopers in 26.06.07.
30 Central Bank of Kenya Annual Report 2007 and Monthly Economic Review, December 2007.

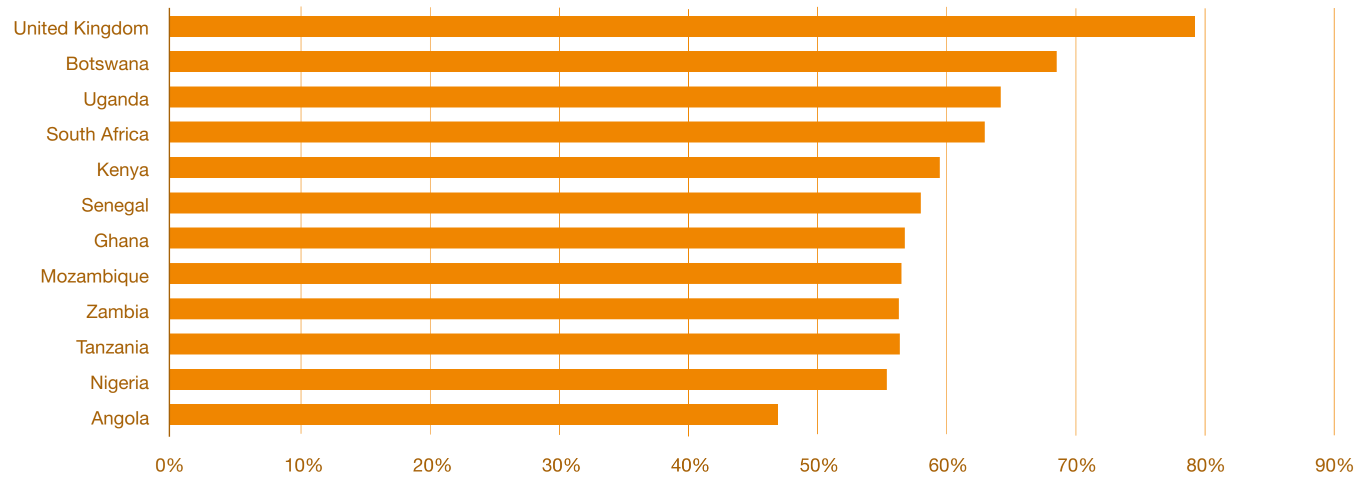
Figure 7 – Top 15 banking groups (by assets) based in sub-Saharan Africa

All figures US$ million

Bank name	Headquarters	Assets	Pre-tax profit
Standard Bank Group (31.12.07)	South Africa	174,920	3,523
FirstRand Banking Group (30.6.07)	South Africa	76,901	2,010
Nedbank (31.12.07)	South Africa	71,454	1,319
Investec (31.3.07)	South Africa	46,813	835
Intercontinental Bank (28.2.08)	Nigeria	11,781	377
Access bank (31.3.08)	Nigeria	10,055	160
United Bank for Africa (30.9.07)	Nigeria	9,479	202
Oceanic Bank (30.9.07)	Nigeria	8,265	183
Zenith Bank (30.6.07)	Nigeria	8,716	202
First Bank of Nigeria (31.3.07)	Nigeria	6,885	192
Ecobank Transnational (31.12.07)	Togo	6,550	191
Guaranty Trust Bank (29.2.08)	Nigeria	6,225	232
Union Bank of Nigeria (31.3.07)	Nigeria	5,460	136
Mauritius Commercial Bank (30.6.07)	Mauritius	3,479	98
Platinum-Habib Bank (30.6.07)	Nigeria	3,001	81

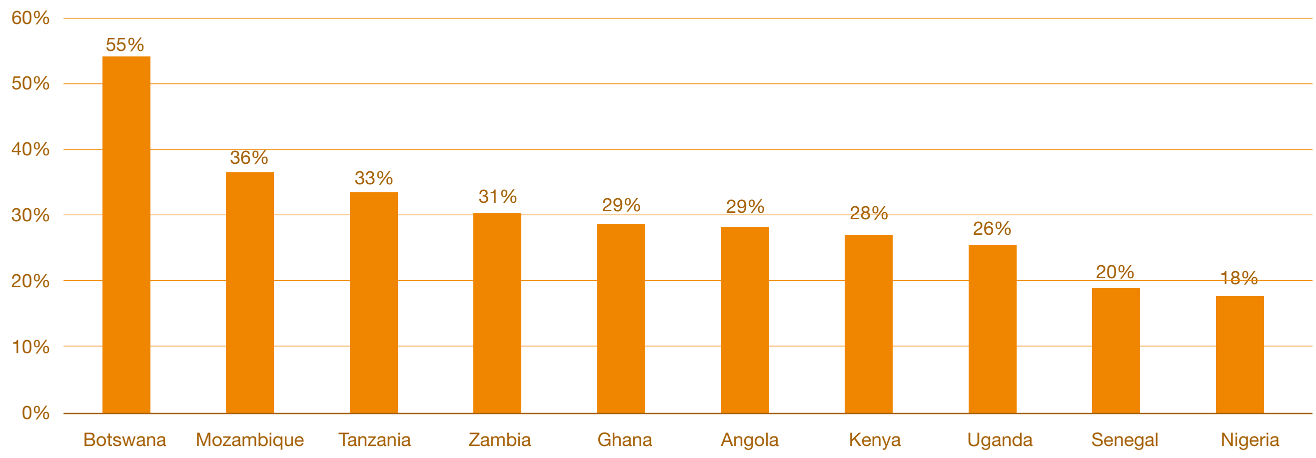
Source: The Banker, July 2008 and annual reports.

