

CHAPTER 3

ACCESSING FINANCING
FROM THE CORPORATE
BANKING SECTOR
IN AFRICA



Most financing mechanisms in Africa are bank-based, and banks are a major source of innovative financing in Africa. By expanding the breadth of financing instruments and enhancing financial inclusion, innovations in retail and corporate banking provide opportunities for borrowers and savers alike, enabling the private sector to improve economic prospects across the continent.

The retail and corporate banking sector in Africa holds more than 90 per cent of the assets in the financial sector. But Africa's banking sector is comparatively underdeveloped when benchmarked against those in emerging market economies in Asia and other industrializing economies. Its assets represent less than 60 per cent of GDP on the continent, compared with more than 100 per cent in other emerging and advanced economies. Addressing the huge financing gap for the private sector and infrastructure development will require more innovative financing solutions in the retail and corporate banking sector.

Despite an overall increase in banking activities, bank financing to the private sector remains low and ill-tailored to the needs of private firms. For example, more than 90 per cent of bank loans are short- to medium-term. Private sector access to financing is impeded by government dominance of banking credit and difficult access for small and medium-sized enterprises (SMEs) and for key sectors of the economy.

Over the past two decades, the banking sector has changed fundamentally in many African economies. Pan-African banks now conduct business in multiple countries. The African banking sector has also made significant advances in mobile banking and marketplace lending, connecting unserved and underserved communities to the financial sector. The resilience and continued development of the banking sector (especially in the face of external shocks or crises such as COVID-19) offer the promise of more progress to come, enabling banks to provide needed funding, to channel savings into investments and to participate more actively in the formal economy.

AN OVERVIEW OF RETAIL AND CORPORATE BANKING

At the time of political independence, most African banks engaged mainly in traditional financial practices, operating as financial intermediaries transferring flows of funds from short-term deposits (from savers) to longer-term borrowers. Traditional banks generally serve two groups of customers: retail (individual) customers and corporate customers. This report focuses largely on corporate banking and the products and services available to the private sector.

The retail and corporate banking sector is a crucial source of funding for private sector investment. According to pecking-order theory, firms prefer sources of finance that dilute ownership and profitability the least. Thus, firms turn first to retained earnings and cash on hand, which have no inherent cost and do not change the ownership structure of the firm. If there are not enough internal funds, firms seek debt funding before turning to equity funding; debt funding leaves the ownership structure of the firm unchanged, and interest expenses are generally regarded as cheaper than the cost of equity, especially because interest expenses are often tax deductible. As a last resort, firms issue equity and dilute ownership in the company to secure funding.

Firms in Africa report that access to financing remains a key constraint to firm entry and growth, second only to a reliable source of electricity (see [CHAPTER 2](#)). Large firms tend to benefit more from bank financing than do SMEs, as their track record and scale reduce their risk profile. Smaller, newer companies and those in the informal sector often face higher borrowing costs, if they are able to borrow at all.

CURRENT FINANCING MECHANISMS FOR BUSINESS FIRMS

Most bank loans to the private sector are short- to medium-term in tenor. Often, however, businesses need financing for longer-term projects, such as to purchase fixed assets or property to expand capacity. Common loan types are shown in [TABLE 3.1](#).

HOW FIRM SIZE AFFECTS ACCESS TO FINANCING

Firm size can have pronounced effects on access to financing. Large companies are more likely to get loans and more likely to get favourable terms. SMEs can be effectively shut out of bank financing.

When considering a loan application, banks look at a variety of factors—reputation and credit history of the firm, management, ability to repay the loan, industry and current capital structure. A small business with little track record of profitability or a highly indebted firm is less likely to get favourable terms. Thus, bank financing tends to favour larger businesses with histories of profitability (American Express, 2019).

The psychology of management can also affect a firm's ability to access financing. Lines of credit are among the most common forms of bank financing because they give firms the flexibility to use cash most efficiently, without having to worry about the cash balance to fund working capital. The low interest rates are especially attractive for firms that can qualify. According to the World Bank Enterprise Survey (2019) database, 40 per cent of large companies have a line of credit or loan from a financial institution. The proportion drops to 26 per cent for medium-size companies and to 13 per cent for small companies ([FIGURE 3.1](#)). The higher proportion of large companies with access to finance may also be partly explained by their higher rate of loan applications, with 30 per cent of large firms applying for loans compared with 15 per cent of small firms.

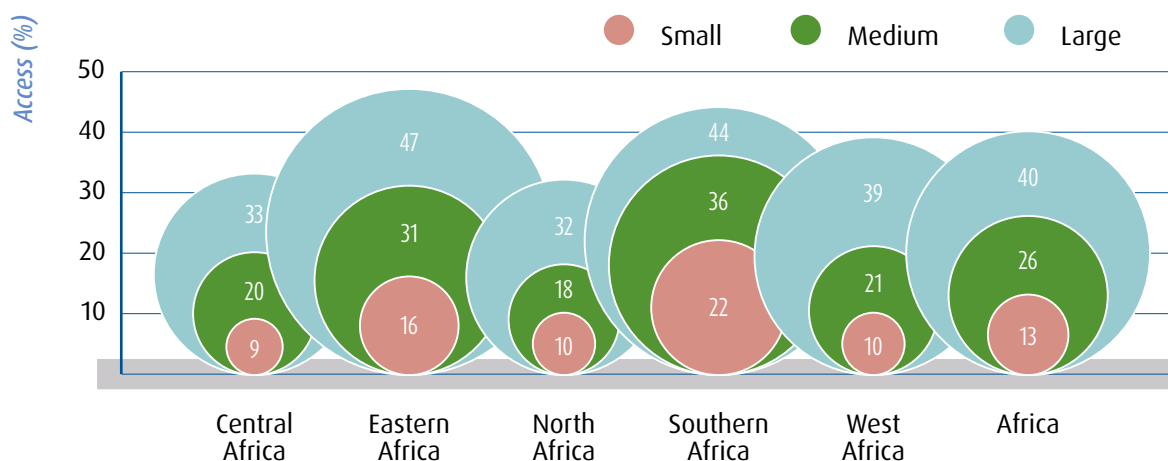
Most companies do not apply for a credit line or a loan because they do not need one (49 per cent) or because the application procedures are too complex (13 per cent), interest rates are unfavourable (16 per cent) or collateral requirements are too high (10 per cent).

