



# FINANCE IN AFRICA

for green, smart and inclusive  
private sector development



European  
Investment  
Bank

*The EU bank* 



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for green, smart and inclusive  
private sector development

## **Finance in Africa: for green, smart and inclusive private sector development**

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This is a publication of the EIB Economics Department.

### **About the report**

The Finance in Africa report is a product of the EIB Economics Department providing an analysis of recent development in the African banking sectors and specific structural topics of relevance. It combines in house research with contribution from leading market experts from commercial banks operating in the region, IFIs and other institutions.

This report was prepared on the basis of data available in September 2021. An addendum at the end of this publication details how the conclusions and recommendations have been further reinforced by more recent data releases, such as the *IMF's World Economic Outlook, October 2021*.

### **About the EIB Economics Department**

The mission of the EIB Economics Department is to provide economic analyses and studies to support the Bank in its operations and in the definition of its positioning, strategy and policy. The Department, a team of 45 economists, is headed by Debora Revoltella, Director of Economics.

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### **Disclaimer**

The views expressed in this publication are those of the authors and do not necessarily reflect the position of the EIB.

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## Foreword

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**Europe and Africa are facing unprecedented challenges, which must be tackled together.** The COVID-19 and climate crises demonstrate that “no one is safe until everyone is safe”. It is in the interests of Europe to complement the recovery schemes being implemented at home with ambitious support for our African partners, who are among our closest neighbours. By working side by side to tackle development challenges, we can provide impetus for a strong, sustainable and inclusive recovery that will benefit us all.

**As part of Team Europe, the European Investment Bank (EIB) stepped up its efforts to help African partners respond to the COVID-19 health and economic crisis.** It provided €5 billion for new private and public investment across Africa in 2020 — a record annual commitment for the Bank — helping to deal with the immediate health emergency and mitigate the pandemic, and to address the economic effects of the crisis. This finance will back more than €12 billion of investments in 28 African countries, with 71% of the funding benefiting fragile or conflict-affected situations and the least developed economies. The projects supported are expected to contribute towards 210 million people getting vaccinated against COVID-19, 595 400 households being supplied with newly generated energy, 778 000 people enjoying an improved water supply, and farmers benefiting from 26 500 hectares of newly irrigated land and 3 076 hectares of newly planted forest. In addition, in July 2021, the EIB committed to support Africa’s first COVID-19 vaccine manufacturing plant in Senegal. This plant is set to produce as many as 25 million doses of an approved COVID-19 vaccine a month by the end of 2022. Together with our support for the COVAX facility, this is a key milestone in the EIB’s global efforts to address the health and economic challenges of COVID-19 and build a better future — yet a drop in the ocean in light of the size of the challenge. The European Union urgently needs to step up its efforts further.

**The EIB will continue to support African partners to “build back better,” including by addressing the impacts of climate change.** Here too, however, the financing gap is huge. A sustainable and inclusive recovery from COVID-19 will require an additional \$1 trillion annually, on top of the \$2.5 trillion annual gap in finance for the Sustainable Development Goals (SDGs) that existed before the crisis<sup>1</sup>. The impacts of the climate crisis only add to the needs. The International Monetary Fund (IMF) has estimated that sub-Saharan Africa alone will need \$30-\$50 billion in additional finance annually to adapt to the impacts of climate change<sup>2</sup>.

**Africa’s recovery will depend on private firms sustaining and creating jobs, but previously thriving enterprises have been badly hit by the COVID-19 crisis.** Data from enterprise surveys carried out in nine African countries during the pandemic period are consistent with a severe economic impact<sup>3</sup>. Around 88% of firms in the countries surveyed were experiencing decreased liquidity, and over 55% of them had temporarily closed at some point. Around 8% had filed for bankruptcy and 26% were overdue on financial obligations.

**This publication examines opportunities for Africa’s financial sector to support the recovery.** Continued access to finance has helped firms to stay afloat during the crisis period and there is an opportunity for Africa’s financial sectors to make an even bigger contribution to sustainable development in future. For example, African financiers are beginning to grasp opportunities in green finance, and banks are increasingly aware of the need to address the risks posed by climate change. Furthermore, digitalisation of the financial sectors has accelerated during the pandemic. Digital financial services offer a huge opportunity to expand access to finance to underserved firms and financial inclusion to groups that were previously excluded from formal finance, helping to improve livelihoods and tackle poverty.

**The impacts of the COVID-19 crisis could persist and make it more difficult for the financial sector to support a smart, green and inclusive economy.** The support of policymakers has helped maintain financial sector stability and soundness during the crisis. Nonetheless, many banks have been left with significant non-performing loans on their books, which may make them cautious about restarting lending. This would widen the large funding gap

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<sup>1</sup> OECD, 2020. The OECD estimates that the COVID-19 crisis caused a shortfall in revenues of \$0.7 trillion during 2020.

<sup>2</sup> IMF, 2020. Chapter 2: “Adapting to Climate Change in sub-Saharan Africa”. Available at <https://www.imf.org/en/Publications/REO/SSA/Issues/2020/04/01/sreo0420>.

<sup>3</sup> Data available at <https://www.enterprisesurveys.org/en/graphing-tool>.

that African firms face<sup>4</sup>, with small and medium-sized enterprises (SMEs), startups and innovative firms particularly affected.

**On September 15, the EIB's Board endorsed a proposal to create a branch of the EIB focused on development finance.** This reorganization will allow us to refocus our contribution to support the goals of the European Union and our partners outside the EU with even greater impact and efficiency. The EU Bank will be able to strengthen its development engagement, by placing more experts on the ground, and be a more effective partner for other multilateral and national development banks. And, we will be in a better position to pursue our global ambition in terms of the fight against climate change.

**Under the new development branch, the EIB will continue working with African financial institutions to help them drive a private sector-led recovery.** The EIB provides patient loans and equity to reinforce the capacity of these institutions to lend for a sustainable recovery, particularly targeting small and medium enterprises and investments in key areas such as climate, the digital economy, innovation and women's entrepreneurship. We support a range of players and tailor our offering, including through local currency lending, to meet the full spectrum of sustainable development needs. To maximise development impact, the EIB complements its financial offering with technical assistance, advisory services and knowledge products, such as this report.

I hope you will find *Finance in Africa* useful and that the analysis contained in this report can inform sound and impactful investment decisions.

Werner Hoyer  
President, European Investment Bank

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<sup>4</sup> The financing gap facing SMEs was estimated at 17% of national income in 2017, based on data reported in International Finance Corporation, 2017.

## Executive summary

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**Africa will struggle to finance economic recovery from the COVID-19 crisis while simultaneously addressing underlying development challenges and the mounting impact of climate change.** The health crisis and its economic consequences set back growth across Africa during 2020 and may have thrown an additional 30 million people into poverty (see **Chapter 1**). Countries highly dependent on tourism were badly hit, and the crash in commodity prices had a major impact on oil and gas exporters, in particular in early to mid-2020. An inclusive, sustainable recovery is essential to avoid further setbacks to sustainable development and to mitigate the risk of further social unrest and destabilisation. However, the economic recovery is expected to be gradual, and financing needs are large. A sustainable and inclusive recovery from COVID-19 will require an additional \$1 trillion annually, on top of the \$2.5 trillion annual gap in finance for the Sustainable Development Goals (SDGs) that predated the crisis<sup>1</sup>. African states stepped up to support their populations and private sector during the crisis. However, fiscal revenues contracted dramatically as growth plummeted. The resulting increase in debt, which compounded an already high debt burden in many countries, will limit the capacity of African governments to invest<sup>2</sup>. Although private external finance flows are recovering after a sharp fall in 2020<sup>3</sup> and the international community is providing debt relief and other financial support, this will not be enough to cover all needs.

**Africa's financial sectors can play an important role in supporting a sustainable, smart and inclusive recovery by helping to attract foreign investment and allocate domestic finance efficiently.** This report explores how Africa's financial sectors have been affected by the COVID-19 crisis and how they have responded. It then examines their ability to support the recovery. The analysis covers the main financial players: banks (**Chapter 1**), microfinance institutions (**Chapter 2**) and private equity funds (**Chapter 3**). The report also reviews how the financial sectors are responding to the digital revolution (**Chapter 4**), how they are handling the challenges posed by climate change, and whether they are taking advantage of the opportunities offered by green finance (**Chapter 5**).

**Africa's banking sectors are the main source of finance for private firms across the continent, but micro, small and medium-sized enterprises (MSMEs) still face a significant financing gap.** The analysis in **Chapter 1** draws on a unique survey of sub-Saharan African banks carried out by the European Investment Bank (EIB) in early 2021; evidence from *Enterprise surveys*, carried out by the World Bank, the European Investment Bank (EIB) and the European Bank for Reconstruction and Development; and a range of secondary data sources. Banking activity in African nations is small relative to the size of their economies<sup>4</sup>, and barriers to serving MSMEs are particularly high. The surveyed banks cited lack of collateral, credit history and bankable projects as the main constraints on expanding their lending to MSMEs, in line with other survey evidence.

**COVID-19 has made this situation more difficult, and its effects are likely to last.** Africa's banking sectors have remained relatively resilient. A liquidity crisis was averted, thanks partly to the fact that most banks were well capitalised before the crisis. The proactive support of policymakers also helped to maintain financial sector stability and soundness. However, evidence collected through *Enterprise Surveys* suggests that firms across Africa have been badly affected by the crisis. This means that banking sector asset quality is likely to fall as support measures are withdrawn and this will reduce banks' ability to finance the private sector as they seek to maintain and rebuild capital buffers. Most of the surveyed banks see impaired asset quality as the most important effect of the crisis on their business. Many have been left with significant non-performing loans on their books, which may make them cautious about resuming lending. This risks widening the large funding gap facing African firms<sup>5</sup>, with small and medium-sized enterprises (SMEs), startups and innovative firms particularly affected.

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<sup>1</sup> OECD, 2020. The OECD estimates that the COVID-19 crisis caused a shortfall in revenues of \$0.7 trillion during 2020.

<sup>2</sup> The average fiscal deficit across sub-Saharan Africa rose from 4.1% of gross domestic product (GDP) in 2019 to 6.9% in 2020, while debt to GDP rose by 6 percentage points during 2020 (International Monetary Fund, World Economic Outlook).

<sup>3</sup> Private external finance for developing countries dropped by \$700 billion in 2020, with remittances down an estimated 20%, foreign direct investment down 35% and net portfolio investment inflows down 80%: OECD, 2020.

<sup>4</sup> Of the 42 countries in the bottom quartile for banking sector size relative to GDP, 28 are in Africa (World Bank data).

<sup>5</sup> The financing gap facing SMEs was estimated at 17% of national income in 2017, based on data reported in International Finance Corporation (IFC), 2017.

**Microfinance is often the only source of formal finance for groups such as the poor, women and the smallest firms.** This is why microfinance plays an essential role in driving an inclusive economic recovery. **Chapter 2** reviews the current state of Africa’s microfinance sectors. Africa has made significant progress in expanding financial inclusion in the past decade, mainly thanks to the expansion of digital financial services. However, large gaps in access to finance remain, particularly among the poorest, women, and people in hard-to-reach rural areas. Various institutions provide microfinance services — these institutions range from commercial banks to commercial and regulated microfinance institutions, informal providers and non-governmental organisations. Formal microfinance institutions are an important source of finance, and were reaching over 6.3 million people across Africa in 2018, of whom 64% were female and 60% were based in rural areas<sup>6</sup>. Africa’s microfinance institutions responded to the COVID-19 crisis with several measures to support borrowers, including significant use of moratoriums, and operational steps such as increasing reliance on digital channels. Policymakers played a supportive role through regulatory forbearance and other measures, although they appear to have been less proactive than regulators in other regions. Africa’s microfinance sectors avoided a liquidity crisis during the pandemic thanks to the resilience of the microfinance institutions, their proactive responses and some support from policymakers. However, asset quality appears to have declined more sharply than in other regions and could threaten solvency among smaller institutions (commonly referred to as Tier 2 and Tier 3) in particular. The largest (Tier 1) microfinance institutions are better placed to withstand the crisis, and appear to be expanding lending quicker than their equivalents in other regions. Conversely, the need to rebuild capital buffers could hold back lending even among more solid institutions.

**Africa’s private equity sectors are very small in comparison to those in other regions<sup>7</sup>, yet they play an important role in supporting younger innovative firms and newer industries by providing patient, risk-absorbing finance.** This gives private equity and venture capital funds an important role in supporting renewable energy and the digital economy, among other sectors. **Chapter 3** reviews the status of Africa’s private equity sectors. Based on data from the Global Private Capital Association, the analysis shows that the pandemic reversed an upward trend in private equity fundraising targeting Africa, which dropped to \$2.3 billion in 2020, a 34% reduction from 2019. The impact on deal value was smaller: private equity firms invested over \$3.7 billion in Africa in 2020. However, the reduction in fundraising will likely make it difficult to sustain high investment volumes in the future. Beyond fundraising, the challenges confronting African markets include the low development level of the financial landscape, a history of modest returns on private investment, and high equity valuations, which may make it difficult to identify profitable investment opportunities in private markets. However, African markets still offer attractive opportunities for private equity investors, with increasing domestic assets under management; relatively strong performance of environmental, social and governance investing; and an emergent consumer class. This means that, despite the challenges, there is an opportunity for private equity sectors to support a smart, green and inclusive recovery by helping younger innovative firms retain access to finance and providing a source of finance for green and digital investments. Development finance institutions play a more important role in private equity in Africa than in other emerging and developing markets; this has been especially pronounced during the pandemic, as other financiers acted cautiously. These institutions are likely to remain important in ensuring that finance continues to flow to high-potential firms during the recovery, at a time when uncertainty remains high.

**The digitalisation of Africa’s financial sectors has enormous potential to drive development and growth, although the accompanying risks must be appropriately managed.** As explored in **Chapter 4**, digitalisation, especially the rapid adoption of mobile money, has been a key driver of financial inclusion in Africa. The digitalisation of African financial services has been driven by new entrants into Africa’s financial sectors. However, the *EIB Banking in Africa survey, 2021* reveals that the sub-Saharan African banks are expanding their digital offering and that this move has been accelerated by the pandemic. Of the banks surveyed, most reported that the pandemic has led them to increase the pace of digital transformation, and that this shift will be permanent. There are opportunities to further expand access to finance via digital channels, and the range of available services is becoming more diverse. However, the increased macro-financial risks associated with digitalisation are not yet adequately addressed by Africa’s regulatory frameworks. The OECD Development Centre, in analysis contributed to the chapter, argues that setting up an enabling regulatory environment at national level and enhancing regional regulatory cooperation can strengthen the adoption of digital financial

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<sup>6</sup> Based on data from the MIX Market, available at <https://datacatalog.worldbank.org/dataset/mix-market>.

<sup>7</sup> Over the last five years, Africa accounted for 3–4% of fundraising in emerging markets, which account for around 10% of total private equity fundraising worldwide (data from the Global Private Capital Association, described in Chapter 3 of this report).

services and reduce associated risks. For digitalisation to bring the expected benefits for inclusive growth, significant investment will be required. Africa's digital financial service solutions and providers are already attracting strong interest from investors, but the tightening of funding conditions in the aftermath of the COVID-19 crisis risks slowing development. Investment in digital infrastructure and technical assistance and training for financial institutions, regulators and users of financial services will also be needed for the digitalisation of financial sectors to reach full development potential.

**Africa and its financial sectors are highly exposed to risks associated with climate change, and the financial sectors must play a key role in financing climate adaptation and mitigation.** Chapter 5 argues that greening Africa's financial sectors is crucial to mobilising additional capital in the fight against climate change. Analysis by the United Kingdom's Overseas Development Institute and the EIB shows that the number and value of issuances in Africa's green bond market have been increasing almost every year. However, this market has yet to achieve its full potential, as it remains small relative to equivalent markets in other regions. Climate change and the energy transition pose serious risks for the business of African banks. The *EIB Banking in Africa survey, 2021* reveals that African banks are increasingly aware of the need to address risks posed by climate change, and are beginning to take advantage of opportunities in green finance. For instance, 54% of surveyed banks were already viewing climate as a strategic issue<sup>8</sup>, and just over 40% had staff working on climate-related opportunities. Other financial institutions, including microfinance, private capital and insurers, are also filling market gaps in green finance, while policymakers are supporting these developments through regulatory intervention, technical support and financing, with initiatives at domestic, regional and international levels. However, Africa's green finance sectors remain underdeveloped relative to those in other regions, and more can be done to ensure that the continent's financial sectors address climate risks and make the most of the opportunities of climate finance. This has become particularly urgent in the context of the recovery from the economic impact of COVID-19. International organisations can play an important role by working with financial institutions to finance the climate transition, and by helping to address gaps in knowledge and capacity to provide sustainable finance products.

**The EIB has actively supported African partners during the pandemic,** as reviewed in Chapter 6. As part of Team Europe, the EIB stepped up its efforts to help African partners respond to the COVID-19 health and economic crisis and will continue to invest in Africa during the recovery and beyond. The EIB provided €5 billion for new private and public investment across Africa in 2020 — a record annual commitment for the Bank. These operations will back more than €12 billion of investments in 28 African countries, with 71% of the funding benefiting fragile or conflict-affected situations and least-developed economies. EIB support has helped African countries to deal with the immediate health emergency and address the economic effects of the crisis. In the longer term, the Bank will help these countries progress towards achieving the Sustainable Development Goals. Projects signed in Africa in 2020<sup>9</sup> are expected to contribute towards 210 million people getting vaccinated against COVID-19, 595 400 households being supplied with newly generated energy, 778 000 people receiving an improved water supply, and farmers benefiting from 26 500 hectares of newly irrigated land and 3 076 hectares of newly planted forest.

**Much of the EIB's support is channelled through partnerships with African financial institutions, allowing the Bank to reach SMEs.** The EIB provides patient loans and equity to reinforce the capacity of these institutions to lend for a sustainable recovery, particularly targeting SMEs and investments in key areas such as climate, digital economy, innovation and women's entrepreneurship. Many of these loans are provided in local currency, which avoids passing on currency risk to EIB clients and helps them serve final beneficiaries, such as SMEs, whose revenues are mainly in domestic currency. The Bank supports a range of players, including banks, microfinance institutions and private equity funds, to meet the full spectrum of sustainable development needs.