Figure 8 – The Heritage Foundation Index of financial sector feedom



Source: Heritage Foundation.

Figure 9 – RoE 2006



Source: Banking supervisory reports and national banking associations.

Foreign investment

International and regional groups are looking to strengthen their footprint as scale becomes an ever-more important competitive advantage.

As Figure 10 (on page 12) highlights, international groups have already developed a strong presence in a number of our featured countries, with associations often rooted in linguistic and former colonial ties. With the exception of Nigeria, Barclays is strongly represented in the English-speaking countries, for example; French banks including BNP Paribas and Credit Agricole have a strong presence in many Francophone countries such as Senegal; Portuguese banks including Formento and Millennium BIM are active in Angola and Mozambique.

The region's economic resurgence has been the catalyst for a renewed wave of cross-border investment (see Figure 11 on page 12). Key sources include international groups and African banks looking to develop a stronger regional/continental presence, along with a number of financial buyers. Local institutions are keen to attract foreign capital and know-how, especially the product and risk management expertise needed to develop retail and SME services.

In 2007, Barclays acquired Nile Bank, Uganda's seventh largest bank. 'The combination sees the scale and global capability of Barclays coming together with the local retail and regional expertise of Nile Bank. Nile Bank customers will be able to take advantage of Barclays' comprehensive world-class range of services, products and capabilities, both here, across Africa and beyond', said Nick Mbuvi, Managing Director of Barclays Bank of Uganda.[31]

Strong regional players seeking to strengthen their footprint include Standard Bank, which acquired a controlling stake in Nigeria's IBTC Bank in 2007. Craig Bond, Chief Executive of Standard Bank Africa, said that 'Standard Bank is proud to add Nigeria to its repertoire of success stories'.[32]

In 2007, Standard took control of CFC Bank in Kenya and merged it with its local subsidiary. CFC is a medium-sized, primarily corporate-focused bank. 'Large corporate and institutional deals will be enabled through the improved technical support and the global market distribution capabilities of Standard Bank Group, which will be sustained by the larger balance sheet of the merged businesses', said a CFC media statement outlining the rationale for the deal.[33]

One of the most interesting developments is Ecobank's acquisition of a controlling stake in EABS of Kenya. Ecobank, which is active in most West African states, has ambitions to be a pan-African bank. 'Our vision is to become the largest bank in Africa and our entry into East Africa is part of that strategy. We have been looking for a partner who will be able to give us a countrywide footprint in Kenya, which is the most important financial hub in the region – we feel that EABS Bank fits the bill', said Michael Monari, Ecobank's Kenya representative. 'The African banking landscape is undergoing change and only banks with a pan-African footprint will remain competitive.'[34]

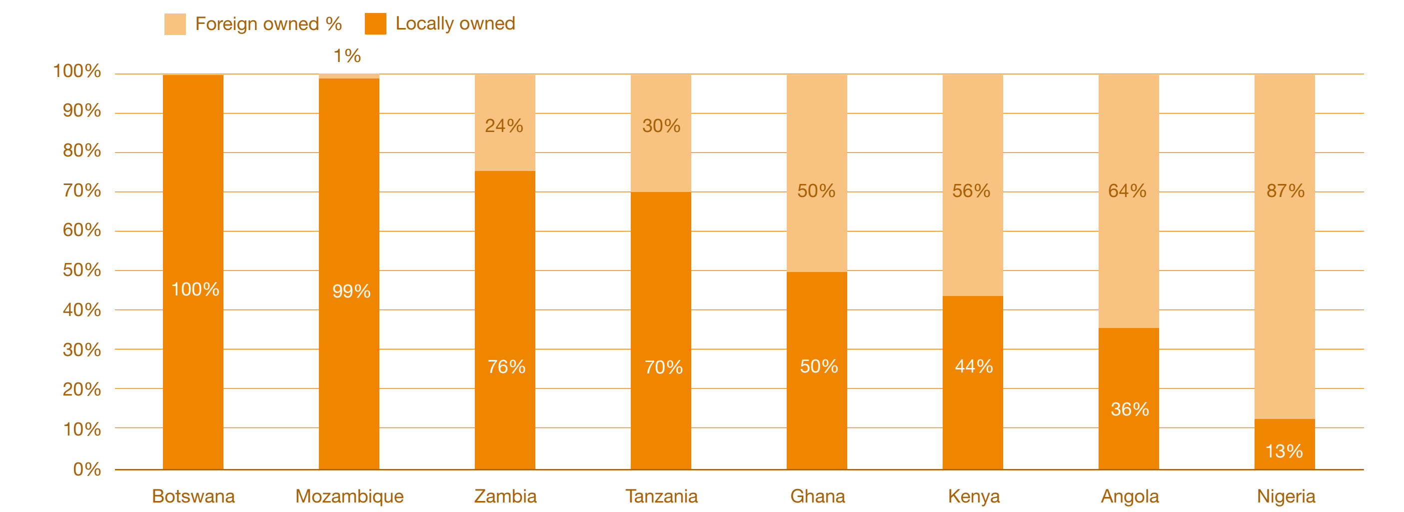
Greenfield development is an alternative option. Standard's expansion plans include seeking a licence as part of a reported move into Angola,[35] for example. However, developing the necessary branch network to achieve competitive scale can take many years. In an interview with the Ghanaian Chronicle in 2007, Craig Bond said that the group would not be able to reach the scale it needed in many of its target markets through organic growth alone. 'A lot of our growth strategy has to be acquisitive', he said.[36]