TABLE 3.1 OVERVIEW OF MAJOR TYPES OF FINANCING MECHANISMS FROM BANKS

LOAN TYPE	LOAN TENOR	DESCRIPTION
Commercial loan	Short-term	<ul style="list-style-type: none"> Generally requires collateral. Not typically used by smaller businesses.
Term loan	Variable	<ul style="list-style-type: none"> Has a pre-specified payment plan. Can have varying rates.
Lines of credit	Short-term	<ul style="list-style-type: none"> Have built-in flexibility and lower rates. Generally require collateral.
Equipment loan	Variable	<ul style="list-style-type: none"> Used to fund equipment purchases. Can have varying rates and tenors, based on pre-specified agreement with bank.
Real estate loan	Variable	<ul style="list-style-type: none"> Used to fund construction costs or property. Can be short-term for construction or longer-term for property purchases. Can take longer to process, with stricter terms and conditions.
Leasing	Short-term	<ul style="list-style-type: none"> Like an equipment loan, but no transfer of ownership from the seller. Cheaper than an equipment loan. More suitable for equipment with frequent technological updates.
Syndicated loan	Variable	<ul style="list-style-type: none"> Like a term loan, but with multiple creditors, which spreads out default risk. Administered by a bank. Usually preferred by companies with higher risk that may struggle to obtain term loans.

Source: United Nations Economic Commission for Africa.

FIGURE 3.1 ACCESS TO A CREDIT LINE OR LOAN FROM A FORMAL FINANCIAL INSTITUTION IS HIGHEST AMONG LARGE FIRMS AND LOWEST AMONG SMALL FIRMS (PER CENT)



Note: Large firms have 100 or more employees, medium-size firms have 20–99 employees and small firms have fewer than 20 employees.

Source: Based on data from World Bank Enterprise Survey, 24 June 2019.

THE AFRICAN BANKING SECTOR

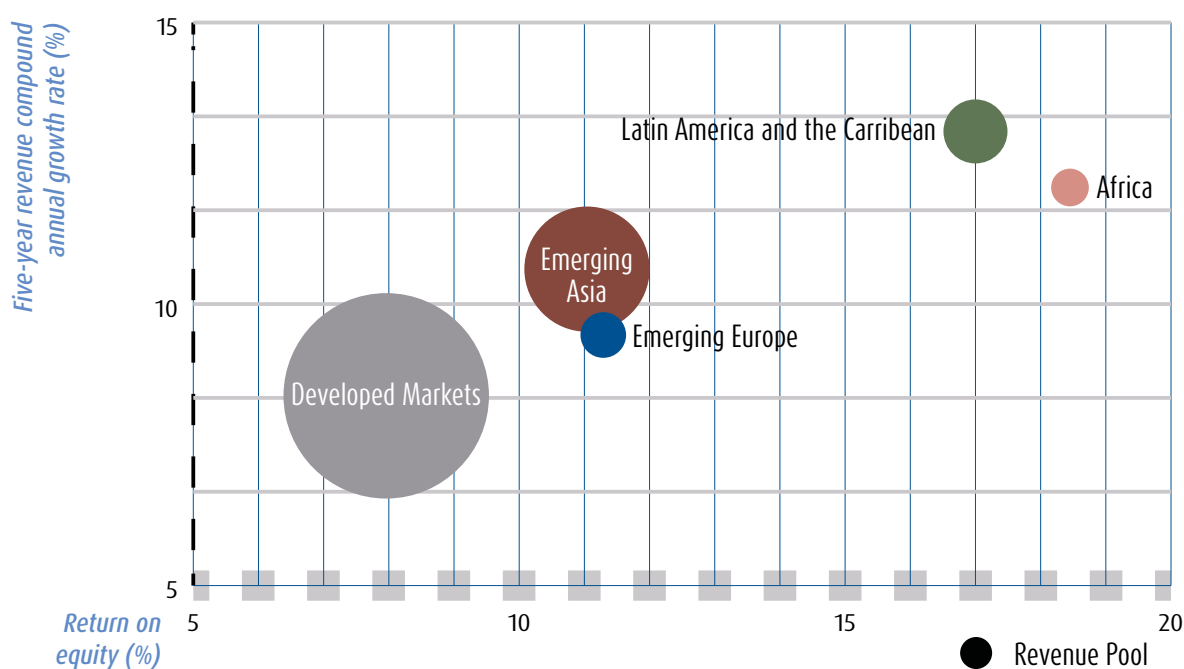
The banking sector is the main source of finance for the private sector in Africa, yet the ratio of bank credit to GDP is very low, less than 30 per cent in 2019, compared with 47 per cent in Latin America and the Caribbean and 94 per cent in Europe and Central Asia. There is considerable variability across the continent in financial sector development, however, with the average ratio of credit to GDP ranging from 60 per cent in North Africa to 9 per cent in Central Africa.