**To maximise development impact, the EIB complements its financial offering with technical assistance, advisory services and knowledge products.** This support can give financial institutions the skills to facilitate sustainable development, for example by reaching underserved groups, or to become more active in high impact sectors, such as renewable energy. For instance, in partnership with the International Monetary Fund, the EIB launched an online course on financial intermediation and inclusion, which is helping government officials and

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<sup>8</sup> Either in a dedicated climate strategy or as part of their overall environmental, social and governance approach.

<sup>9</sup> *Annual report 2020 on European Investment Bank activity in Africa, the Caribbean, the Pacific, and the Overseas Countries and Territories.*

financial intermediaries to ensure that financial markets remain stable while meeting the needs of private sector enterprises, especially MSMEs<sup>10</sup>. The Bank also continues to invest directly in larger projects with high sustainable development impact. One example is support enabling the Institut Pasteur in Dakar, Senegal, to scale up production of COVID-19 vaccines — a key milestone in the EIB’s global efforts to address the health and economic challenges caused by the pandemic and build back better.

**The EIB, as the European Union’s development bank, is reorganizing its activities beyond the European Union to improve the way we deliver our development financing.** In September 2021, the EIB’s Board of Directors endorsed a proposal to create a branch of the EIB focused on development finance<sup>11</sup>. The aim is to strengthen the Bank’s development engagement outside the European Union to boost impact and efficiency. Under the new development branch, the EIB will continue to support Africa’s private sector firms, to foster a smart, green and inclusive recovery, particularly targeting underserved firms and groups.



*Debora Revoltella*  
Director, Economics Department  
European Investment Bank

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<sup>10</sup> Since the course’s launch in 2019, over 500 participants have enrolled, representing 33 developed and developing countries across five continents, ranging from the Dominican Republic to Somalia. Course participants have gained deeper knowledge of financial products and services designed to meet the needs of private sector enterprises and SMEs, and of standard risk management methodologies for SME lending.

<sup>11</sup> <https://www.eib.org/en/press/all/2021-304-eib-strengthens-global-development-focus-and-backs-eur-4-8-billion-new-financing-for-energy-transport-covid-vaccines-and-business-investment>.

# Banking in Africa: supporting a sustainable and inclusive recovery<sup>1,2</sup>

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<sup>1</sup> This chapter is co-authored by the European Investment Bank (EIB) and Making Finance Work for Africa Partnership (MFW4A). Authors: Muazu Ibrahim, Hugues Kamewe Tsafack and Guy Menan (MFW4A); Alfredo Baldini, Frank Betz, Claudio Cali, Emmanouil Davradakis, Nina Fenton, Kevin Koerner, Vincenzo Langella, Ricardo Santos, Andrea Tizzani and Sanne Zwart (EIB).

<sup>2</sup> The EIB and MFW4A would like to thank, first and foremost, the staff of African banks who generously gave their time to complete the online questionnaire. We would also like to thank the many colleagues who have provided feedback on the *EIB Banking in Africa survey, 2021* as well as comments and input on the results of the survey and on this report. Particular thanks are due to Abdelkader Benbrahim (MFW4A), Colin Bermingham, Sanja Blatt, Martin Burkat, Miriam Djari, Yolanda Embid-Segura, Matteo Ferrazzi, Marion Hoenicke, Eleni Kyrou, Christophe Litt, Inmaculada Martinez, Samuel Miquel, Faith Njoroge, Nicholas Nzioka, Jean-Luc Revéreault, Anne Schmidt-Sheehan, Markus Schulte, Jean-Philippe Stijns, Kiril Stoychev, Annamaria Tueske, Christoph Weiss and Peter Zajc.

The views expressed here are those of the authors and do not necessarily reflect those of the European Investment Bank. All remaining errors are the responsibility of the authors.

## Introduction and context

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### Africa's economies – emerging from crisis to uncertain prospects

**The COVID-19 crisis has had a significant human and economic impact on Africa, despite the reported virus caseload being relatively low for the continent.** As of July 2021, Africa has reported fewer COVID-19 cases and deaths, relative to the population, than any other world region except the Western Pacific<sup>3</sup>. Nonetheless, some countries (particularly Tunisia and South Africa) have been severely hit, with seven African countries reporting death rates above the world average<sup>4</sup>. Moreover, as test rates in most African countries are extremely low, the extent of the health crisis may be understated. Almost all African countries have implemented measures to contain the pandemic, which has significantly reduced economic activity. The crisis has also affected international financial and commodity markets and Africa's trading partners, with knock-on effects for African economies. Tourism, which is important for numerous African economies (particularly but not only small island states), came to an almost complete standstill during 2020, while the prices of oil, gas and other commodities plummeted early in the year. Overall, gross domestic product (GDP) contracted by 2.3% on average across Africa during 2020 (IMF, 2021a), with the vast majority of countries experiencing a contraction (Figure 1). Countries highly dependent on tourism or commodity exports experienced the most severe slowdowns, along with states already grappling with severe macroeconomic challenges before the crisis (such as growth slowdowns or nascent debt crises). Furthermore, like many emerging or developing markets, African economies had fragilities at micro and macro levels that have exacerbated the impact of the crisis, despite their growth contraction being smaller in percentage terms than that of advanced economies.

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<sup>3</sup> By 14 July 2021, Africa (including the North African countries in the World Health Organization's Eastern Mediterranean region) had recorded around 6 million cumulative cases of COVID-19 and around 150 000 deaths, based on data retrieved from <https://covid19.who.int/>.

<sup>4</sup> Tunisia, South Africa, Namibia, Seychelles, Eswatini, Botswana and Cabo Verde all have death rates above 51 per 100 000 population (the global average, based on case data from Johns Hopkins University, available at <https://coronavirus.jhu.edu/data>, and the United Nations' global population estimate of 7.9 billion).

Figure 1: The contraction – GDP growth in Africa, 2020 and change to growth projections, %

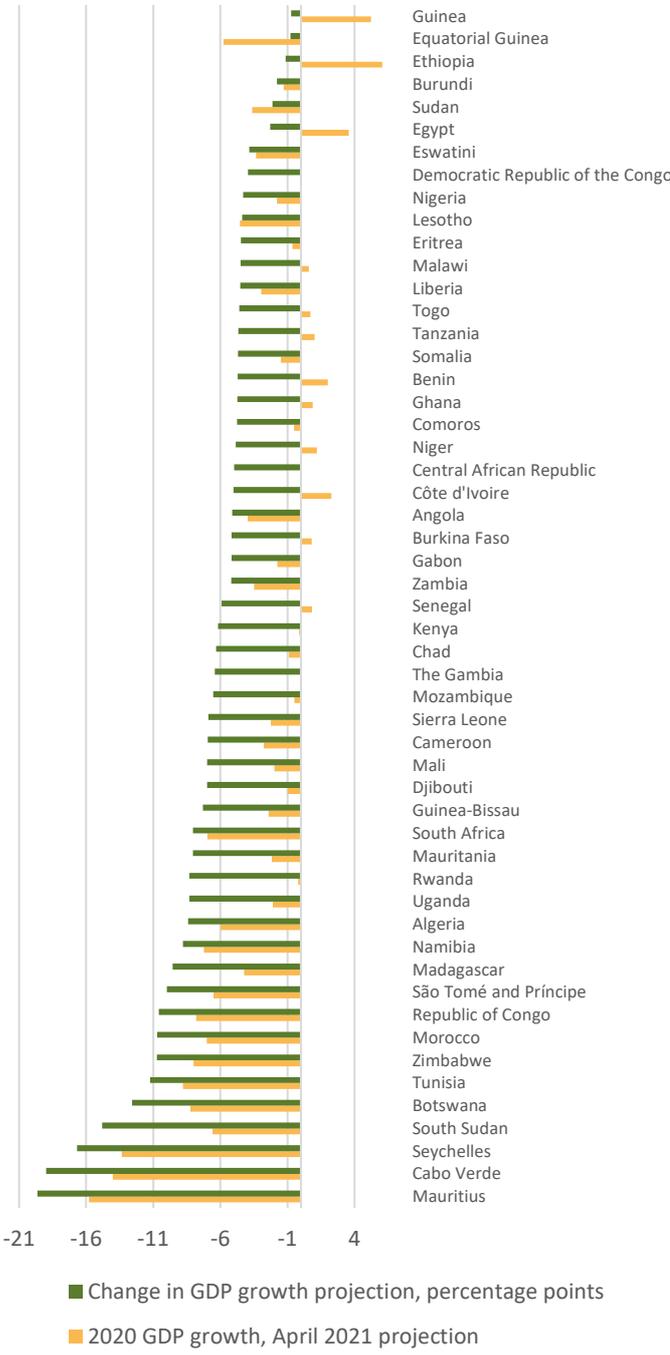
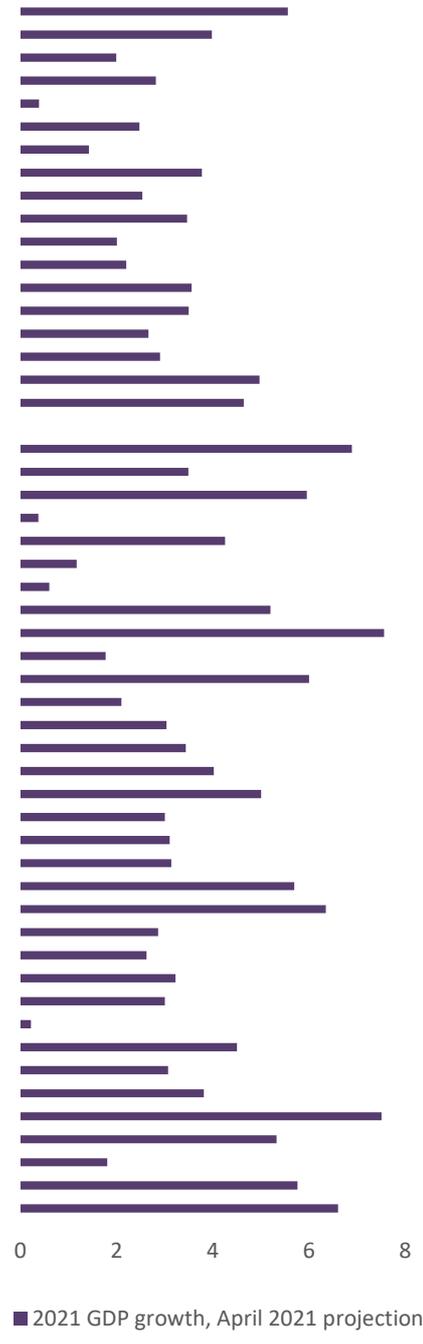


Figure 2: The recovery – projected GDP growth in Africa, 2021, %



Source: IMF World Economic Outlook database, October 2019 and April 2021 versions<sup>5</sup>.

Although the average growth contraction in Africa has been smaller than in developed regions, African firms and households are highly exposed to financial risks, with already vulnerable groups most severely affected. The small and informal enterprises and self-employed workers that form the backbone of African economies often have limited resources to withstand economic downturns. Many may find it difficult to restart activities even when conditions improve. Most low-income households lack savings to cushion the impact of lost earnings. Furthermore, few workers can rely on social safety nets or insurance, as these generally do not cover informal

<sup>5</sup> <https://www.imf.org/en/Publications/SPROLLS/world-economic-outlook-databases#sort=%40imfdate%20descending>.

sector workers and, in many African countries, provide only limited benefits even to formal sector workers. Within countries, the poor and vulnerable are particularly exposed, with migrant workers, refugees and other marginalised groups likely to be worst hit. GDP per capita is not expected to recover to 2019 levels until 2024 (with risks tilted to the downside), and the crisis has reversed an expected decrease in the number of people living in poverty (IMF, 2021a). This could result in an additional 30 million people in sub-Saharan Africa living in extreme poverty by 2021, plus an additional nine million in the Middle East and North Africa (MENA) region, relative to pre-crisis projections (World Bank, 2021a)<sup>6</sup>. The economic challenges facing households and the imposition of lockdown measures have exacerbated existing tensions and reduced trust in government institutions, triggering social unrest and destabilisation in several cases. Pangea-Risk, for example, reports that many African governments are facing criticism from citizens for a perceived lack of preparedness, corruption scandals, and for imposing new lockdowns too late, thus weakening confidence in the state (Pangea-Risk, 2021). Of the 39 countries on the World Bank's harmonised list of fragile and conflict-affected situations, 20 are in Africa<sup>7</sup>.

**The fiscal response to the crisis has been muted in African states compared to advanced economies, but the increased debt burden in Africa has limited capacity to support the recovery.** African countries' fiscal stimulus packages up to mid-2020 represented about 1-2% of GDP, supplemented by monetary stimulus estimated at 2% of GDP<sup>8</sup>. This is close to the average for low-income developing countries worldwide reported by the IMF (around 2% of 2020 GDP over a one-year period from the start of the crisis). By contrast, emerging markets implemented a package equivalent to around 4% of GDP over the same period, while the package implemented by advanced economies was equivalent to around 16% of GDP (IMF, 2021b). This reflects the weaker capacity of African states, compared even to emerging markets, to use fiscal stimulus to support their economies during crises. Even without a large fiscal stimulus package, the average fiscal deficit across Africa rose from 5% of GDP in 2019 to over 8% in 2020 as African states sought to address the health and economic effects of the crisis while experiencing often dramatic contractions in revenues<sup>9</sup>. A lack of fiscal space meant that the deficit led to increased borrowing, which African states have less capacity to absorb than advanced economies. Before the pandemic, average public debt was expected to gradually decline across Africa, but average net government debt rose by 2 percentage points during 2020, reaching 61% of GDP. The rise was even steeper for sub-Saharan Africa, exceeding 6 percentage points on average. Because of this increased debt burden, countries are facing higher debt servicing costs and some have lost international market access altogether, leaving them dependent on relatively limited domestic resources and concessional funding<sup>10</sup>. Sixteen African countries have been downgraded by at least one ratings agency since the start of the pandemic, including one country that defaulted (Zambia)<sup>11</sup>. Further defaults have been forestalled, partly thanks to debt relief initiatives by the international community, but these are limited and not all countries will take up debt relief to preserve market access<sup>12</sup>. Even countries that retain market access are likely to face higher costs of funding. Overall, African governments are left with limited capacity to either stimulate the economy during the recovery or support much-needed investments for a resilient, sustainable and inclusive future.

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<sup>6</sup> In 2017, 41% of sub-Saharan Africans (43 million people) were estimated to live in extreme poverty (World Bank), and the World Bank has used "nowcasting" techniques to generate estimates or projections for 2018–2021. These projections were generated pre-crisis, making it possible to estimate the impact of the pandemic. Separate data for North Africa are not available, but given that North African countries account for most of the population of MENA, estimates for that region should give a good indication of the impact in North Africa.

<sup>7</sup> The World Bank's list of fragile and conflict affected countries is available at <https://thedocs.worldbank.org/en/doc/bb52765f38156924d682486726f422d4-0090082021/original/FCList-FY22.pdf>.

<sup>8</sup> Raga and Housseini, 2020; Organisation for Economic Co-operation and Development (OECD), 2020.

<sup>9</sup> By contrast, the fiscal deficit in advanced economies rose from 3% of GDP in 2019 to 12% in 2020.

<sup>10</sup> The increase in public debt is also likely to exacerbate crowding out of the private sector, discussed in more detail below, making access to finance even more challenging for private sector firms.

<sup>11</sup> According to data retrieved in April 2021, six sub-Saharan African countries are currently in debt distress (Republic of Congo, Mozambique, São Tomé and Príncipe, Somalia, Sudan and Zimbabwe) and 13 are at high risk. Most of the remainder are classified as moderate risk. Tanzania and Uganda are the only low-income sub-Saharan African countries judged to be at low risk of debt distress. In November 2020, Zambia became the first African nation since the start of the pandemic to go into default after it missed bond repayments and creditors rejected a proposal for restructuring liabilities. Based on data retrieved from <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative>.

<sup>12</sup> Of the 38 African countries eligible for the G20 Debt Service Suspension Initiative, six were not accessing this support as of July 14 2021, based on data retrieved from <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative>.

**The recovery is expected to be gradual, and uncertainty about economic prospects remains very high.** The IMF expects average growth across Africa to recover to 4.5% in 2021 and 4.0% in 2022, with all economies apart from Comoros expanding in 2021 (IMF, 2021a). However, significant variation in growth rates is forecast (between 0.2% in the Republic of the Congo and 7.6% in Kenya during 2021; see Figure 2). More recent estimates have downgraded the growth prospects even further. For example, the World Bank's June 2021 economic update adjusted the growth projection for sub-Saharan Africa down by 0.2 percentage points<sup>13</sup>. The relatively moderate projected growth rates for the medium term are below pre-crisis projections, both on average and for most countries<sup>14</sup>. This reflects sluggish growth prospects in most of the continent's large economies<sup>15</sup>. Although the recovery in commodity prices has boosted the medium-term prospects of countries dependent on oil, gas and mining exports, vaccine rollouts have been very slow compared to developed countries<sup>16</sup>, which raises the risk of further disruption to domestic economies and means that prospects for tourism are very weak. Vaccine rollouts are unlikely to be significantly accelerated unless the international community and African governments substantially increase their efforts. In June 2021, Africa accounted for less than 1% of vaccine doses administered globally, and the World Health Organization expected 47 of Africa's 54 countries to miss the target of vaccinating 10% of their populations by September 2021. Even this target is extremely modest compared to developed nations and would allow the countries, in theory, to protect only the most vulnerable and healthcare workers. The slow pace of the rollouts and the limited ability to use fiscal stimulus will constrain economic recovery prospects.