In what is still a relatively under-developed market, an acquirer would have considerable freedom to select target markets and develop an innovative operating model without the encumbrances of legacy systems and practices. However, investors need to weigh the benefits of acquisition against the cost and potential availability of suitable targets. Increasing recognition of the growth potential, along with deal size and control premium considerations, have led to price-to-book ratios of between five and seven.

Potential buyers will need to develop a strong relationship and agreement on shared objectives with both the target and the local regulator – despite the relative openness to foreign investment, a predatory takeover would be virtually inconceivable. They will also generally need to be closely involved in the development of strategies for transformation and growth in areas ranging from HR to service and product enhancement. The transfer of expertise is likely to include bringing in managerial and technical personnel from more established markets.

31 Barclays Bank media release, 27.2.07.
32 Standard Bank media release, 31.3.08.
33 CFC media release, 22.6.07.
34 Ecobank/EABS media release, 27.1.08.
35 Reuters, 30.1.08.
36 'Initial perspectives on strategic and emerging banking issues in key African markets', a survey report published by PricewaterhouseCoopers on 26.6.07.

Figure 10 – Share of total assets held by foreign banks



Source: PricewaterhouseCoopers analysis.

Figure 11 – Significant foreign investments in 2007 and 2008 to date

Announced	Target Company	Bidder	Stake %	Price ($m)
2008	EABS (Kenya)	Ecobank Transnational (Togo)	75.00	–
2008	Loita Bank (Malawi)	Ecobank Transnational (Togo)	73.00	
2008	Uganda Microfinance (Uganda)	Equity Bank (Kenya)	100.00	25.0
2007	IBTC (Nigeria)	Standard Bank (South Africa)	33.30*	620.0
2007	Equity Bank (Kenya)	Helios Investors	24.90	176.0
2007	Compagnie Bancaire de L'Afrique Occidentale (Senegal)	Attijariwafa Bank (Morocco)	79.15	
2007	CFC Bank (Kenya)	Standard Bank (South Africa)	60.00*	273.0
2007	Investment & Mortgages Bank (Kenya)	Consortium including PROPARCO and DEG Bank, Germany	12.00	5.6
2007	BDC (Mozambique)	First National Bank (South Africa)	80.00	18.5
2007	Intercontinental Bank (Nigeria)	Consortium including Vectis Capital, EMP Africa Fund, AIG Capital Partners	12.40	161.0
2007	Diamond Bank (Nigeria)	Actis Capital LLP	19.10	134.0
2007	Zambia National Commercial Bank (Zambia)	Rabobank (Netherlands)	49.00	
2007	Nile Bank (Uganda)	Barclays Bank (UK)	100.00	–
2007	Banque Internationale pour Centrafique (Central African Republic)	Ecobank Transnational (Togo)	75.00	5.7
2007	Bank of Commerce, Development and Industry (Rwanda)	Ecobank Transnational (Togo)	90.00	11.7

* Holding merged with existing national subsidiary – percentage is share in merged entity.
PricewaterhouseCoopers provided transactional support for seven of the deals listed.
Source: M&A Global and company announcements

Future prospects

Demand for banking services is likely to expand and become more sophisticated as economies move up a gear and wealth begins to permeate a growing consumer class. Banks are enhancing their product and distribution capabilities to tap into this expanding market. Market development is likely to include both branch and more innovative mobile/e-banking strategies.

Acquisition offers the fastest way to develop a competitive presence in local and regional markets. Now is still a good time to secure a share of this exciting growth, but potential buyers need to move reasonably quickly. Prices are already high and could conceivably increase still further, while the choice of suitable targets may decline as interest and acquisition accelerate. International groups are set to face ever-stronger competition for the most attractive opportunities from ambitious regional and pan-African players.

While much of the investment to date has sought to deliver a fairly quick financial payback, the scale of the necessary investment in acquisition and market development is likely to grow and require a more long-term strategic approach in securing a favourable return. This includes sustained investment in product and talent development.

Naturally, investors need to consider the risks of a still volatile and poorly developed region. Yet, the potential rewards certainly merit a fresh look and could make investment ultimately worthwhile.

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- Going for growth: The outlook for mergers and acquisitions in the financial services sector in Asia (2006)

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