Credit to firms follows the same pattern. In most subregions, the largest share of credit goes to firms, with the exception of Southern Africa, which allocates a larger proportion of credit to households. The average ratio of firm credit to total credit varies from 92 per cent in West Africa and 88 per cent in Central Africa to 50 per cent in Southern Africa. The high

share of credit to firms implies that it can be difficult to stimulate economic growth on the demand side by expanding consumer credit, which is effectively unavailable in some countries.

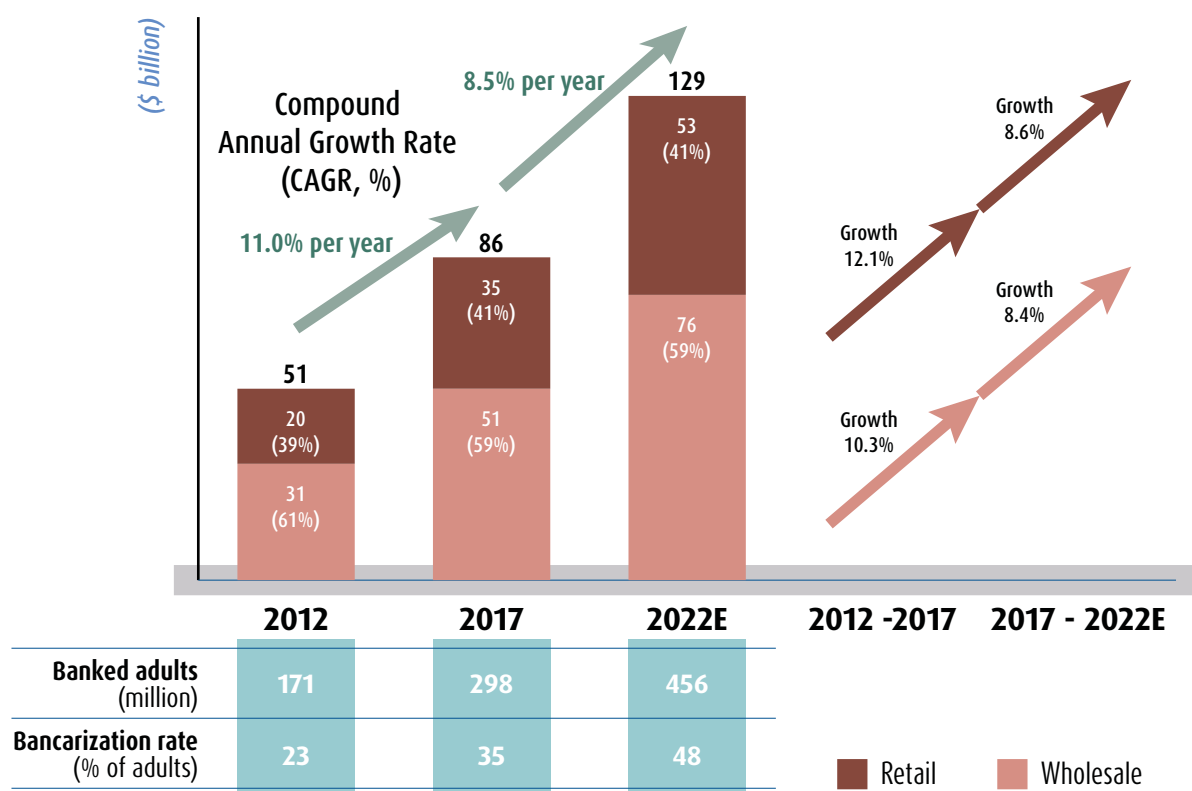
Though still small, the African banking sector is one of the fastest growing and most profitable in the world (FIGURE 3.2), making it one of the key sectors propelling economic growth on the continent this century. The average return on equity for publicly listed banks is between 11 per cent and 22 per cent in Africa, compared with 14 per cent for emerging market economies and 8 per cent for developed economies in 2019. Between 2017 and 2022, the African banking sector is projected to grow at 8 per cent a year (McKinsey, 2019; FIGURE 3.3).

FIGURE 3.2 THE AFRICAN BANKING SECTOR IS ONE OF THE FASTEST GROWING AND MOST PROFITABLE IN THE WORLD, 2019



Note: Bubble size designates revenue pool.
Source: Based on data from S&P Capital IQ.

FIGURE 3.3 HISTORICAL AND PROJECTED GROWTH OF THE AFRICAN RETAIL AND WHOLESAL CORPORATE BANKING SECTORS (REVENUE POOLS BEFORE RISK COST IN BILLIONS OF US DOLLARS)



Note: Bancarization rate refers to the proportion of the population that uses banking services.

Source: McKinsey & Company (2018).

The low levels of financial inclusion in Africa mean that there is massive potential for growth if the banking sector can bring financial services to underserved and unserved populations. Expanding inclusion will lead to rising deposits, which banks can lend to retail and corporate customers, enhancing access to housing and assets for retail customers and to financing that can increase capacity for businesses.