**The COVID-19 crisis has led to a decrease in private investment in Africa, putting sustainable and inclusive growth at risk.** For developing countries, a sustainable, inclusive recovery from COVID-19 would require an additional \$1 trillion of investment annually, on top of the \$2.5 trillion annual gap in finance for the Sustainable Development Goals (SDGs) that predated the crisis<sup>17</sup>. Sub-Saharan Africa as a whole would need to increase spending by about 6% of GDP (\$100 billion) to fund the recovery, while MENA would need to increase spending by 9% of GDP. In addition to tackling the COVID-19 crisis, Africa urgently needs to address the climate transition and adapt to the digital revolution, as discussed in more detail in subsequent chapters. For example, according to estimates from the IMF, 2020, \$30–\$50 billion a year in incremental finance is needed for climate adaptation in sub-Saharan Africa alone. However, the COVID-19 crisis is expected to set back external private finance to developing countries by \$700 billion, a 60% greater drop than after the 2008–2009 financial crisis<sup>18</sup>.

**Africa's financial sectors can play a larger and more effective role in financing private sector investment to support a strong recovery and resilient future.** Banking activity in African nations remains small relative to the size of their economies, even when compared to peer economies in other developing regions. Of the 42 countries in the bottom quartile for deposit-taking banks' assets as a share of GDP, 28 are in Africa<sup>19</sup>. Besides the small size of the banking sector, access to finance for private sector firms is constrained by other challenges, such as state dominance of some sectors and crowding out. Crowding out is likely to increase as a result of the crisis, and banks in several countries have significantly increased their exposure to government debt. Private sector credit averages 42% of GDP in sub-Saharan Africa and 44% in North Africa, compared to 123% for middle-income countries, leaving private sector firms significantly underserved. The impact of the COVID-19 crisis could exacerbate this financing gap, which particularly affects small and medium-sized enterprises (SMEs) and underserved groups (as discussed in more detail later in this chapter). Furthermore, the crisis has demonstrated the risks of heavy reliance on foreign investment. Portfolio flows, in particular, reversed sharply in 2020, as they also did in 2008<sup>20</sup>. Improving the intermediation matching domestic savings with the private sector via financial institutions could reduce the volatility facing these institutions and their private sector clients. It could also make

<sup>13</sup> World Bank, 2021b.

<sup>14</sup> Based on a comparison of projections for 2021–2024 between the IMF's *World economic outlook* reports in October 2019 and April 2021 (IMF, 2019 and IMF, 2021a).

<sup>15</sup> Ethiopia and Egypt are expected to experience growth rates above 5.5% from 2022 onwards, but growth rates in Nigeria, Morocco, Algeria and South Africa will remain below 5% up to 2025, with most of them experiencing annual growth of 1–3%.

<sup>16</sup> Apart from the Seychelles, where 69% of the population has been fully vaccinated, Morocco (25%) and Mauritius (17%), all African countries are below the global average for percentage of population vaccinated. Algeria, Côte d'Ivoire and Ethiopia are yet to roll out any vaccination campaign (Johns Hopkins University, 2021).

<sup>17</sup> OECD, 2020.

<sup>18</sup> OECD, 2020.

<sup>19</sup> World Bank estimates, based on raw data from the IMF, available at <https://datacatalog.worldbank.org/deposit-money-banks-assets-gdp>.

<sup>20</sup> See IMF, 2021, Figure 6 on page 3. Data on portfolio flows are available from the IMF International Finance Statistics at <https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b&sid=1390030341854>, and from the Institute of International Finance at <https://www.iif.com/publications/id/4486>.

it easier for institutions to provide local currency finance — crucial for underserved groups such as SMEs — without taking on foreign exchange risk. Overall, there is a very clear need for African financial sectors to play a bigger role in channelling finance to investment.

### Impact of the crisis on banking sectors

In a recent survey, sub-Saharan African banks indicated that they have been severely hit by the COVID-19 crisis, which could compromise their ability to serve private firms during the recovery. The European Investment Bank (EIB), supported by the Making Finance Work for Africa Partnership (MFW4A), surveyed 78 banks in sub-Saharan Africa in early 2021 (the *EIB Banking in Africa survey, 2021*)<sup>21,22</sup>. The banks that participated account for approximately 30% of the continent’s assets. Therefore, although the data are unlikely to be fully representative of the continent, they provide valuable insights into the situation in Africa’s financial sectors as perceived by the banks<sup>23</sup>. The analysis reveals how sub-Saharan African banks have been affected by COVID-19 (Figure 3), the ways they have responded (Figure 4), and their perceptions of the risks and opportunities facing Africa’s banking sectors. This chapter will focus on how the banking sector is set up to support the private sector, particularly SMEs, during the recovery from COVID-19. Subsequent chapters will also draw on the survey results to investigate how banks are responding to the digital revolution (Chapter 4), which has been accelerated by the pandemic, and on how the financial sector is adapting to the challenges of climate change and grasping opportunities in climate finance, including through the development of the green bond market (Chapter 5).

Figure 3: Impact of the COVID-19 crisis on business, as perceived by banks in sub-Saharan Africa (% respondents)

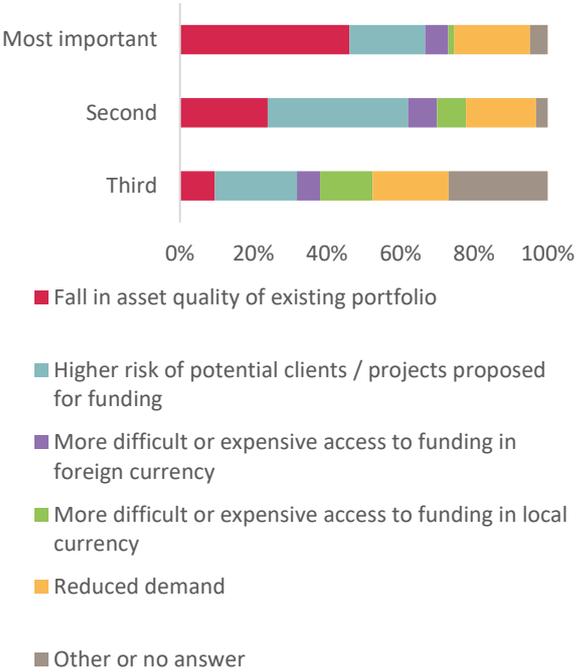


Figure 4: Adjustments made by banks in sub-Saharan Africa to respond to the COVID-19 crisis during 2020 (% respondents)

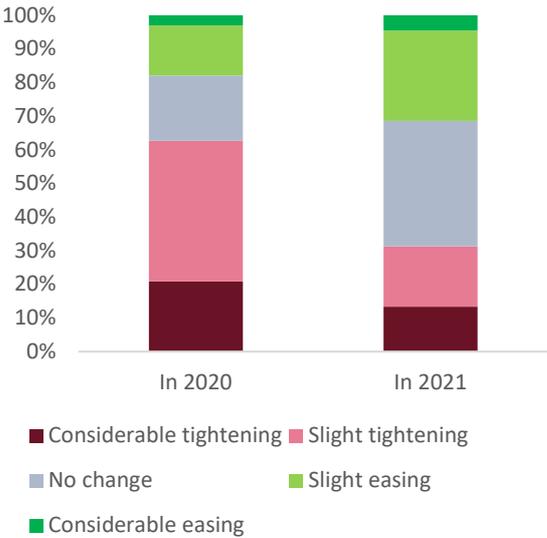


Source: EIB Banking in Africa survey, 2021.

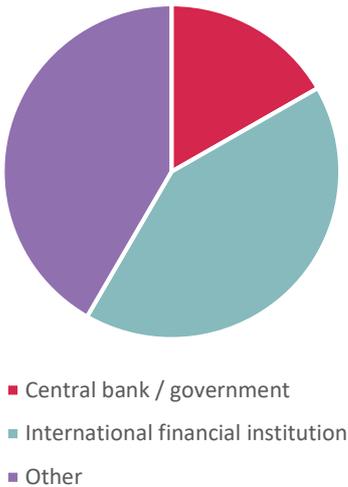
<sup>21</sup> This survey was administered online and had an overall response rate of around 43%. Response rates did not differ significantly by subregion, although the smaller number of responding banks (seven) in the Central African subregion means that data for that subregion should be interpreted with caution.  
<sup>22</sup> The survey for North African banks was disrupted by the pandemic.  
<sup>23</sup> Total assets coverage was computed based on *BankFocus* data for the latest available year. For pan-African banks, consolidated assets have been taken into account.

**Banks have adapted their operations during the crisis period, with the increased use of restructuring and moratoriums and movements to increase the use of digital channels the most commonly cited response mechanisms.** Almost two-thirds tightened their credit standards but over 80% made increased use of restructuring or loan moratoriums (Figure 4). Conversely, few banks were forced to adjust their staffing levels, while just under one-third adjusted pricing. Around half of the responding banks had used guarantees, mostly from the central bank, government or an international financial institution (Figure 6). Almost all (89%) of the surveyed banks reported that the pandemic had accelerated the digital transformation of their internal processes; the same proportion believe that the customer shift towards digital channels will persist after the pandemic ends (data available on request).

**Figure 5: How credit standards changed / will change (% banks surveyed)**



**Figure 6: Source of credit guarantees (% respondents using a guarantee scheme)**



Source: EIB Banking in Africa survey, 2021.

**Deteriorating asset quality is the most pressing immediate concern for banks, and may compromise their ability to serve private sector firms during the recovery.** As the recovery is expected to be gradual, with high levels of uncertainty prevailing, there is a risk that asset quality may deteriorate further over the coming months. Also, various policy measures (detailed in the next section) were in place in many countries up to the end of 2020 or even later. This means that 2020 data (the most recent available for most institutions) are unlikely to fully reflect the seriousness of asset quality problems. As policy measures are unwound, asset quality is likely to deteriorate further, even if economic growth starts to pick up. The impact of asset quality problems on bank loan books will likely lead banks to become more cautious: they will need to provision for non-performing loans (NPLs) and rebuild their capital buffers to compensate for eventual write-offs.

**Access to and the cost of financing have not been major concerns for banks during the crisis, but they will need access to appropriate finance to support the recovery.** The cost of international finance increased significantly during the first half of 2020. The vast majority of African banks were able to withstand liquidity pressures because they entered the crisis relatively well capitalised and have benefited from supportive policy measures (see next section). Looking ahead, however, there is a strong risk that crowding out by the public sector could undermine banks’ contribution to the recovery by further pushing up funding costs. Previous analysis showed that crowding out increased during 2014–2018 and reached elevated levels in a number of countries, especially Ghana, Niger, Tanzania and Zambia (EIB, 2018). The build-up of debt in Africa between 2008 and 2017, in the wake of the global financial crisis, resulted in increased public debt on banks’ balance sheets, higher interest rates on sovereign paper in many African countries and failing banks. Considering the rapid increase in indebtedness during 2020 across Africa, there is a clear risk of this pattern repeating, thus hindering the recovery.

## Policy responses

Many African central banks have reduced policy rates to encourage lending, and a number of regulators have adopted other policy measures aiming to secure access to finance and maintain the stability of financial sectors. As described by Alonso Gispert et al., 2020, a World Bank database has categorised the policy measures taken to support financial sectors. The data give a useful overview of the responses but contain no information about how the measures have been implemented in practice. Countries in North and Southern Africa have implemented the highest overall number of measures to address the financial sector crisis, with an average of 14 measures per country (Figure 7). This partly reflects these subregions being the first in Africa to be seriously affected by the health crisis, to which they responded by implementing relatively stringent containment measures, leading to economic disruptions. It also reflects the higher sophistication of financial sectors and regulatory frameworks in these subregions. Countries in East, West and Central Africa have adopted a smaller number of measures on average. In total, 34 African countries have implemented measures to boost liquidity and reduce the cost of borrowing, mainly by reducing the policy rate. Some countries, including South Africa, have reduced policy rates by 200 basis points or more. A large number of regulators have also adopted measures directly targeting the banking sector (discussed in more detail below), while some policymakers have targeted interventions at other financial institutions, notably microfinance institutions, and at payment systems, as well as implementing measures directly targeting firms (such as altering insolvency regulations).

Figure 7: Average number of COVID-19 finance-sector-related policy measures by subregion

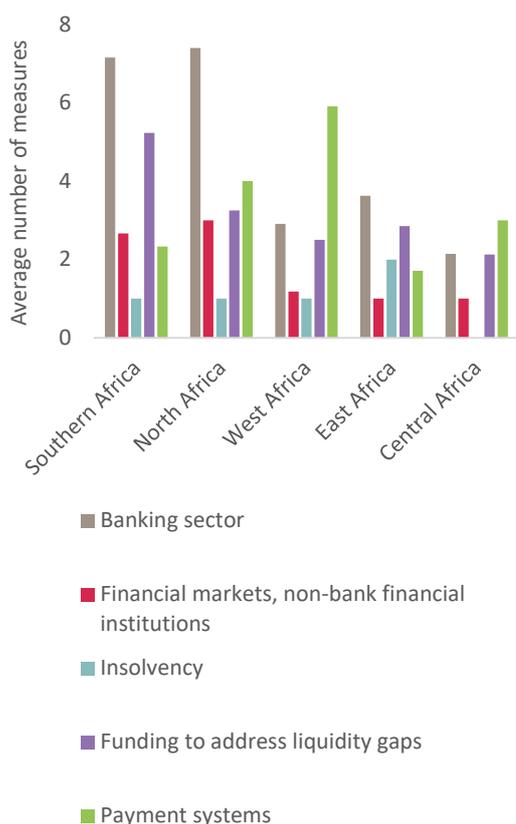


Figure 8: Average number of COVID-19 banking-sector-related policy measures by subregion



Source: World Bank COVID-19 Finance Sector Related Policy Response Database<sup>24</sup>. Data for Cabo Verde, Guinea, Burundi and Somalia are missing.

<sup>24</sup> Data are available at <https://datacatalog.worldbank.org/dataset/covid-19-finance-sector-related-policy-responses>, and the database is described in Alonso Gispert et al., 2020.

**The measures taken to support the banking sectors have included a mix of adjustments to or forbearance on prudential guidelines and direct or indirect support for borrowers (Figure 8).** The most common prudential measure has been the relaxation of the treatment of NPLs, such as by reducing provisioning requirements (Table 1). To support banks through the crisis period, regulators have also restricted dividends or other uses of profits, allowed for the temporary release of capital buffers, relaxed capital or liquidity requirements, or made other temporary changes to prudential requirements. The measures taken to support borrowers have involved the direct or indirect transfer of government funding to companies (state subsidies, state guarantees, direct lending by the government or central bank, and tax incentives). In a number of countries, the authorities have encouraged or even required banks to provide debt moratoriums and restructuring of loans to certain sets of borrowers. More detail on the measures adopted in individual countries is provided in the subregional snapshots later in this chapter.

**Table 1: Measures implemented to support African banks**

Prudential measures	Average number of times applied in Africa	Support for borrowers	Average number of times applied in Africa
Relaxation of non-performing exposure treatment	0.4	Subsidies and direct loans	0.7
Restrictions on use of profits	0.3	State guarantees	0.3
Release or deferral of capital buffers	0.2	Moratoriums and other restructuring – facilitated or encouraged	0.7
Relaxation of capital requirements	0.1	Moratoriums – mandatory for certain loans	0.2
Temporary easing of liquidity requirements	0.1	Increased flexibility in credit information requirements	0.1
Controls on banking fees	0.1	Caps on interest rates or similar fees	0.0
Other prudential relaxation or flexibility	0.6	Other	0.1

*Source: World Bank COVID-19 Finance Sector Related Policy Response Database<sup>25</sup>. Data for Cabo Verde, Guinea, Burundi and Somalia are missing.*

**Many African governments have paid special attention in their policy responses to digitalisation and to the particular needs of SMEs.** Countries in all subregions have introduced measures targeting payment systems (Figure 7), aiming to encourage or facilitate the use of digital payment systems and thus reduce the use of cash. A separate dataset made available by the IMF<sup>26</sup> (Table 2, in Annex) indicates that nine African countries have raised balance or transaction limits for mobile money, and 11 have intervened to reduce transaction fees. The same dataset provides further detail on the policy support for SMEs, showing that 14 African countries have provided direct financial assistance to SMEs during the crisis, while six have encouraged or mandated the use of moratoriums specifically for SME borrowers. Support for SMEs recognises these firms’ important role in African economies and their particular vulnerability to the economic impact of COVID-19.

## **Financing the private sector: bank lending to small and medium-sized enterprises and corporates**

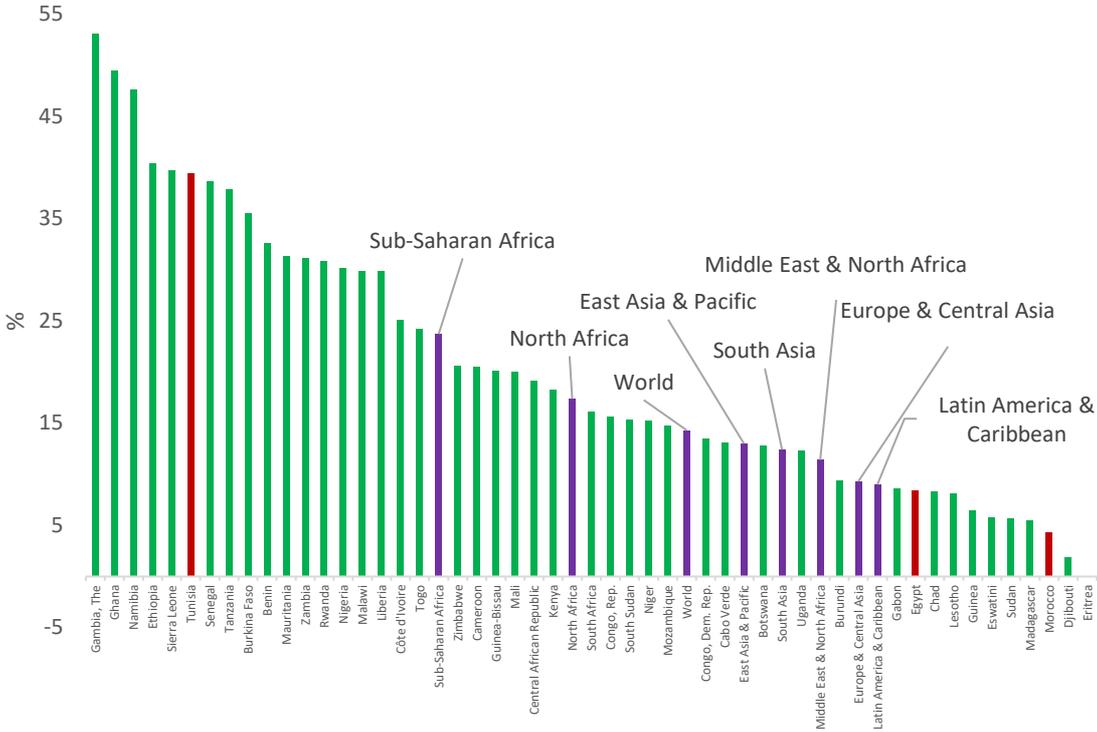
**Inadequate access to financing remains a major obstacle to the survival, growth and development of African firms, especially SMEs.** Figure 9 maps each country’s share of firms listing access to finance as a major constraint in the most recent *Enterprise surveys* carried out by the World Bank, EIB and European Bank for Reconstruction and Development. Africa stands out as the region where access-to-finance problems are most acute. The self-

<sup>25</sup> Data are available at <https://datacatalog.worldbank.org/dataset/covid-19-finance-sector-related-policy-responses> and the database is described in Alonso Gispert et al., 2020.