The success and profitability of the African banking sector are based on geography, segmentation, operating costs, digitization and innovation. Banks can leverage large fluctuations in macroeconomic conditions across countries to accelerate their growth and profitability. Segmentation also plays a large role: companies with annual revenue of \$6,000–\$36,000 are projected to contribute 70 per cent of retail banking growth

through 2025. Potential is high in all segments since fewer than 20 per cent of African banking customers have active bank accounts and products.

Bank operating costs are high, particularly since digital banking use is still limited by the low levels of internet connectivity and financial literacy, and thus control of costs will be crucial for profitability. The cost of borrowing is also high, and banks must sharpen their credit risk assessment capabilities to determine an interest rate spread that accurately reflects risk and is profitable for bank, as in Ghana (Owusu-Antwi, Banerjee and Antwi, 2017).

Digitization and innovation are vital for reaching new customers: since only 17 per cent of African banking

customers having taken out a consumer loan, the opportunities are enormous for banks that can successfully sign up new customers. When provided the opportunity, consumers prefer using digital and mobile money channels. In Kenya's Equity Bank, digital transactions accounted for 60–70 per cent of transactions in some product categories as early as 2017, and Kenya's M-Shwari, a mobile banking service, makes 80,000 consumer loans monthly (with only 1.9 per cent of loans categorized as non-performing).

Although financial inclusion is low in Africa (35 per cent in 2017), the bancarization rate, defined as the proportion of the population that uses banking services, is projected to rise to 48 per cent in 2022, with more than 450 million banked Africans (see [FIGURE 3.3](#)). The expansion of traditional banks

to reach more people and the entry of new banks are expected to create even more opportunities for the banking sector.

THE RISE OF PAN-AFRICAN BANKS

During the past two decades, the African financial sector has changed dramatically. The financial liberalization policies of the early 1990s greatly increased cross-border financial flows, which became an increasingly important component of the African financial landscape ([FIGURE 3.4](#), see page 64).

Pan-African banks are concentrated in West, Southern and East Africa. Among the 10 key players ([TABLE 3.2](#)), Standard Bank Group alone represents 12 per cent of the total assets

TABLE 3.2 THE 10 LARGEST PAN-AFRICAN BANKS IN 2019 (US\$ MILLIONS)

RANK	BANK	ORIGIN	NUMBER OF AFRICAN COUNTRIES IN WHICH BANK IS PRESENT	US\$ MILLIONS			PER CENT		
				TOTAL ASSETS	TOTAL REVENUE	NET PROFITS	CAPITAL ADEQUACY RATIO	RETURN ON ASSETS	RETURN ON EQUITY
1	Standard Bank Group	South Africa	18	162,627	8,830	1,881	16.7	1.4	15.0
2	Absa Group	South Africa	12	99,993	5,166	1,019	15.8	1.2	12.8
3	FirstRand Bank	South Africa	10	92,493	5,264	1,527	17.1	1.7	21.7
4	Nedbank Group	South Africa	8	81,710	3,575	858	11.5	1.2	13.5
5	Attijariwafa Bank	Morocco	14	55,727	2,290	609	12.7	1.3	13.3
6	Banque Centrale Populaire	Morocco	12	45,141	1,592	314	13.3 ^a	0.9	9.5
7	BMCE Bank of Africa	Morocco	17	33,038	1,221	201	12.6 ^b	0.8	10.0
8	Ecobank	Togo	36	23,641	1,489	194	28.8 ^a	1.2	14.9
9	Access Bank	Nigeria	7	19,742	1,019	267	n.a. ^c	1.6	17.7
10	Zenith Bank	Nigeria	5	17,533	1,313	577	23.0	3.4	23.8

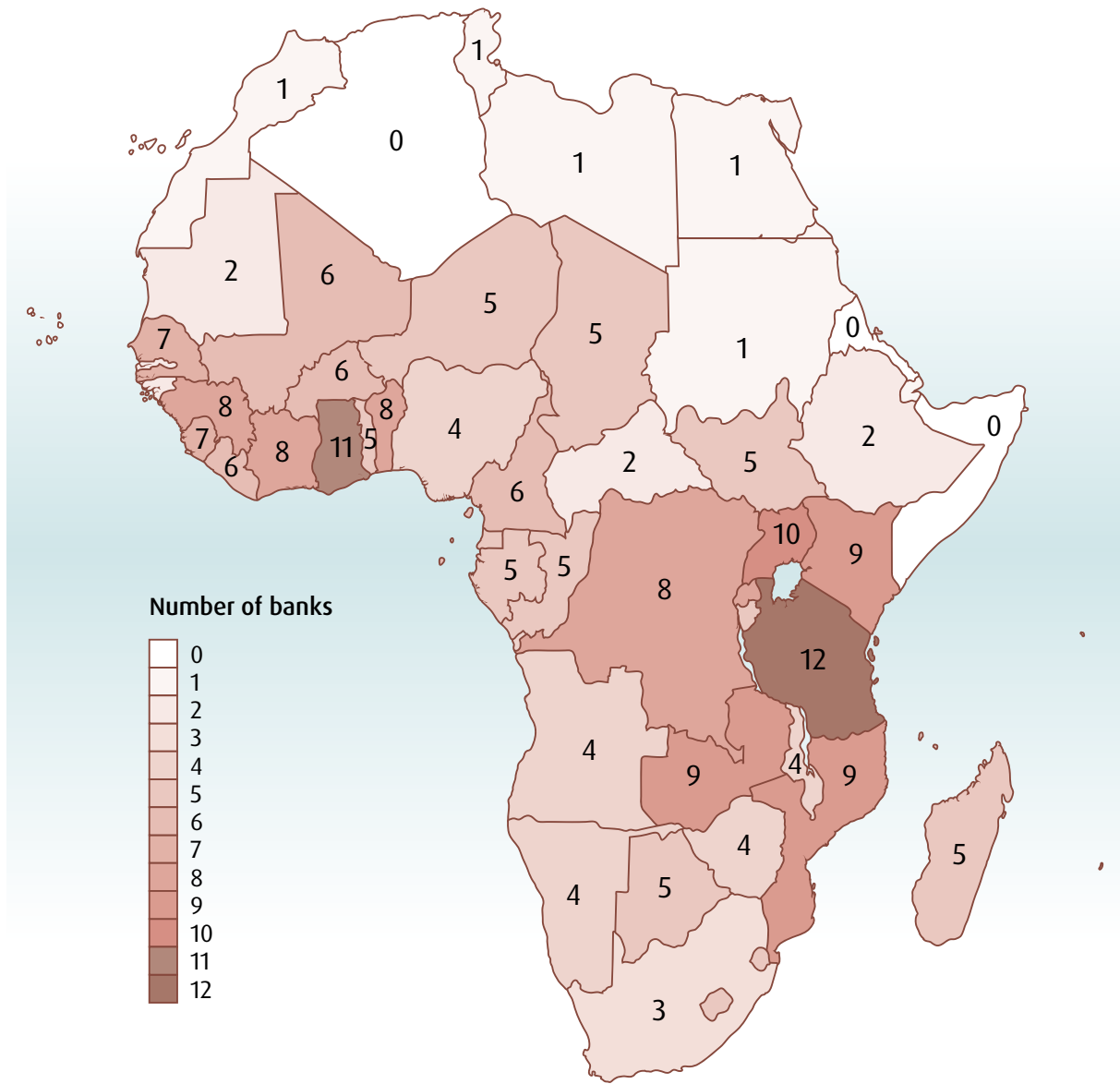
a. Data are for 2017.

b. Data are for 2018.

c. Data for 2017–2019 are unreported

Source: Publicly disclosed financial statements and company websites.

FIGURE 3.4 MAP: THE NUMBER OF AFRICAN CROSS-BORDER BANKS HAD GROWN CONSIDERABLY BY 2019



Source: Adapted from Bankscope.

under management at the top 100 banks in Africa at the end of 2018. Three other banks represent 8 per cent.

Pan-African banks began building their own national identities and competed with global banks. They have collaborated—as did Ecobank and Nedbank in 2008—to manage regulatory costs and increase their presence in Africa and have created

a network of more than 2,000 branches in 39 African countries. Such collaboration allows both parties to leverage the local knowledge that each member of the alliance has on its region of influence. Some pan-African banks also have representative offices and branches in key financial centres outside the continent.

The increasing presence of pan-African banks is driven by the forces of globalization, deregulation and technology. The emergence of a global financial system has opened a wide range of financing options. Financial liberalization—a key component of the financial reforms undertaken by most developing countries—has widened the geographic domain in which competition operates. An empirical study of the impact of the liberalization of African financial markets on banking in Africa found that it not only spurred banking sector development but could also induce banking crises (Batu and Mlambo, 2012). As networks expand, new channels may emerge for transmitting macro-financial risks and spill-overs between home and host countries. The 2008 financial crisis did not have a severe impact on African banking sectors, especially in less open economies, but as African banks integrate themselves into the global economy, future global financial crises are more likely to present a severe risk.

Deregulation has relaxed entry barriers, paving the way for competition in the banking sector. In addition, technology is eroding some entry barriers, such as the need for scale and physical branches, while competition and regulatory changes are eroding some strategic entry barriers, such as anti-competitive mechanisms. If domestic banks are not structured properly to enable them to compete on pricing, they are likely to face tough competition from new pan-African entrants.

A recent study found that the expansion of pan-African banks was associated with factors such as geographic and cultural proximity that are related to transaction costs (Mathieu et

al., 2019). Cross-border investments by pan-African banks are larger between countries that share a common language or border and diminish as geographic distance and exchange rate risks increase.

With the establishment of the African Continental Free Trade Area (AfCFTA), and liberalization of financial services as one of the priority service sectors, African banks will have the opportunity to tap into a continental market of over 1.2 billion consumers. As barriers to trade in financial services are dismantled, pan-African banks already operating across borders may have a head start in providing such services to African business operators, institutional clients and end consumers of the retail banking business. More important, as such services thrive, other banking and financial services providers that were unable to conduct cross-border transactions because of non-tariff barriers will be able to enter new markets in Africa. As the new entrants offer their services, complementing and diversifying those of current pan-African banks, opportunities will arise for the deepening and greater development of African financial markets.

However, translating these potential gains into reality will require significant regulatory change at national and sub-regional levels. As financial markets open, risks of contagion and the transmission of financial instability increase, requiring prudential regulation and other preventive measures to avoid or mitigate financial crises. Furthermore, financial liberalization will also require the elimination of measures that contravene the financial service trade liberalization commitments that African countries agreed to. Striking a healthy balance between safeguarding the economy from financial contagion and allowing financial institutions to conduct their business will depend on a careful weighing of macroprudential measures and an arm's length approach to financial service trade transactions.