<sup>26</sup> IMF tracker of COVID-19 responses to facilitate financial access, from the IMF *Financial Access Survey*, available in excel format at <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>.

reported data indicate that around 62% of SMEs in sub-Saharan Africa that need a loan cannot access one, either because their loan application is rejected (3.2% of cases) or, more commonly, because they are discouraged from applying in the first place. The same holds for around 59% of the SMEs that report needing a loan in North Africa<sup>27</sup>. The situation is much more challenging than in other regions: in Latin America and the Caribbean only 31% of firms needing a loan report being discouraged or rejected. African SMEs often struggle to find the capital they need to grow, for a number of reasons detailed below. According to the SME Finance Forum, the formal funding gap for SMEs in Africa averaged 17% of GDP across the 43 countries surveyed in 2017<sup>28</sup>.

Figure 9: Percentage of firms listing access to finance as their biggest obstacle

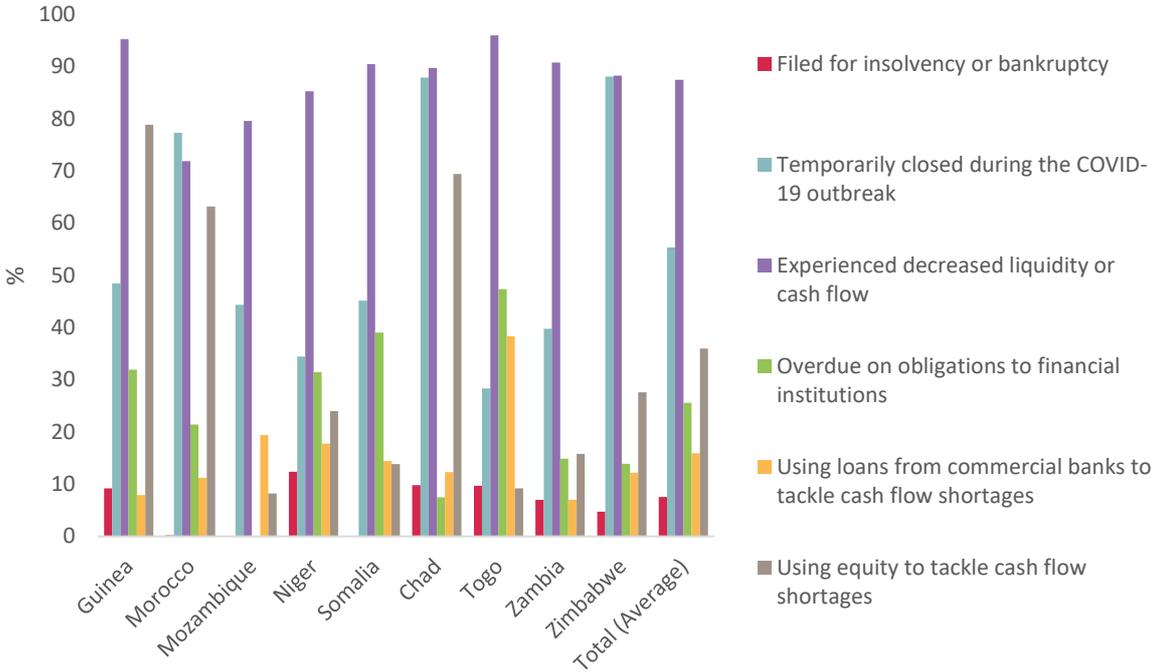


Source: EBRD-EIB-World Bank Enterprise Surveys, most recent data. Countries in sub-Saharan Africa are depicted in green, countries in North Africa in red and regions in purple.

**The pandemic could further widen the financing gap in Africa, with SMEs likely to be most affected.** The sudden drop in revenues during the crisis negatively impacted the cash flows of businesses, compromising their ability to repay existing credit facilities, creating acute liquidity shortages for many and threatening the survival of viable businesses. COVID-19 follow-up modules of the *Enterprise surveys*<sup>29</sup> were carried out in nine African countries during 2020 and 2021, yielding data consistent with a severe economic impact. As Figure 10 shows, around 88% of firms in countries where COVID-19 follow-up surveys were carried out (three in Southern Africa, one in East Africa, four in West Africa and one in North Africa) were experiencing decreased liquidity, with over 55% of them temporarily closed during the pandemic. Overall, around 8% had filed for bankruptcy. Furthermore, 26% of firms are overdue on obligations to financial institutions. More firms tackle cash flow shortages by relying on equity (36%) than on loans from commercial banks (16%). The policy responses discussed above have provided some relief to borrowers and to banks, but the situation could deteriorate once these measures are withdrawn and as the impact of asset quality deterioration leads banks to take a more cautious attitude to lending.

<sup>27</sup> Enterprise surveys, most recent data, available at [www.enterprisesurveys.org](http://www.enterprisesurveys.org).  
<sup>28</sup> Calculated by MFW4A based on data reported by the International Finance Corporation (IFC), 2017.  
<sup>29</sup> Data available at <https://www.enterprisesurveys.org/en/graphing-tool>.

Figure 10: Impact of COVID-19 on firms in African countries where COVID-19 follow-up surveys were carried out, 2020

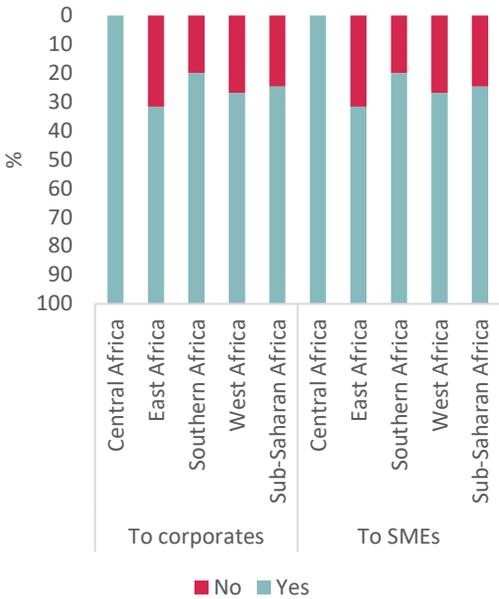


Source: Enterprise surveys, COVID-19 follow-up surveys, 2020<sup>30</sup>.

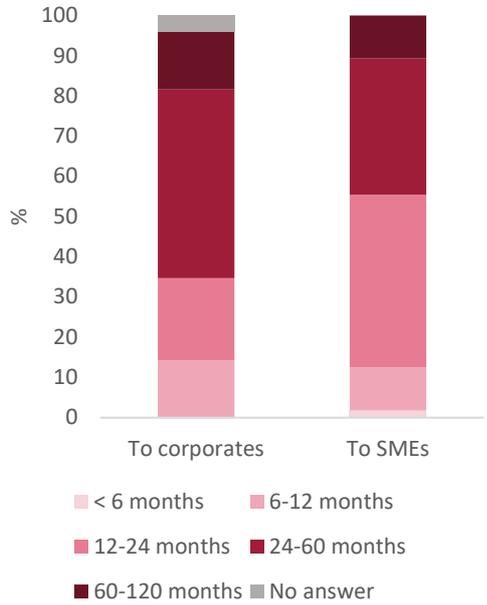
The **EIB Banking in Africa survey, 2021** did not reveal that banks have a higher propensity to lend to corporates than to SMEs (Figure 11), but bank loans to corporate clients tend to have significantly longer tenors. The vast majority of responding banks reported serving both market segments. However, while almost two-thirds of banks (61%) reported a relatively long average maturity (over two years) on corporate lending, only around 45% reported average tenors of this duration for SME clients (Figure 12). Although these data do not address whether SMEs actually apply for longer-tenor loans, they do suggest that access to longer tenors could be restricted for SMEs.

<sup>30</sup> Data available at <https://www.enterprisesurveys.org/en/enterprisesurveys>.

**Figure 11: Percentage of banks lending to corporates and small and medium-sized enterprises in 2020 (% respondents)**



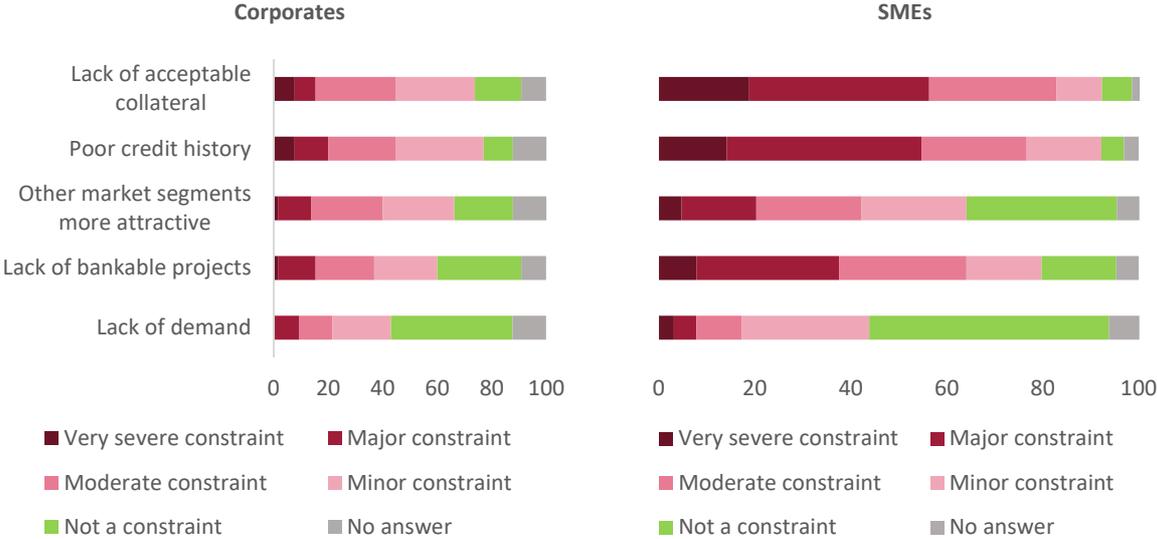
**Figure 12: Average maturity of loans, 2020 (% respondents)**



Source: EIB Banking in Africa survey, 2021.

**Structural factors continue to hold back lending to the private sector, particularly SMEs. These constraints predate the COVID-19 crisis but may have been exacerbated by it.** The main factors constraining credit supply to corporates and SMEs are a lack of acceptable collateral and poor credit history, with a lack of bankable projects an additional constraint for SMEs (Figure 13). Although these are structural, demand-side factors, intervention is needed to prevent the compounding impact of the COVID-19 crisis leading to persistent restrictions on access to finance. For example, firms forced to sell collateral will struggle to access finance again even after economic conditions improve. Structural barriers affect corporate lending too. However, a lack of collateral, poor credit history and a lack of bankable projects are much more commonly reported with respect to SMEs than corporates. In the longer term, these structural barriers will need to be addressed to narrow the SME finance gap. Even in the immediate recovery period, policies aiming to address these barriers could support a revival of SME lending to promote economic recovery.

Figure 13: Perceived constraints on lending (% responding banks)



Source: EIB Banking in Africa survey, 2021.

**Lending against collateral remains the most popular form of bank financing in Africa, and a lack of collateral is a particular barrier for SMEs.** SMEs often lack sufficiently valuable fixed assets to pledge as security for loans. Results from the survey, as shown in Figure 14, also revealed a majority of the banks indicating more than 80% of loans were secured by collateral with only a minority of the banks opining that less than 20% of their lending was backed by collateral (Figure 15). This is consistent with the findings from the analysis of *Enterprise Survey* data, which also show that banks require collateral for most of their SME lending, and that this may constrain employment growth (see for example, the European Bank for Reconstruction and Development, European Investment Bank and World Bank, 2016). Banks report that they have tightened their credit appetite and enhanced collateral requirements in the wake of the pandemic (see the section on impacts of the crisis on the banking sector, above). As a lack of collateral was already a greater constraint for SMEs than for corporates, and bearing in mind the general tendency of banks to favour larger clients and corporates in difficult times, SMEs are likely to be particularly affected by the rejection of loan applications in the wake of the crisis.

Figure 14: Percentage of banks who see a lack of acceptable collateral as a constraint to lending (% of responding banks)

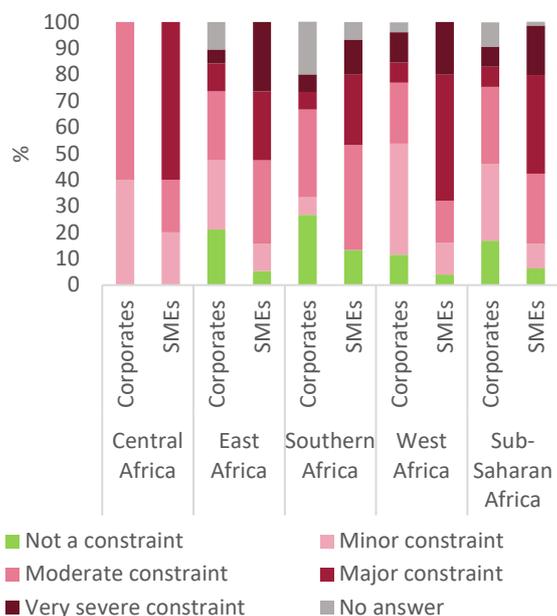
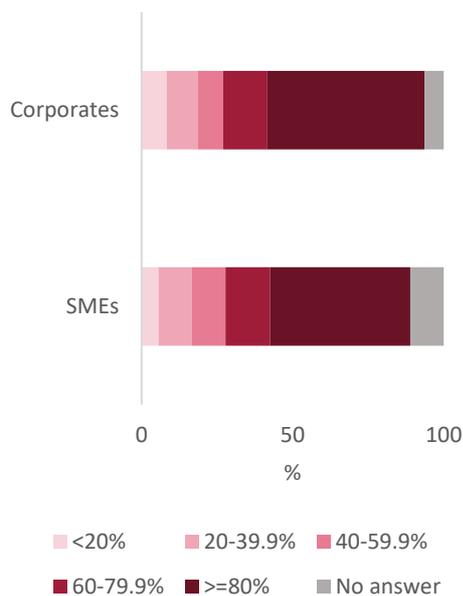


Figure 15: Proportion of loans secured by collateral (% of responding banks)



Source: EIB Banking in Africa survey, 2021.

The availability of detailed credit information with broad coverage is also crucial for closing the SME finance gap. About 41% of responding banks highlighted poor credit history as a major constraint on access to finance for SMEs, while only 12.3% reported this as a major issue for corporates (Figure 16).

Figure 16: Percentage of responding banks that see poor credit history as a constraint on lending

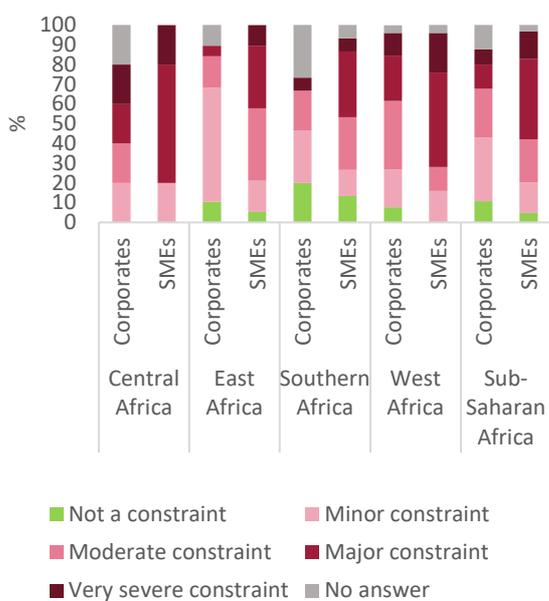
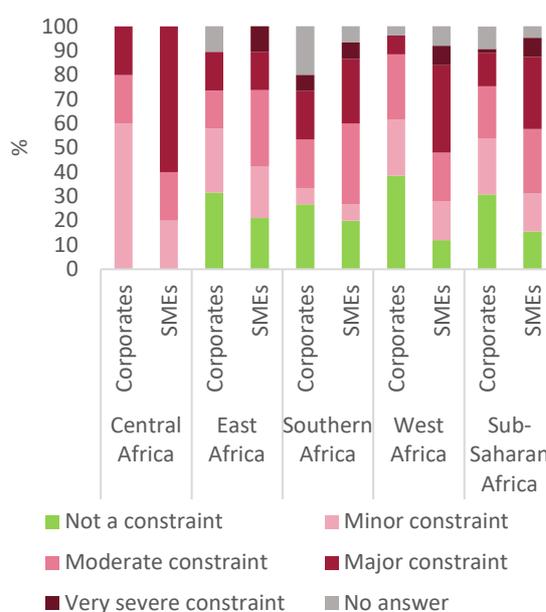


Figure 17: Percentage of responding banks that see a lack of bankable projects as a constraint on lending



Source: EIB Banking in Africa survey, 2021.

**There is a widespread perception among banks that micro, small and medium-sized enterprises (MSMEs) lack bankable projects.** This may be explained by MSMEs' lack of technical knowledge and formal financial statements and documentation. For many banks, formal financial statements and official documentation are essential parts of loan applications. However, the quality and reliability of these statements vary across countries and firms. MSMEs often lack the necessary technical knowledge to prepare the kind of sound financial statements needed for successful loan applications. Figure 17 indicates that the lack of bankable projects more severely inhibits bank lending to SMEs (37.5%) than to corporates (15.3%). Business development services could help develop more expertise in this area. A number of banks have begun providing such services via SME "academies," often supported by international or regional organisations. For example, the African Union Development Agency has launched the MSME Academy in partnership with the Ecobank Group<sup>31</sup>, while the Invest in Africa Initiative, whose members include private companies and pan-African and domestic commercial banks, has developed an online learning academy for SMEs in partnership with the African Management Initiative<sup>32</sup>.

**Broader enabling environment issues are also key determinants of access to finance, although they are not covered in detail by the *EIB Banking in Africa survey, 2021*.** These issues span the macro environment, including political stability, macroeconomic policies, and the legal and administrative environment, such as tax policies, trade rules, physical infrastructure, and governance structures. Regulatory reforms that encourage informal firms to formally register may lead to better business information and documentation (Bruhn, 2013; Campos et al., 2015).

**Gender inequality is a critical policy issue in Africa, and the *EIB Banking in Africa survey, 2021* data confirm that banks in sub-Saharan Africa are taking steps to consider gender issues in their lending approaches.** Supporting economic opportunities for women and youth is vital for achieving the SDGs and building inclusive, resilient economies in Africa. According to the World Bank, 58% of all MSMEs in Africa are women-owned<sup>33</sup>. However, women's businesses are particularly constrained by the dearth of finance. This indicates the importance of establishing a favourable environment to encourage lending institutions to finance businesses owned by women and young entrepreneurs, thereby empowering and enabling them to invest in productive activities. African banks are increasingly aware of the need to address gender inequality and of the opportunities presented by gender finance. Among the responding banks, 60% reported having some form of gender strategy in place. Structural barriers must also be addressed. For example, in some countries collateral can only be pledged or, de facto, owned by men, which can make it almost impossible for female entrepreneurs to access finance.

**Expanding the range of financing opportunities and solutions and tailoring them to serve MSMEs are important steps for boosting access to finance for private sector firms in Africa.** Recent studies indicate that more financially diverse markets are associated with improved access to finance. Allowing a variety of financial institutions to operate improves competition within the financial system, potentially increasing firms' access to various forms of financing instruments to address medium- and long-term financing needs (Love and Martínez Pería, 2015). Besides bank finance, other debt and equity financing options are often at nascent stages of development in Africa. Leasing and factoring activities, private equity and venture capital can benefit SMEs, and microfinance is an important source of finance for the smallest firms. The situations in the microfinance and private equity sectors are reviewed in Chapters 2 and 3 of this report.

**A number of policy measures could be considered to address the private sector finance gap, particularly for MSMEs.** By aggregating and processing credit data, public credit registries and private credit bureaux have reduced information asymmetries, thereby lowering reliance on collateral. There is abundant evidence that credit bureaux and collateral registries increase firms' access to finance (Martínez Pería and Singh, 2014; Love et al., 2013). Although very few countries have introduced credit-scoring guidelines or regulations, some credit bureaux have begun to provide credit rating and scoring services that give additional information on MSMEs. SME lending could also be boosted by measures to improve the efficiency of insolvency resolution and by enabling banks to accept movable assets as loan collateral. African SMEs' access to finance has also been

<sup>31</sup> <https://www.nepad.org/news/auda-nepad-launches-msme-academy-all-africas-micro-small-and-medium-enterprises>.

<sup>32</sup> <https://investinafrica.com/ourpartners>.

<sup>33</sup> Darko and Ahiagbede, 2021.

improved through the reform of collateral frameworks and the development of property laws, land registries and electronic registries for pledging assets (including movable assets) and receivables (collateral registries).

## The potential of Africa's banking sectors to support the recovery

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**Africa's banking sectors are relatively small, suggesting that significant numbers of firms may be under-banked, while high levels of concentration in some markets suggest weak competitiveness.** Key descriptive indicators of Africa's banking sector are provided in Table 3 in the Annex based on data from the IMF<sup>34</sup>, the World Bank<sup>35</sup> and Moody's Analytics BankFocus<sup>36</sup>. The continent has 558 banks that are likely to be lending to the private sector (including commercial, cooperative or Islamic banks)<sup>37</sup>. These banks hold more than \$860 billion in total assets (Orbis Bank Focus, most recent data as of June 2021)<sup>38</sup>. West Africa is home to almost 240 banks, followed by East and Southern Africa, with almost 200 banks each. On average, the top three banks in each subregion hold 71% of total assets, which is higher than the 60% average in emerging and developing economies. This proportion ranges from 90% in Central Africa to 58% in North Africa—the continent's most competitive banking market.

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<sup>34</sup> IMF Financial Soundness Indicators, available at <https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA>.

<sup>35</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.

<sup>36</sup> Moody's Analytics BankFocus combines content from Bureau van Dijk and Moody's Investors Service, with expertise from Moody's Analytics. The data are available to subscribers at [https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChM18Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9\\_D\\_BwE](https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChM18Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9_D_BwE).

<sup>37</sup> As the analysis focuses on banks lending to private sector firms, the following types of institutions were excluded: central banks, development institutions, microfinance institutions, mortgage banks, saving banks, investment banks, private banking/asset management companies, finance companies, non-banking credit institutions, securities firms, clearing institutions, and investment & trust corporations.

<sup>38</sup> Orbis Bank Focus is a database of banks worldwide. The information is sourced by Bureau van Dijk from a combination of annual reports, information providers and regulatory sources. Not all African banks are featured, and in some cases data are missing for certain indicators. However, Africa's largest banks are featured as they report their data publicly. This means that the gap between reported assets and total assets is not expected to be large. Banks' assets are unconsolidated. When available, Bank Focus data were used to compute the Surveyed Banks (Total Assets). When computing the number of banks in Bank Focus, only commercial, cooperative, Islamic and holding banks were counted. Consequently, the Regional Total Assets in Bank Focus refer only to these entities (to avoid double-counting, Total Assets of consolidated parents were not used to retrieve the total).

Figure 18: Credit as % of GDP and annual credit growth (2020, unweighted)

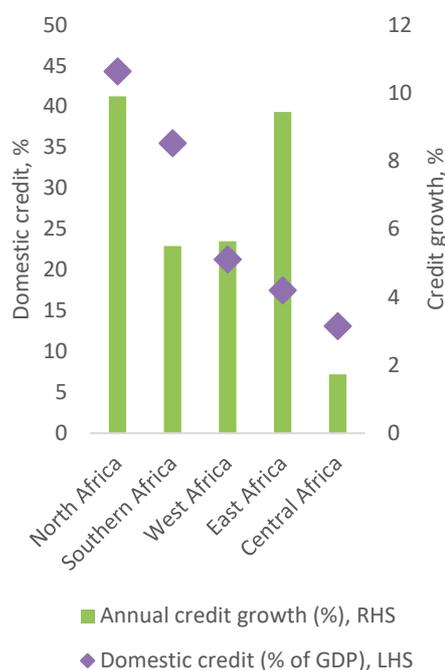
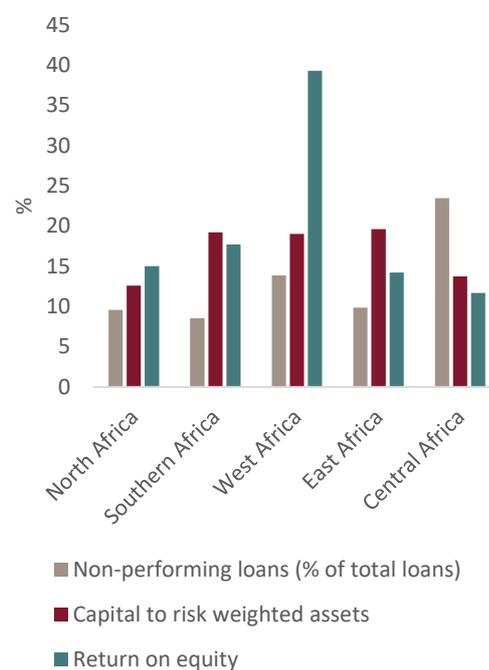


Figure 19: Solvency, profitability and asset quality indicators (2019 or most recent data, unweighted)



Sources: Orbis Bank Focus, IMF and World Bank, for details see Annex.

As Figure 18 shows, credit markets remain underdeveloped, particularly in West, East and Central Africa. North Africa's share of credit to GDP (commonly used as a proxy of credit market development) is highest at 44%, followed by Southern Africa. Financial markets are considerably less developed in the other subregions, with credit to GDP in Central Africa at just 13%. Credit growth in Africa as a whole was weak during 2020, averaging 6.4% in nominal terms, against average inflation of around 15%. At the end of 2019, the loan-to-deposit ratio was significantly below the indicative overheating threshold of 100% in all subregions (averaging 78%), with Central Africa standing out at 90% because of lower deposits. This suggests that it may be challenging to restart lending and extend access to finance, given the probable increased risk aversion of banks.

Africa's banking sectors are well capitalised and profitable, but asset quality problems pose risks to future soundness and stability, potentially limiting credit growth (Figure 19). Based on the most recent data, the average capital adequacy ratio stood at 17.4% in 2019, comfortably above the minimum recommended under Basel III, an internationally agreed set of measures designed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-2009. Even West Africa's average capital adequacy ratio, the lowest among the five subregions, is above this threshold. Profitability also remains solid, with an average return on equity (ROE) of 16.2%. Asset quality, however, gives cause for concern. The ratio of NPLs to total assets averages 12% on the continent and is as high as 24% in Central Africa; even in Southern Africa, around 8% of loans are classified as non-performing. Furthermore, because compulsory moratoriums and other regulatory forbearance measures were still in place in many countries at the time these data were reported, these NPL ratios may understate the extent of asset quality challenges. Evidence from the *EIB Banking in Africa survey, 2021* (Figures 20 and 21) suggests that the majority of responding banks had an NPL ratio of at least 5%, with NPLs accounting for at least 10% of the SME portfolio in around one-third of banks. On top of this, half the banks had at least 5% of their SME portfolio under moratorium, and 40% had at least 5% of SME loans under some kind of restructuring. Corporate loans show a similar picture. If the economic recovery is weak, it is highly likely that some of the loans under moratoriums or restructuring will ultimately default, causing a further deterioration in NPLs. This could impact on capital adequacy and profitability in the future, as a proportion of these loans are written off. In turn, future credit growth could be limited as these non-performing assets constrain the balance sheet growth of banks across the continent. The extent of the potential deterioration will depend on the speed of economic recovery.

Figure 20: Problem loans to small and medium-sized enterprises (% of surveyed banks)

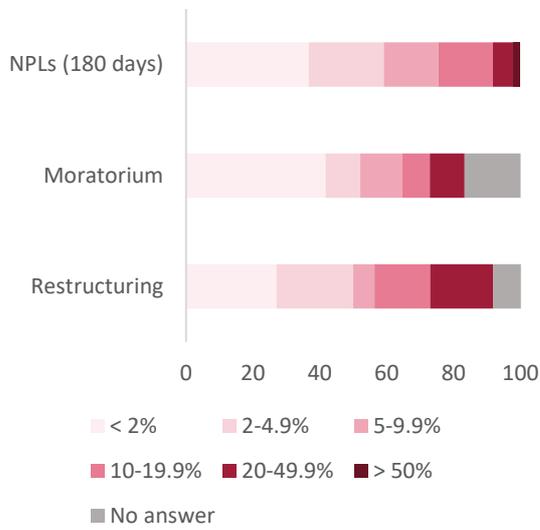
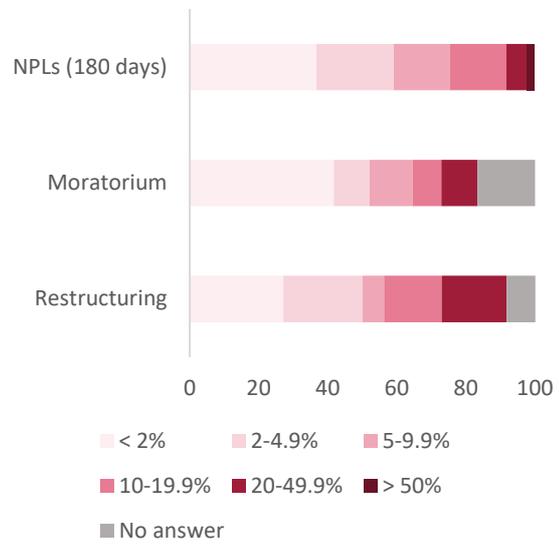
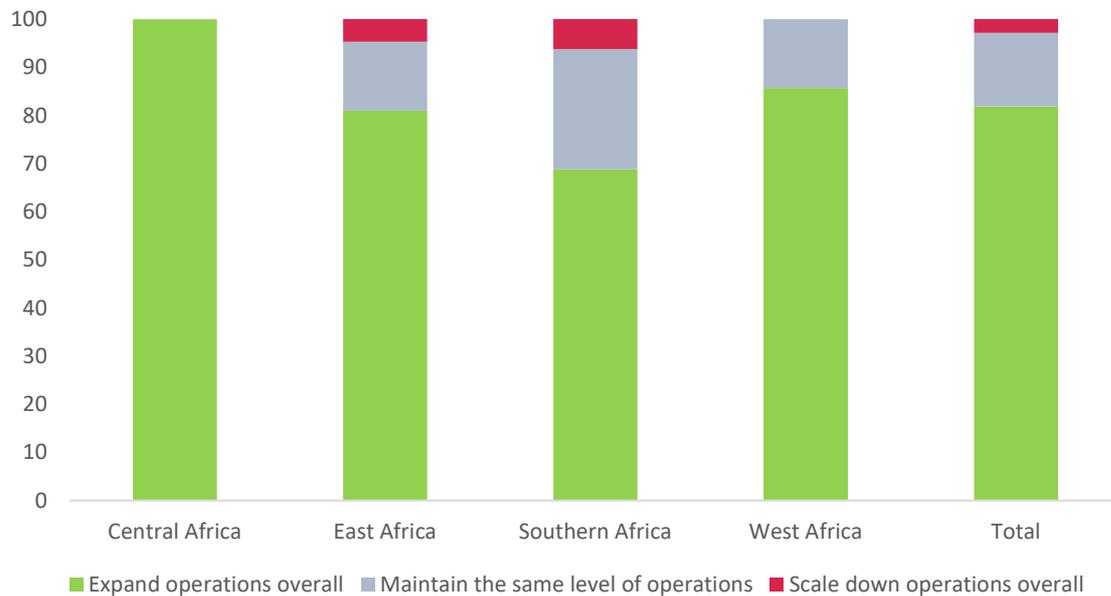


Figure 21: Problem loans to corporates (% of surveyed banks)



Source: EIB Banking in Africa survey, 2021.

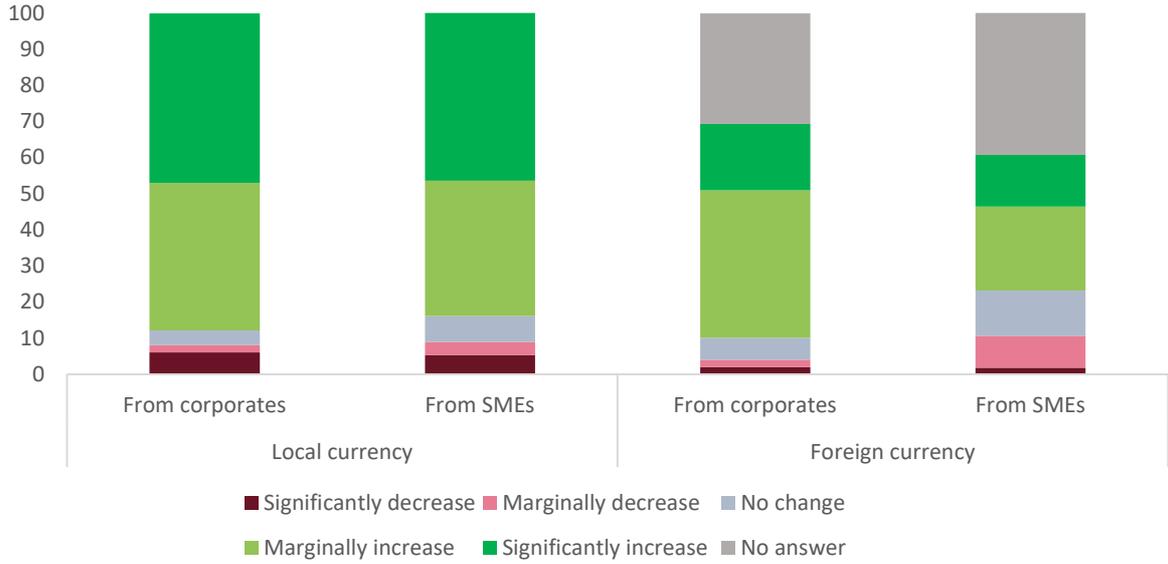
Figure 22: Banks' plans for the next 12 months (% respondents)



Source: EIB Banking in Africa survey, 2021.

**Going forward, 80% of surveyed banks in sub-Saharan Africa expect to expand their activities over the next 12 months (Figure 22).** This expansion is expected to bring an increase in funding that will be more pronounced in local currency (90% of surveyed banks) than in foreign currency (75%). Southern African banks report somewhat less ambitious plans, with 70% of the respondents planning to expand operations, whereas all surveyed banks in Central Africa (the lowest number in the continent) plan to expand.