THE AFRICAN INTERBANK MARKET

Financial institutions use the global interbank market to trade currencies among themselves, mostly on behalf of the banks' own accounts, and to borrow and lend funds on a short-term, often unsecured basis. Banks with surplus liquidity lend it to banks that need liquidity. A well-functioning interbank market provides a ready source of funds for banks with temporary liquidity needs and provides a comparatively low-risk

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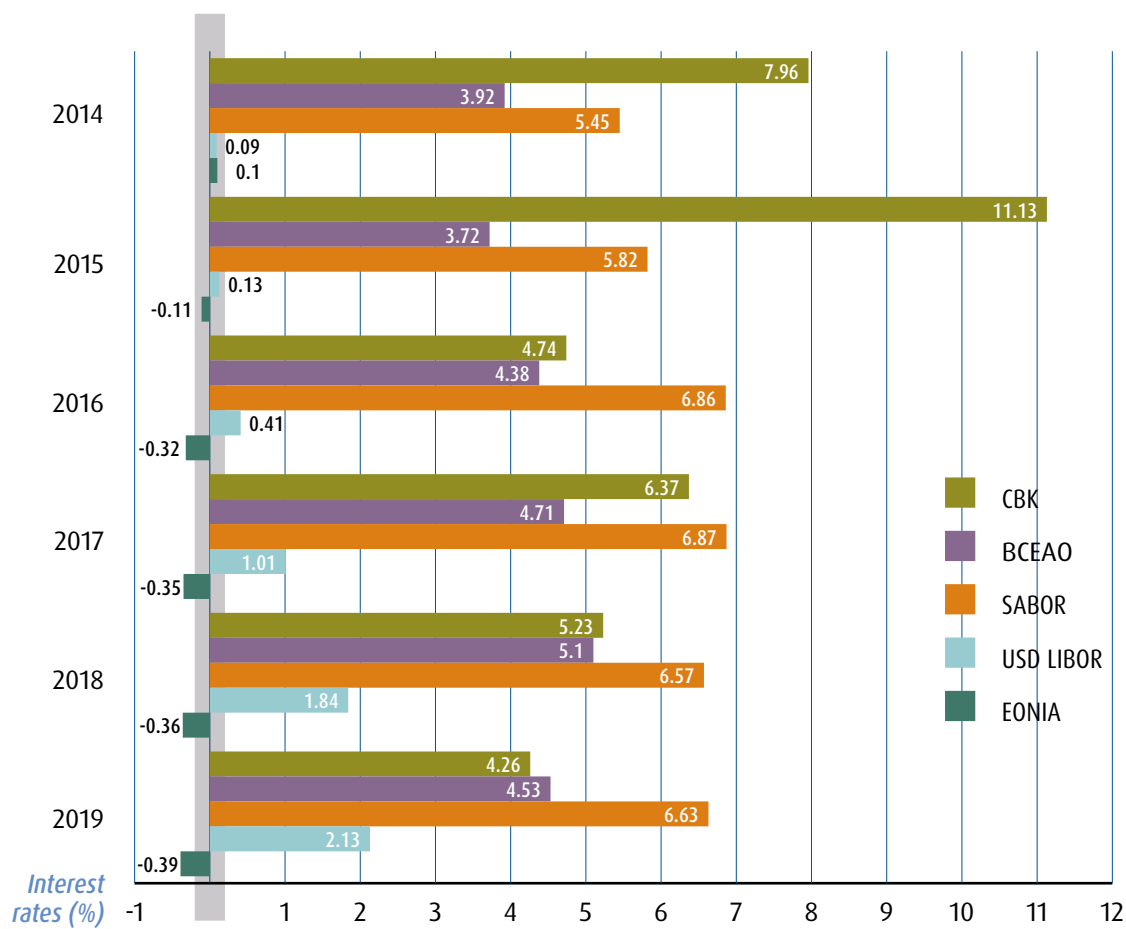
destination for the funds of banks with a temporary liquidity surplus. The interest rates in these markets are often used as a reference for the risk-free interest rate on various financial products that are tied to a variable interest rate.

In Africa, interbank markets are struggling to play their role. Because of limited participation by banks, interbank markets rely on the intervention of central banks. In African interbank markets, as in many emerging market economies, trading is too thin to fully support a monetary policy based on open market operations (Green et al., 2016). In part because of the small number of traders in these markets and the high policy

interest rates, interbank lending is more expensive in African markets than in mature markets (FIGURE 3.5). Most African interbank markets rely on a limited number of small banks. Large international banks can access intergroup funding, and the largest banks can access market finance, which reduces their participation in the interbank markets. Small banks are less able to attract deposits and end up relying on more expensive interbank funding.

Interbank markets in Africa are also segmented, fragmented and inefficient, compromising the effectiveness of monetary policy in the short run (Oduor et al., 2014). For example, there

FIGURE 3.5 INTERBANK LENDING IS MORE EXPENSIVE IN AFRICAN MARKETS THAN IN MATURE MARKETS, 2014-2019
INTEREST RATES, PERCENTAGE POINTS



Note: CBK is Central Bank of Kenya; BCEAO is Central Bank of West African States, SABOR is South African Benchmark Overnight Rate; LIBOR is London Interbank Offered Rate; EONIA is the Euro Overnight Index Average.