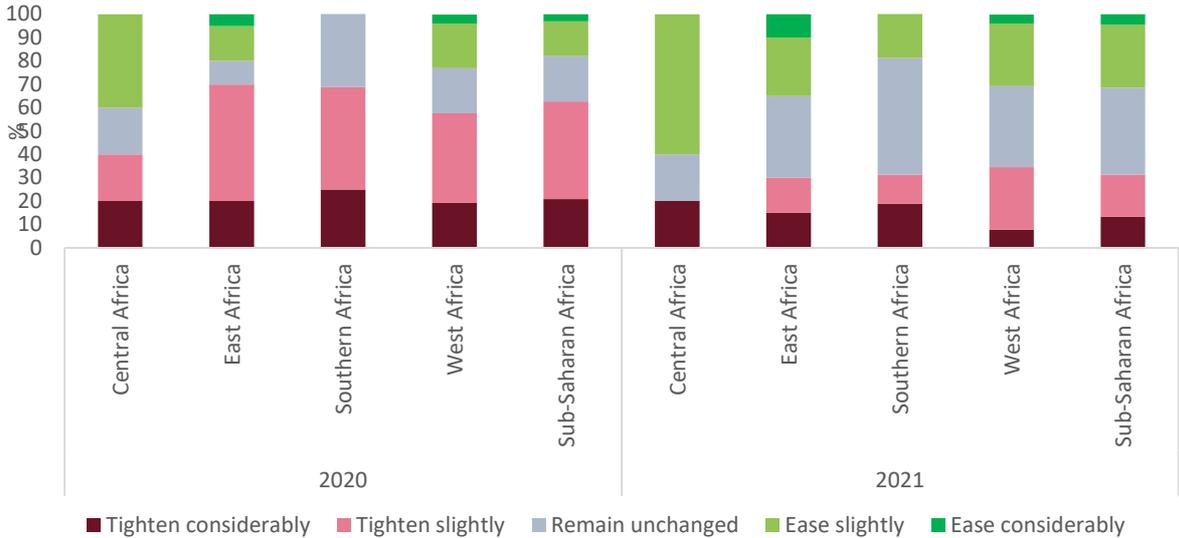
Figure 23: Expected change in demand for credit (% respondents)



Source: EIB Banking in Africa survey, 2021.

**Credit demand, particularly from SMEs, is also expected to increase, but banks will remain relatively cautious across all the sub-Saharan African subregions (Figure 23).** Banks are expecting increased demand for loans from corporates and SMEs in both foreign and local currency. However, credit standards are unlikely to be fully supportive of this increase in demand. Only around 31% of responding banks plan to ease their credit standards in 2021, whereas more than 60% tightened their standards in 2020 and less than 20% reported easing them (Figure 24). Further tightening during 2021 is planned by 31% of responding banks. Overall, although banks report some hope for lending in 2021, it seems they are also planning a cautious approach, so the impact of the COVID-19 shock on lending could be relatively persistent.

Figure 24: Change in credit standards over 2020 and expected change over 2021 (% respondents)



Source: EIB Banking in Africa survey, 2021.

## Subregional snapshots

### Banking in North Africa

**North Africa's banking sector is among the most developed on the continent, with banks offering a broad range of financial products both domestically and across African markets.** Key indicators are displayed in Table 4 in the Annex. The Egyptian, Moroccan and Algerian banking sectors are moderately concentrated, with 62–67% of assets held by the three largest banks. State-owned banks play an important role in the Egyptian and Algerian markets, where they respectively account for about 50% and 80% of total assets. Morocco, by contrast, has one of the most developed financial systems in Africa, and public banks' share of total assets has declined to around 18%, from 40% in 2002. A number of large Moroccan banks have expanded internationally, including to around 35 countries across Africa. Cross-border exposure accounts for about 20% of the assets of Moroccan banks. Tunisia has a more fragmented banking sector with significant state involvement: only 35% of assets are held by the three largest banks, all of which are government-controlled.

**Provision of credit to the private sector compares favourably to sub-Saharan Africa on average, but varies across the subregion (Figure 25).** Credit to the private sector as a proportion of GDP is particularly low in Egypt and Algeria in comparison to other middle-income countries. In Egypt, total assets account for about 85% of GDP, yet credit to the private sector is only 24%, reflecting crowding out by public debt, a problem that is likely to increase as a result of the crisis. In Tunisia and Morocco, by contrast, domestic credit is over 60% of GDP, easily exceeding the average of middle-income countries. Based on data from Orbis Bank Focus, Egypt exhibited the strongest credit expansion in North Africa during 2020, at 25%, partly reflecting monetary easing by the central bank in response to the pandemic<sup>39</sup>. Credit growth in the other North African countries was more moderate, at 3–7%.

**Financial soundness indicators have held up well (Figure 26), but the full impact of the pandemic may not yet have materialised.** Capital adequacy pre-crisis was comfortably above recommended minimum values in all four countries in the subregion. Emerging data suggest that capital adequacy and liquidity have largely been sustained, benefiting from central banks' support policies. For example, according to data from the Central Bank of Egypt, total capital accounted for 17% of risk-weighted assets in Q1 2021. Profitability was also comfortable pre-crisis, with ROE ranging from 9% in Morocco to 22% in Algeria. According to IMF data, profitability in Morocco came under pressure in 2020 as provisioning costs increased in anticipation of higher credit losses and lower transaction volumes. In Egypt, ROE declined from 23% in 2019 to 15% in Q1 2021. For the other countries, 2020 data on ROE are not yet available. Asset quality appears to have remained relatively strong in Egypt, with an NPL ratio of only 4%. In Algeria, by contrast, 13% of gross loans were non-performing even pre-crisis, and NPLs were at similarly elevated levels in Tunisia. In Morocco, NPLs increased marginally from 7.5% in 2019 to 7.9% at the end of Q2 2020. A further increase in NPLs may materialise in the subregion as policy support is unwound. On average, loan-to-deposit ratios are higher than in sub-Saharan Africa, reflecting the high ratio in Tunisia (137%) and the moderate ratio in Morocco (70%). The low loan-to-deposit ratio in Egypt (53%) reflects the strong linkage between the sovereign and the banking system, which is a key vulnerability for Egyptian banks.

**North Africa's central banks responded to the COVID-19 crisis with a broad suite of policy measures, including lower policy rates, the relaxation of prudential requirements and some direct support for lending.** Egypt responded to the pandemic with aggressive cuts to the policy rate, although it remained relatively high<sup>40</sup>. In addition, the central bank mandated that loan repayments be deferred for six months, while loan growth benefited from subsidies on loans for the tourism, industry, construction and agricultural sectors. In Morocco, Bank Al-Maghrib lowered the policy rate to a very low level<sup>41</sup> and addressed growing demand for liquidity through several measures: expanding the range of collateral eligible for repos and credit guarantees; increasing and lengthening refinancing operations to support bank credit to SMEs; providing foreign exchange swaps to domestic banks; and easing regulatory capital and reserve requirements. These measures were complemented by a funding for lending facility, which provides loans to SMEs at subsidised interest rates. Economic disruptions

<sup>39</sup> A recent report by the ratings agency Fitch cited credit growth of 16% during 2020, which is below the estimate from Bank Focus but still high (Fitch Solutions, 2021).

<sup>40</sup> The central bank has lowered overnight deposit and lending rates by 400 basis points since March 2020, taking them to 8.25% and 9.25%, respectively.

<sup>41</sup> By 25 basis points to 2% in March 2020 and by 50 basis points to 1.5% in June 2020.

caused by the COVID-19 crisis and the volatility of hydrocarbon prices over the years led to pressure on liquidity for banks across the subregion. In response, the Bank of Algeria focused on steep cuts in reserve requirements, lowering the policy rate, and relaxing prudential requirements related to solvency, liquidity and NPL ratios<sup>42</sup>. The Central Bank of Tunisia combined cuts in the policy rate<sup>43</sup> with loan moratoriums to cushion the economic impact of the pandemic. Moreover, the dividend distribution deadline for banks was deferred, and banks breaching the maximum loan-to-deposit ratio were granted more time to reach it<sup>44</sup>.

**Meanwhile, Egypt continued to move towards compliance with international standards by introducing a new banking law.** The new law stipulates a significant increase in minimum capital requirements, which will likely lead to further consolidation in the sector. It also strengthens regulatory oversight and establishes a financial stability committee.

Figure 25: Credit as % of GDP and annual credit growth, North Africa

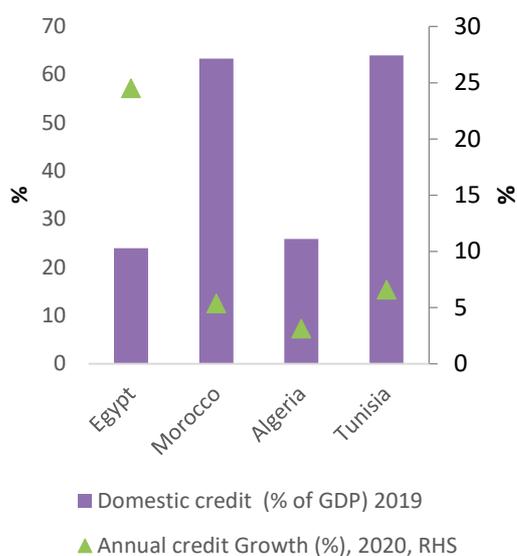
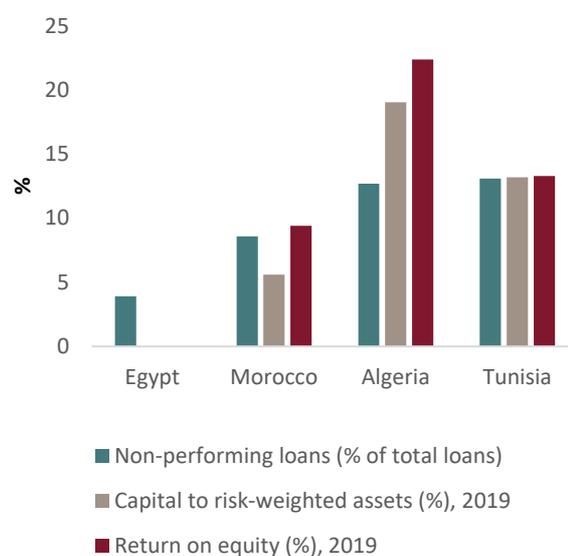


Figure 26: Solvency, profitability and asset quality indicators, North Africa



Sources: IMF<sup>45</sup>, World Bank<sup>46</sup> and BankFocus<sup>47</sup>.

**Firm-level data reveal that access to finance is a significant challenge in North Africa – a large share of firms that need a loan are unable to obtain one.** In collaboration with the EBRD and the World Bank, the EIB recently conducted enterprise surveys in 41 economies located in Europe, Asia, the Middle East and North Africa. This survey collected data from representative samples of each economy’s formal private sector. In North Africa, Egypt, Morocco, and Tunisia were surveyed. Figure 27 demonstrates the prevalence of credit constraints in the subregion. According to the survey, 80% of Egyptian firms that need a loan are credit-constrained – these firms have had their loan application rejected or have been discouraged from applying in the first place – significantly exceeding the average of lower-middle-income countries (59%). The share of firms in Morocco (50%) and Tunisia (53%) that are credit-constrained is below the lower middle-income average, but nonetheless significant. The vast majority of these credit-constrained firms are discouraged – very few have applied for loans and been

<sup>42</sup> The Bank of Algeria has progressively lowered the reserve requirement ratio from 10% to 2% (down to 8% in March 2020, 6% in April, 3% in September, and 2% in February 2021). It has also lowered its main policy rate from 3.5% to 3%, first by 25 basis points to 3.25% in March 2020 and then to 3% in April.

<sup>43</sup> Which remains above 6%, considerably higher than Morocco but lower than Egypt.

<sup>44</sup> In particular, the Central Bank of Tunisia cut the policy rate by 100 and 50 basis points in March and October 2020, respectively. It also requested that banks temporarily defer payments on loans (including for the tourism sector), as well as suspending fees for electronic payments and withdrawals.

<sup>45</sup> IMF Financial Soundness Indicators, available at <https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA>.

<sup>46</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.

<sup>47</sup> Moody's Analytics BankFocus combines content from Bureau van Dijk and Moody's Investors Service, with expertise from Moody's Analytics. The data are available to subscribers at [https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9\\_D\\_BwE](https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9_D_BwE).

rejected. A comparison with the previous survey round, carried out in 2013, indicates that the share of credit-constrained firms has increased throughout the subregion, with the sharpest increase in Morocco, followed by Tunisia.

**Stringent collateral requirements, complex application procedures, and high interest rates are the main factors discouraging North African firms from applying for a loan.** As Figure 28 shows, the relative importance of these factors differs between countries. Egyptian firms most frequently mentioned collateral requirements, Moroccan firms tended to be concerned by complex application procedures, and Tunisian firms frequently cited high interest rates.

**Moroccan firms have been severely impacted by lockdowns, which have adversely affected cash flows and liquidity.** A COVID-19 follow-up survey was implemented in Morocco. The data reveal that 78% of Moroccan firms had to close at least once during the pandemic. Lockdowns also affected firms’ liquidity positions, with 72% reporting lower liquidity and cash flows. Liquidity shortages led firms to seek fresh capital: 63% of firms experiencing lower cash flows have resorted to equity finance. This is consistent with a need for loss-absorption capacity.

Figure 27: Credit-constrained firms in North Africa

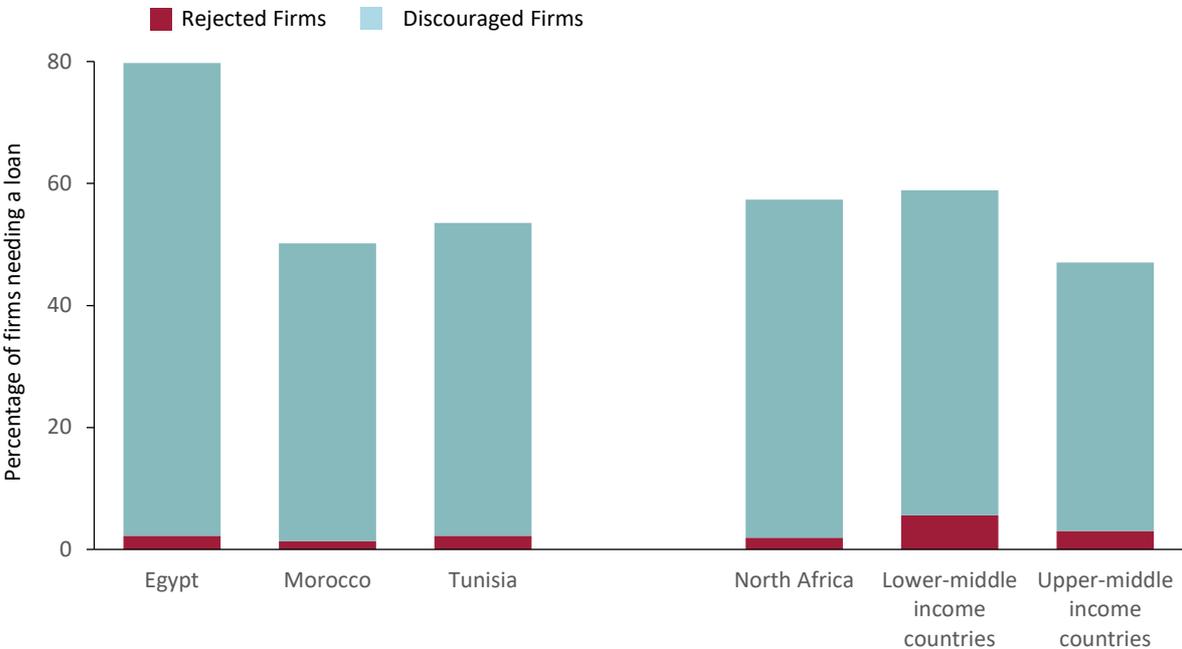
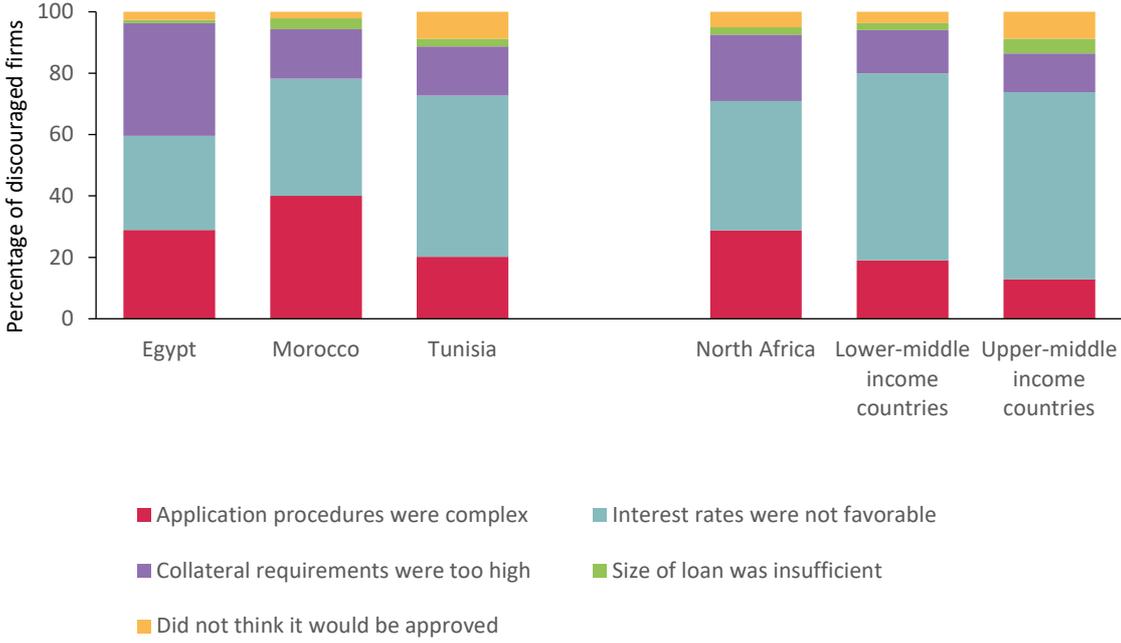


Figure 28: Factors discouraging firms from applying for a loan



Source: EBRD-EIB-World Bank Enterprise Surveys.

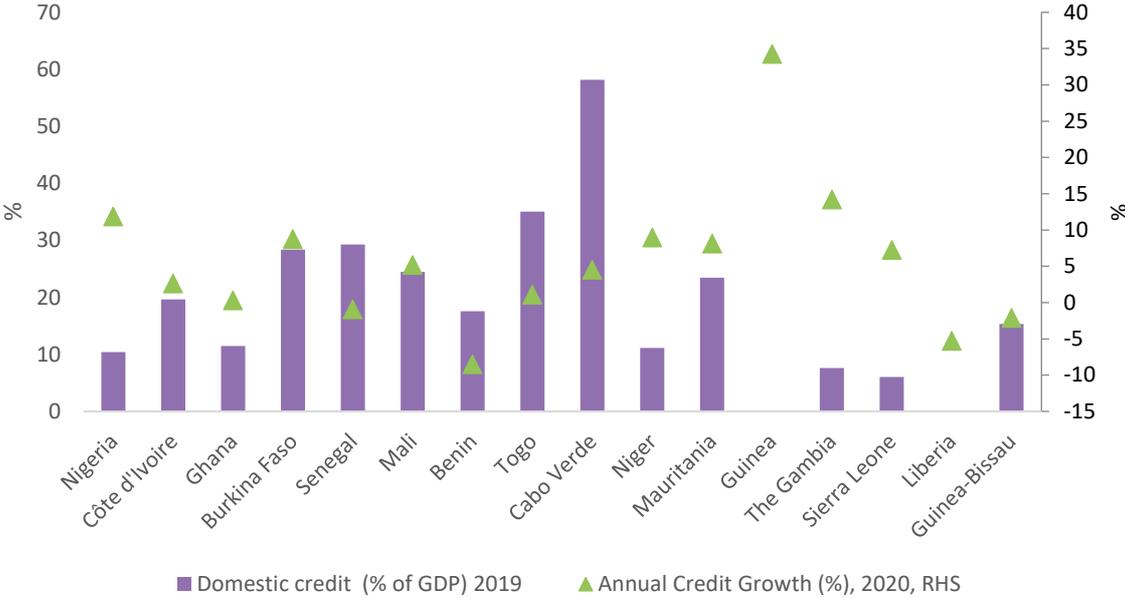
### Banking in West Africa

**Driven by the relatively large number of commercial banks in its largest markets, West Africa has the second most competitive banking sector among Africa’s subregions** (see Table 5 for key indicators of the banking sectors in West Africa). West Africa has a total of 230 banks. Nigeria, Senegal, Côte d’Ivoire and Ghana are sizeable markets with a relatively large number of commercial banks, even following recent banking sector consolidation in Ghana. The smaller economies, by contrast, are more concentrated. The banking system in the West African Economic and Monetary Union (WAEMU) is comparable in size to that of its peers in sub-Saharan Africa. In 2019, it included 4.5 branches per 100 000 adults (compared to 4.7 in sub-Saharan Africa) and comprised 148 banks with a total capital of 2.4% of GDP. On average, WAEMU’s banking concentration, proxied by the weighted average of the share of assets held by the three largest banks, stood at 52%, with the highest levels recorded in Guinea-Bissau and Togo. Also in 2019, foreign ownership stood at 61%, while the state’s share of banks’ capital represented 15% of total capital.

**Overall, financial depth in the subregion remains low.** With exception of Cabo Verde, credit to the private sector stood below the average of 42% of GDP for sub-Saharan Africa, with Sierra Leone placed in the bottom four worldwide. Larger WAEMU countries have relatively developed credit markets, but credit accounts for a small percentage of GDP in the smaller economies (Figure 29). Nigeria and Ghana also have low shares of private sector credit to GDP, partly explained by: banks’ tendency to invest in high-yielding sovereign securities, rather than lending to the private sector; the significant size of oil economies; and substantial levels of economic informality, with informal firms struggling to access credit. The scarcity of funding for private sector enterprises is reflected in firm-level data (see Figure 9 and the above discussion of access to finance for SMEs). Before the crisis, Ghanaian and Nigerian policymakers were aiming to stimulate lending to the private sector: for example, the Central Bank of Nigeria was imposing a minimum loan-to-deposit ratio.

**The COVID-19 crisis has set back growth in credit to the private sector in most West African countries.** In Ghana and Nigeria, the positive growth in credit witnessed in 2019 has been curtailed<sup>48</sup>. The lending slowdown in Ghana led to a fall in the loan-to-deposit ratio from over 56% in January 2020 to 48% by year-end 2020<sup>49</sup>. In Liberia, lending by commercial banks contracted by 13.4% in 2020<sup>50</sup>. Data for the other West African countries are not yet available but will likely show a similar pattern. The largest share of credit in WAEMU in mid-2020 targeted trade, restaurants and hotels (26.7% of total credit) followed by other services (18.6%) and manufacturing (14.1%). As the COVID-19 crisis hit these sectors severely, loans in the WAEMU subregion dropped to 84.7% of deposits on average in mid-2020, from 90.2% in 2019 and 92.2% in 2018.

**Figure 29: Credit as % of GDP and annual credit growth, West Africa**



Sources: World Bank<sup>51</sup> and BankFocus<sup>52</sup>.

**The banking sectors of larger West African countries appear well placed to withstand the economic shock triggered by COVID-19, but risks are likely to surface as support measures are unwound (Figure 30).** In Nigeria, financial soundness indicators appear healthy but the ratings agency Fitch estimates that banks have placed around 40% of loans under moratoriums (principal and interest), making use of central bank regulatory forbearance policies introduced to support pandemic-affected sectors (Fitch Ratings, 2021a)<sup>53</sup>. Banks are not permitted to classify loans under moratoriums as higher risk and are not required to provision for these loans. No information is available about the situation currently facing borrowers with loans placed under moratoriums, but the economic recovery is expected to be slow, so a significant proportion could be expected to default once the moratoriums are lifted in March 2022. Fitch forecasts that NPLs in Nigeria will rise to 11% by the end of 2021 (Fitch Ratings, 2021a), from around 6% in 2019 (Figure 30). Ghana’s banking system is well capitalised following a sectoral cleanup in 2015-2019, and capital adequacy rose during 2020 as a result of the slowdown in lending to the private sector. NPLs in Ghana were high going into the crisis (14% in February 2020) as a result of legacy issues, particularly in loans to state-owned enterprises, and rose to 15% of total loans by year-end 2020 (Bank of Ghana data, 2020) and then to 15.5% by March 2021 (Fitch Ratings, 2021b). The electricity, gas and water sub-sectors continued to drive NPLs in early 2021, meaning that these legacy issues remain relevant. However, the

<sup>48</sup> In Nigeria, credit grew by 12% on a nominal basis but real credit growth was only around 2% in the year up to January 2021 (data from the Central Bank of Nigeria). Ghana’s zero nominal credit growth implies a real-terms contraction in lending.  
<sup>49</sup> Sectoral breakdown of loans as of March 2021 reveals that the services sector continued to receive the largest share of credit, followed by the commerce and finance sectors and the manufacturing sector.  
<sup>50</sup> IMF, 2021d.  
<sup>51</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.  
<sup>52</sup> Moody’s Analytics BankFocus combines content from Bureau van Dijk and Moody’s Investors Service, with expertise from Moody’s Analytics. The data are available to subscribers at [https://www.bvdfinfo.com/en-us/our-products/data/international/bankfocus?gclid=EALalQobChM18Ja5xY6a8glV0eF3Ch0CdA4uEAAYASAAEgLw9\\_D\\_BwE](https://www.bvdfinfo.com/en-us/our-products/data/international/bankfocus?gclid=EALalQobChM18Ja5xY6a8glV0eF3Ch0CdA4uEAAYASAAEgLw9_D_BwE).  
<sup>53</sup> The relevant measures are described in Central Bank of Nigeria, 2020.

share of loans under moratoriums is lower than in other sub-Saharan African countries, representing around 10% of the total loan portfolio according to a Bank of Ghana statement in May 2021. Both Ghanaian and Nigerian banks are highly exposed to sovereign risk, which could become a concern if the economic situation deteriorates relative to the IMF's baseline assumptions. Asset quality deteriorated in more fragile economies such as the Gambia, Liberia and Sierra Leone because of pandemic-related disruptions to economic activities. Banks in these countries remain well capitalised, with capital adequacy ratios above 30%, but the NPL proportion of total loans rose by an average of 3% from 2019 to 2020. In Liberia, almost one-quarter of loans were non-performing as of September 2020, driven by the halt of tourism and service sectors. The Central Bank of Gambia's advice to limit dividend payments during the pandemic may have helped to preserve capital buffers.

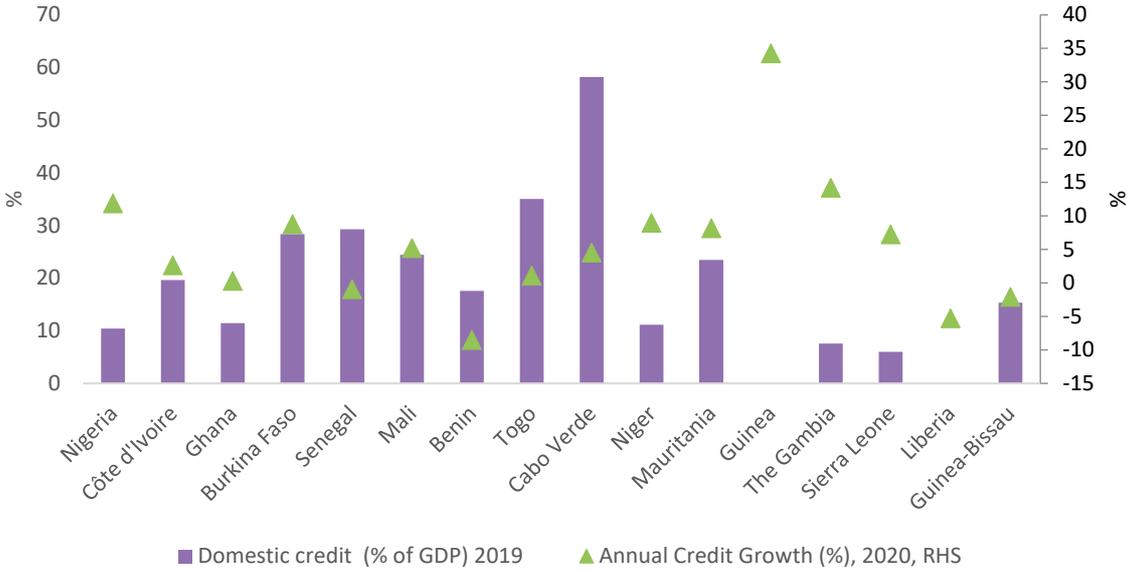
**In the WAEMU subregion, the banking sector has demonstrated resilience but available prudential data should be interpreted with caution (Figure 30).** The banking sector remained adequately capitalised with a capital adequacy ratio of 12.1% of risk-weighted assets in mid-2020, compared to 11.5% in 2019 and 10.5% in 2018. The after-tax return on average equity was solid, at 15.3% in 2019 (from 14.6% in 2018), but profitability is expected to have declined in 2020 as the provisioning rate increased relative to 2019. Based on data from the Central Bank of West African States, the quality of the loan book did not decline between year-end 2019 and mid-2020, with NPLs at 11.4% of total loans. Nevertheless, the impact of the crisis cannot yet be reliably quantified. The IMF expects NPLs to rise once the economic situation stabilises and once the exceptional relief measures taken by the central bank are phased out. According to IMF calculations, this will increase WAEMU banks' recapitalisation needs (to comply with the regulatory capital adequacy ratio and meet provisioning requirements) from the equivalent of 1.4% of GDP required pre-crisis to 1.9% of GDP<sup>54</sup>. NPL ratios are particularly elevated in Guinea-Bissau, Benin and Togo, because of negative equity in a systemically important bank (Guinea-Bissau) and the impact on the international trade-related loan book from the closure of the border with Nigeria (Togo and Benin). Consequently, Togo's banks have the highest need for additional capital, estimated to be equivalent to 6.5% of GDP, while Guinea-Bissau's banks require injections equivalent to 4.7% of GDP. Provisioning coverage increased to 67.1% of NPLs in mid-2020, from 63.3% in 2019 and 65.3% in 2018, in anticipation of new NPLs due to the pandemic.

**West African central banks have implemented a number of measures to support banks and borrowers through the crisis.** For example, in March 2020 the Central Bank of West African States adopted a full allotment strategy at a fixed rate of 2.5% (the minimum monetary policy rate) and extended the list of collateral accepted in central bank refinancing operations. It also endorsed renewable moratoriums of up to three months on debt service falling due, without the need to classify these restructured loans as non-performing, and launched a special three-month refinancing window, while also extending by one year the transition to Basel II/III bank prudential requirements. This means that the regulatory capital adequacy ratio will remain unchanged at 9.5%, before gradually increasing to 11.5% by 2023. Elsewhere in the subregion, central banks cut policy rates, required or encouraged banks to provide moratoriums, and made other adjustments to prudential requirements to help banks through the crisis period.

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<sup>54</sup> IMF, 2021c.

Figure 30: Solvency, profitability and asset quality indicators, West Africa, most recent data



Sources: IMF<sup>55</sup>, World Bank<sup>56</sup> and BankFocus<sup>57</sup> with the exception of Ghana (NPLs, ROE and capital to risk-weighted assets from monthly financial soundness indicators, December 2020, available on the Bank of Ghana website) and Nigeria (NPLs and capital to risk-weighted assets replaced with December 2020 values from Central Bank of Nigeria, 2021).

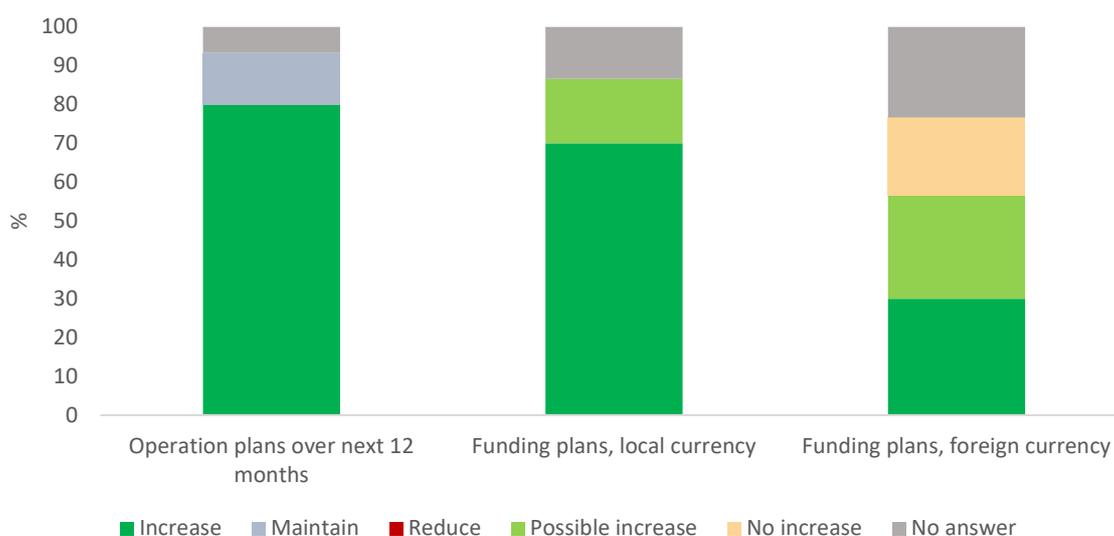
**Going forward, of the 30 West African banks that responded to the EIB Banking in Africa survey, 2021, 80% expect to expand their activities over the next 12 months (Figure 31).** This expansion is expected to bring an increase in funding, although more pronounced in local currency (87% of respondents planning or considering an increase) than in foreign currency (57% planning or considering). A lack of certainty about foreign currency finance among West African banks reflects the situation in Nigeria, where forex availability remained limited in early 2021, at the time of the survey, as well as de-dollarisation efforts in Liberia and a more general reduction in import and export activities amid pandemic-related disruption.

<sup>55</sup> IMF Financial Soundness Indicators, available at <https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA>.

<sup>56</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.

<sup>57</sup> Moody's Analytics BankFocus combines content from Bureau van Dijk and Moody's Investors Service, with expertise from Moody's Analytics. The data are available to subscribers at [https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9\\_D\\_BwE](https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9_D_BwE).

Figure 31: Plans for funding in the next 12 months (% respondents), West Africa



Source: EIB Banking in Africa survey, 2021.

**Most West African banks expect credit demand in local currency, particularly from SMEs, to increase, but they will remain relatively cautious about lending; structural issues must be addressed before credit can be significantly expanded.** Only around 10% of banks expect an increase in demand for foreign currency lending (Figure 32). Again, this may reflect the difficult forex situation in Nigeria. It is unclear, however, whether West African banks will fully accommodate increased demand. In 2020 most banks (58%) tightened credit standards, but only around 40% are planning to relax them in 2021 (Figure 33).