Source: Based on data from Benhamdane, Hidane and Stijns (2018).

is a strong borrowing relationship among small banks and a weak relationship between large and small banks in the interbank market in Kenya, marked by a 4.24 per cent interbank rate in November 2019. In the West African Economic and Monetary Union region, the interbank market recorded low volumes of liquidity trading and high interest rates, with an average volume of transactions of CFAF 276 billion (about \$466 million) and a weighted average interest rate of 5.1 per cent in 2018.

The structure of interbank markets in Africa implies that the interbank rate has no signalling effect on the state of market liquidity or market distress. Central banks often step in to provide liquidity to the market to give the appearance of normal

conditions on the interbank market (Osoro and Santos, 2018). For instance, when the volume of transactions in the interbank market in the Central African Economic and Monetary Community region fell to \$45 million in 2016, the central bank provided \$1 billion in liquidity to eligible credit institutions.

African bank lending activities depend primarily on deposits. When banks fail to attract adequate deposits, they try to fill the gap by participating in the interbank market or by relying on liquidity provided by the central bank. But because interbank markets in some African countries are not functioning properly, they are unable to support bank lending. Only large and listed banks can issue debt securities or raise equity on stock markets.

THE BANKING SECTOR AND FINANCING OF THE REAL SECTOR

AGRICULTURE SECTOR

Firms in the agricultural sector need financing for seed capital for production. Banks have stepped in to provide loans to farmers in need of capital to purchase seeds and livestock at the beginning of the farming season. Many land-owning farmers use their land as collateral. But African farmers are predominantly smallholders who operate in the informal sector and lack financial literacy and legally registered property that they can use as collateral. As a result, banks in Africa view agricultural activities as high risk, and agricultural loans account for only 4 per cent of bank loan portfolios. To encourage banks to lend to farmers, some governments provide credit guarantees through agricultural development banks or microfinance institutions.

The financial services sector recognizes the changes to the agricultural sector's landscape and the importance of maintaining a financially healthy agricultural sector. Increasingly, African countries are developing and adopting innovative financing mechanisms to support the sector. For instance, Standard Chartered Bank introduced innovative collateral mechanisms to promote access to finance by smallholder farmers and mitigate their risks. These included valorising the commodity or underlying asset being financed for use as collateral and offering advisory and monitoring services to ensure loan repayment and protect loan portfolios. Such services are well advanced in Canada, for example, where all major banks have units and specialists in agricultural economics to process and manage agricultural loans. Additionally, these specialists provide business consultation services to support farmers in the business aspect of farming. As of 2016, Canadian banks

have supplied more than Can \$36 billion to farmers across the country, and farmers account for 15 per cent of loans to SMEs.

Traditional banks may not be able to close the financing gap in the agricultural sector alone but may need to coordinate with the public sector, as in the European Union. Recognizing the importance of agriculture to the economy, the European Investment Bank and the European Commission, in cooperation with local banks in Croatia, France, Greece and Italy, announced a €1 billion loan program for the agricultural and bio-economy sectors. To attract young people to farming, the program allocates 10–30 per cent of funds to young farmers.

EXTRACTIVES SECTOR

The extractives sector has expanded greatly in the last few decades in many African countries as demand has risen for electronics and their components, many of which require the use of rare earth minerals in their manufacture. For instance, lithium, a key component of long-life batteries, has Namibia and Zimbabwe among its top producers. Cobalt, another key component of batteries and corrosion-resistant alloys, is the chief export of the Democratic Republic of the Congo.

The heavy capital and investment requirements of the extractives industries (for exploration, production and export), the global price volatility of some metals and resource depletion in some countries limit the appetite of the African banking sector for financing the extractives sector. Financing has been mostly project by project rather than based on a balanced sector-wide approach. To support the growing mining subsector and to increase demand for rare earth minerals, the banking sector has expanded from generic equipment loans to more innovative products and production-based financing. Financing based on mining companies selling the rights to future revenues is becoming increasingly popular for higher-value mining projects and rare earth minerals such as nickel, cobalt and lithium.

For example, in 2018, the Australia-based mining company NQ Minerals signed an agreement with the commodities trading firm Traxys to access a \$10 million prepaid facility. The agreement grants Traxys the rights to all lead and zinc concentrate produced in NQ's Hellyer mine for the first five years of concentrate production, while enabling NQ to refurbish the mine, which it had purchased in May 2017.

“The extractives sector has expanded greatly in the last few decades . . . as demand has risen for electronics and their components, many of which require the use of rare earth minerals . . . ”

But as mining firms continue to grow, traditional banks in Africa may have to forgo financing for some of these projects because of perceived high risk and limitations imposed by international regulations. Similar dynamics are also observed in oil and gas firms. Innovative financing sources are emerging to more efficiently meet the industry's immense capital needs, with companies increasingly shifting from traditional bank loans to equity markets, bond markets and project finance. The natural next step for extractive industries is accessing additional financing from financial markets through the intermediation of an investment bank.

MANUFACTURING AND SERVICE SECTORS

As economies develop and people have more disposable income, domestic consumption rises, spurring expansion of the private sector and a shift from agriculture to manufacturing and service firms. Traditional banks generally step in to meet the financing needs of these new firms. Conventional loans and lines of credit are common among SMEs, but banks can also provide other services, such as trade finance, as firms grow. This can be a critical service for SMEs seeking to grow their business in response to cross-border opportunities, such as those that will emerge as trade expands under the AfCFTA, with its dismantling of trade barriers in goods and services across the continent.

Globally, many traditional banks with experience providing loans to manufacturers and service providers now have divisions and programs to support SMEs. In China, for example, the government has pushed banks to provide more favourable

interest rates for SMEs. At the same time, the Chinese government recognizes the risk profile of these firms and the regulatory requirements that make it unattractive, especially for smaller banks, to lend to these smaller manufacturers and service providers. The government is looking into introducing less stringent regulations on smaller banks to allow them to provide the necessary financing in this space, particularly since smaller firms tend to be more geographically spread out, with some of them situated in areas not covered by large traditional banks. This is evidence, again, of policymakers coordinating with traditional banks and financial institutions to close the financing gap and support the growth of the private sector.

As these firms continue to grow, they turn to financial markets to finance their expansion. But this is not the end of these

firms' relationships with their traditional banks. The growth of private firms pushes traditional banks to establish investment banking arms to expand the breadth of the financial services they provide. At the same time, this growth expands the breadth and depth of financial markets, as more companies seek larger-scale financing, creating opportunities for smaller financial firms to diversify as well, especially in anticipation of opportunities under the AfCFTA. As SMEs scale up production to enter other markets in Africa and engage in cross-border activity, they will need trade finance and other types of credit to ramp up their business. Financial institutions can also take advantage of this increased demand by agglomerating activities and entering the cross-border financial markets in which larger pan-African banks that typically do not serve SMEs operate.

IMPLICATIONS OF COVID-19 FOR THE AFRICAN BANKING SECTOR

As a consequence of the 2008–2009 financial crisis and new financial regulations under the Basel III regulatory framework that focus on increased capital buffers, many banks strengthened their balance sheets and lowered their lending ratios to build resilience to financial and macroeconomic shocks. These measures helped many banks, especially in advanced and emerging market economies, to better prepare and address the losses and liquidity challenges arising from the current COVID-19 crisis. In some countries, banks helped bail out governments and businesses. For instance, to help finance huge stimulus packages and address some of the challenges of the pandemic (such as large numbers of people at risk, increased health expenditure, heavy demands on public finance and financial markets in turmoil), governments have been selling bonds to banks to maintain levels of capital and

liquidity. In measures known collectively as quantitative easing, central banks lowered long-term interest rates and purchased sovereign bonds to tamp down yields at various maturities.

In Africa, many governments and central banks have also been addressing the economic and financial risks associated with the COVID-19 pandemic. They cut interest rates to encourage personal and business lending, lowered capital and liquidity requirements to support bank lending and meet the liquidity needs of governments and firms and introduced quantitative easing to pump money into the economy and boost aggregate demand. For instance, in early March, the Bank of Ghana cut key interest rates to 14.5 per cent and amended regulations to allow the government to borrow up to 10 per cent of tax

revenue from the central bank. The South African Reserve Bank lowered the liquidity ratio, which unlocked 320 billion rands in bank lending. The Central Bank of Nigeria cut interest rates from 9 per cent to 5 per cent on central bank intervention facilities and announced a one-year moratorium on principal repayment.

While vital to navigate the COVID-19 crisis and maintain lending to businesses, these policy measures pose a challenge to bank profitability and financial sustainability. Over time, the lower interest rates and flat yield curves will reduce the profitability of many banks, impeding their ability to raise new capital and support the economy through lending.

Another challenge to the African banking sector may come from the solvency crises created as the sharp slowdown in economic activity caused by COVID-19 and tightening in financial conditions lead to a rising share of non-performing loans. In many countries, the coronavirus outbreak and lockdown measures have significantly constrained the operations of firms, especially SMEs, even as they still bear the burden of paying wages and rent. This has constricted cash flows and reduced solvency in the short term and increased repayment pressures (Ernst & Young, 2020). In extreme cases, some firms might have to suspend operations, plunging them into financial distress, undermining their ability to guarantee debt repayment or forcing them to liquidate their assets, often at fire-sale prices (World Bank, 2020).

CONCLUSION

The retail and corporate banking sector is vital to the economic development of Africa. To drive economic growth and job creation, the private sector needs better access to finance. Research suggests that robust legal, institutional and regulatory frameworks are key to unlocking bank credit to the SME sector.

Innovations and technological advances are expanding the reach of bank lending, reducing regulatory and geographic obstacles, bringing more people and more savings into the financial system and increasing the ability of banks to make loans. But despite these developments, the SME financing gap remains. Unleashing the potential of the private sector to contribute to sustainable development requires strengthening the supporting structures for financial development. That includes liberalizing trade in goods to facilitate cross-border trade for African SMEs seeking to expand their operations beyond domestic markets by tapping into the opportunities

that AfCFTA will usher in. At the same time, many African financial institutions could benefit from liberalization of trade in financial services, enabling them to offer trade finance and credit lines so SMES can up their game. Innovative lending activities to increase SME financing appear to be positively and significantly correlated with GDP growth.

From a policy perspective, a regulatory framework that strikes an optimum balance between ensuring financial stability and offering innovative financing schemes for all is key to developing a strong and robust private sector and ultimately to accelerating economic development. For their part, private firms need to take advantage of advances in technology to improve their business practices, particularly in bookkeeping and financial reporting, in order to access the new financing instruments.

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