Figure 32: Expected change in credit demand from small and medium-sized enterprises in 2021 (% respondents), West Africa

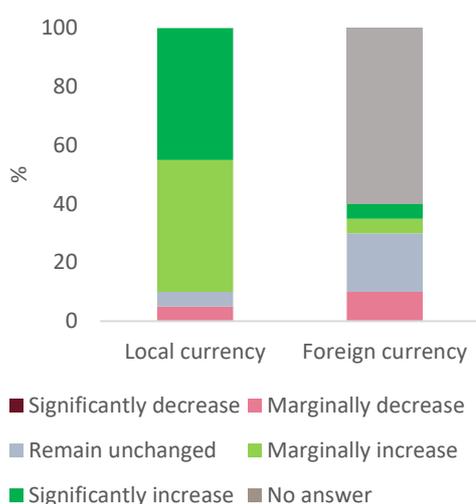
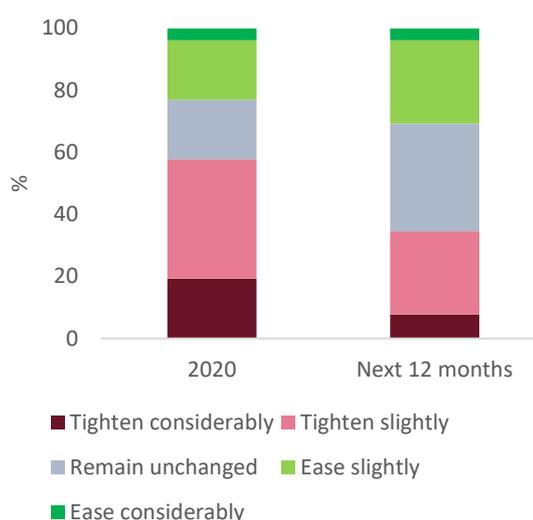


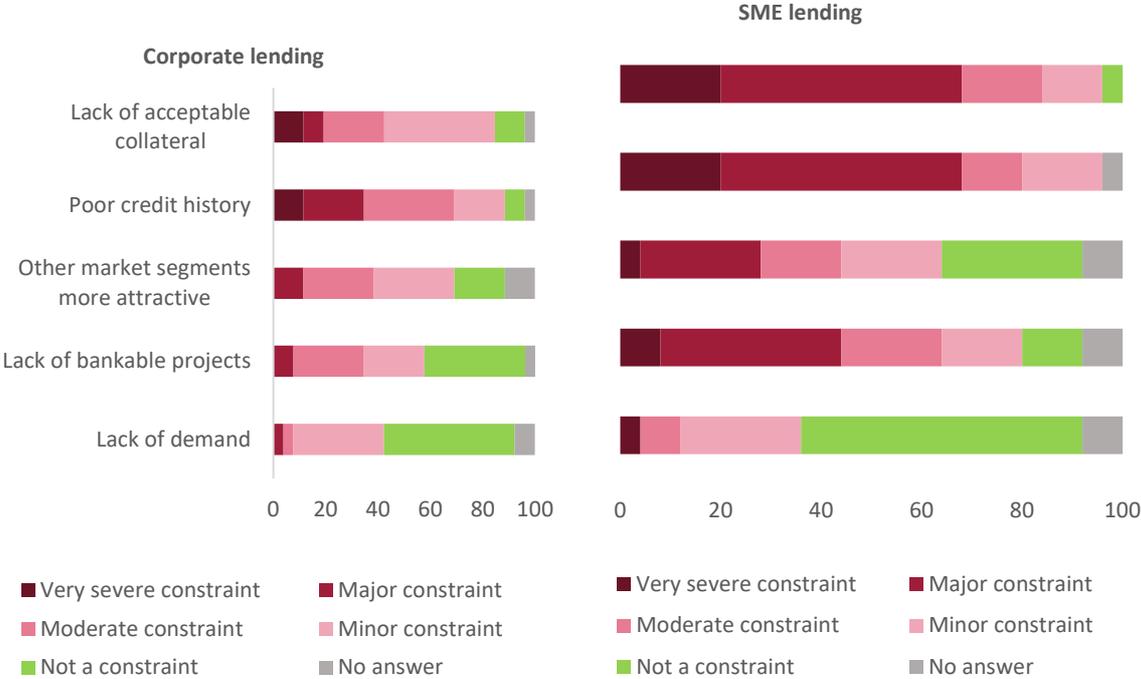
Figure 33: Change in credit standards in 2020 and expected change over in 2021 (% respondents), West Africa



Source EIB Banking in Africa survey, 2021.

The main factors constraining credit supply to corporates and SMEs are a lack of acceptable collateral and poor credit history (Figure 34). According to the surveyed banks, a lack of acceptable collateral and poor credit history are the principal obstacles to lending to corporates, followed by other market segments being more attractive and a lack of bankable projects. This pattern is even more pronounced for lending to SMEs, revealing the need to support such lending in order to help SMEs overcome the impacts of the pandemic.

Figure 34: Factors constraining credit supply, West Africa



Source: EIB Banking in Africa survey, 2021.

**Banking in Central Africa<sup>58</sup>**

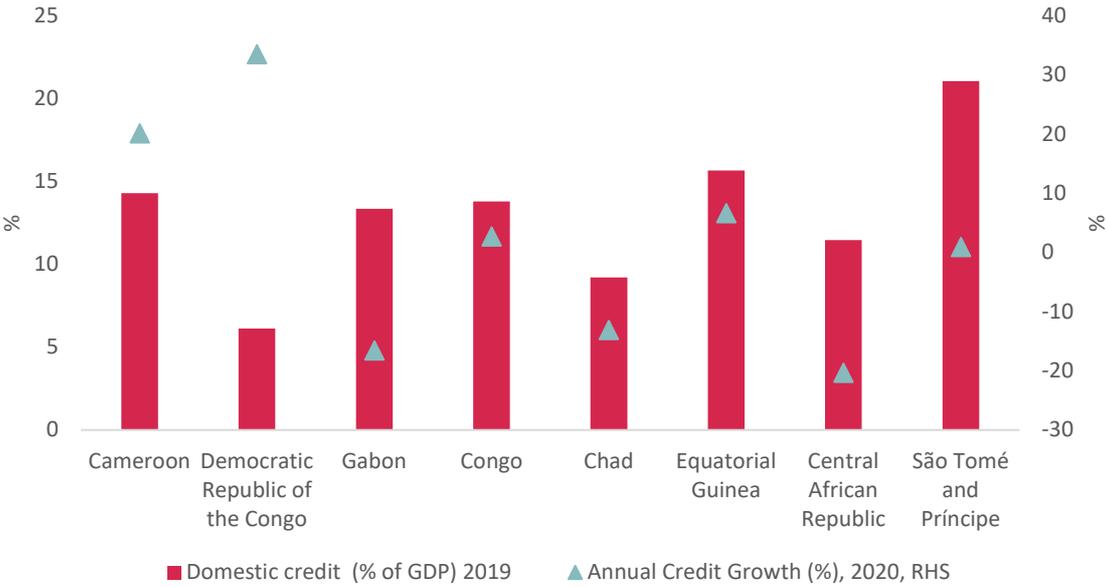
Central Africa has the lowest number of banks and highest banking concentration in Africa, with only 58 banks reporting data publicly (Table 6 in the Annex). This reflects the relatively small size of the economies in the Central African subregion – the subregion accounts for just over 8% of the GDP of sub-Saharan Africa (IMF, 2021a) – and the concentration of economic activity in the subregion’s largest economies—Cameroon, the Democratic Republic of the Congo (DRC) and Gabon, which together account for 76% of the subregion’s GDP (IMF, 2021a). These three markets account for 88% of the subregion’s total banking assets<sup>59</sup>. The low number of banks translates into relatively weak competition, as measured by the weighted average of the share of assets held by the three largest banks. Banking concentration in Central Africa is lowest in Cameroon (52%) and the DRC (66%), while few banks in the smallest economies report their assets publicly, meaning that the BankFocus data reflect 100% concentration (Table 6 in the Annex).

<sup>58</sup> Of the eight Central African countries covered in this section, six (Cameroon, Central African Republic, Republic of Congo, Chad, Equatorial Guinea and Gabon) form the Central African Economic and Monetary Community (CEMAC); the others are the Democratic Republic of the Congo (DRC) and São Tomé and Príncipe. In 2019, CEMAC comprised 39% of Central Africa’s 143 million population and 64% of its \$143 billion GDP; the DRC accounted for almost all of the remaining population and GDP. Monetary policy in CEMAC is conducted by the Bank of Central African States and joint banking supervision is carried out by the Banking Commission of Central Africa.

<sup>59</sup> Asset data are based on 36 of the 58 Central African banks for which total assets data are available in BankFocus.

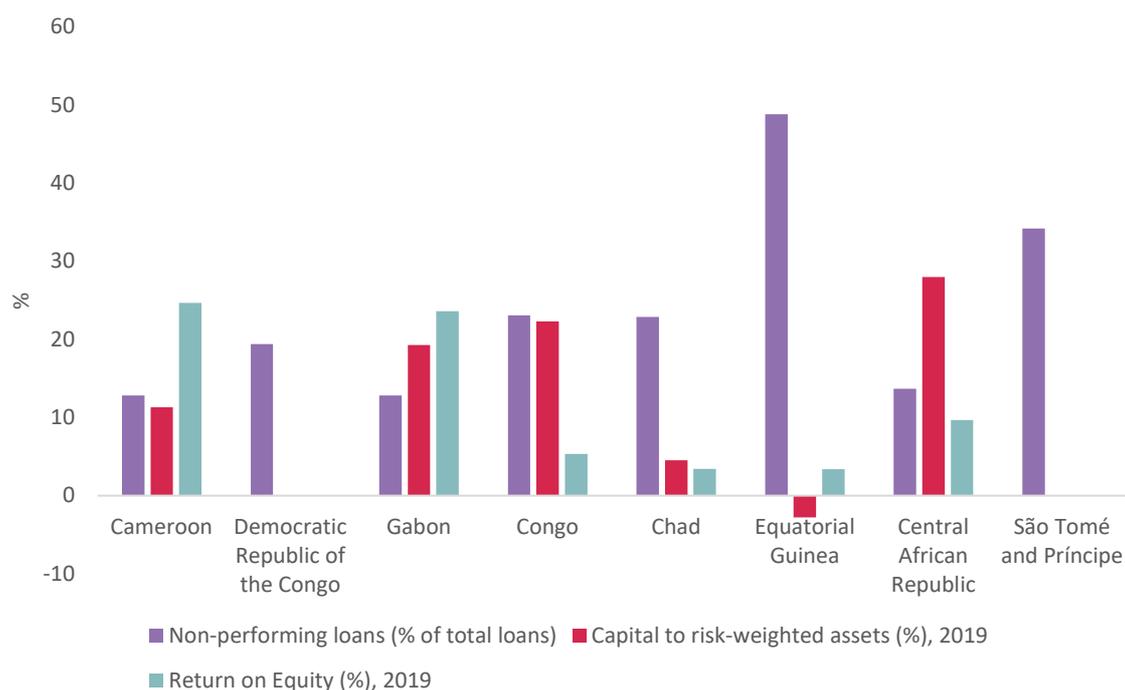
**Central Africa’s credit market is shallow on average, although the level of development varies between countries (Figure 35).** Credit to the private sector averages 11% of GDP across the subregion. São Tomé and Príncipe has the highest share of credit to GDP in the subregion (21%), but even this is below the average for Africa (25%). Credit accounts for less than 10% of GDP in the DRC (6%) and in Chad (9%). Credit growth at the subregional level remained solid in 2020 at 15%, despite the impact of the COVID-19 crisis, but credit dynamics during the pandemic varied substantially across the subregion. There was a double-digit decline in credit in the Central African Republic, Gabon and Chad, whereas the DRC and Cameroon showed a significant expansion (Figure 35). Most countries in the subregion report a loan-to-deposit ratio below 100%, and as low as 64% (DRC), reflecting the cautious approaches to lending taken by these banks.

Figure 35: Credit as % of GDP and annual credit growth, Central Africa



**The soundness and performance of banking sectors vary between countries, but asset quality is highly concerning across the subregion.** Banks’ profitability in 2019, as measured by ROE, ranged from 3% in Chad and Equatorial Guinea to 24% in Gabon and 25% in Cameroon (Figure 36). Capital adequacy also differs substantially across the subregion. Within the Central African Economic and Monetary Community (CEMAC), regulatory capital stands at 13%, which is above the prudentially mandated minimum of 9.5%, but less than half of banks comply with regulatory capital requirements, according to the IMF. At year-end 2019, the ratio of capital to risk-weighted assets was negative (-3%) in Equatorial Guinea, where high levels of public sector arrears had translated into very high NPL ratios. Capital to risk-weighted assets was highest in the Central African Republic at 28% and in the Republic of Congo at 22%. The health of Central Africa’s banking systems is further undermined by high levels of NPLs, ranging from 13% of total gross loans in Cameroon and Gabon to 34% in São Tomé and Príncipe and almost 50% in Equatorial Guinea in 2019. NPLs are expected to have risen further in 2020 as the pandemic and global recession hit Central African economies, which depend strongly on exporting oil and other natural resources (and on tourism in the case of São Tomé and Príncipe). There could be improvements in oil and mineral sector loans during 2021, as commodity prices have recovered. However, prospects for the tourism sector remain weak.

Figure 36: Solvency, profitability and asset quality indicators, Central Africa



Sources: IMF<sup>60</sup>, World Bank<sup>61</sup> and BankFocus<sup>62</sup>.

**CEMAC countries face concentration risks and high levels of arrears.** In this subregion, risks to financial stability are heightened by the strong concentration of banks' exposure to large (often oil) companies and to the public sector, including high levels of sovereign debt on banks' balance sheets (almost 18% of total assets in 2020, according to the IMF). High levels of domestic arrears weigh on asset quality and profitability and depress lending activity. The situation has likely been exacerbated by the negative impact of the COVID-19 crisis.

**Central banks and supervisors in Central Africa responded to the COVID-19 crisis by attempting to mitigate the fallout on their economies and banking systems.** Measures included liquidity support through policy rate cuts in CEMAC and the DRC, and the reduction of the discount rate in São Tomé and Príncipe. In CEMAC, to alleviate pressure on banks' balance sheets, the supervising Banking Commission of Central Africa allowed banks to reduce their capital conservation buffers, meaning that the overall minimum capital requirement was reduced from 10.5% to 9.5%. Reserve requirements were also reduced by the Central Bank of São Tomé and Príncipe, while Banque Centrale du Congo postponed a deadline to comply with the new capital requirement to 2022. These measures were accompanied by more restrictive policies on dividend distribution in CEMAC and São Tomé and Príncipe, aiming to protect banks' capital.

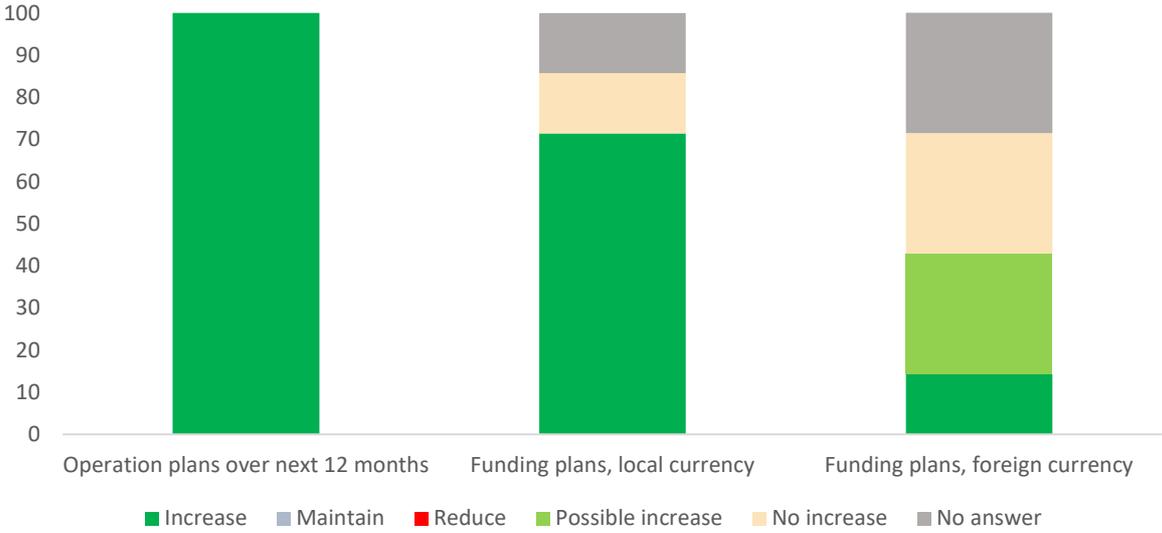
**The seven banks in the subregion that completed the EIB Banking in Africa survey, 2021 all reported plans to expand their activities over the next 12 months (Figure 37).** Five of them specified that they certainly planned to increase funding in local currency. Expectations for funding in foreign currency were more varied: only one bank reported being sure about plans to increase foreign currency funding, while two were considering an increase and two had no plans to increase foreign currency funding levels. The banking system of the DRC is almost entirely dollarised, with almost 90% of loans denominated in foreign currency in Q1 2021. On the other hand, the currency of the CEMAC region, the CFA franc, is pegged to the euro, and foreign currency lending is almost absent in those markets.

<sup>60</sup> IMF Financial Soundness Indicators, available at <https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA>.

<sup>61</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.

<sup>62</sup> Moody's Analytics BankFocus combines content from Bureau van Dijk and Moody's Investors Service, with expertise from Moody's Analytics. The data are available to subscribers at [https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9\\_D\\_BwE](https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9_D_BwE).

Figure 37: Plans over the next 12 months (% respondents), Central Africa



Source: EIB Banking in Africa survey, 2021.

**Credit demand from SMEs is expected to increase moderately over the next year, while banks anticipate gradually easing their credit standards.** Among the five Central African banks who reported lending to SMEs, four expect increased demand for local currency loans from SMEs over the next 12 months, while one expected no change (Figure 38). Notably, none of the surveyed banks expect a decrease in SMEs’ credit demand. Regarding credit standards, three Central African banks were planning to ease standards during 2021, while two reported having tightened them in 2020 (Figure 39). Although the sample is small, the findings suggest that Central African banks may be hoping to accommodate an increase in lending.

Figure 38: Expected change in credit demand from small and medium-sized enterprises over next 12 months (% respondents), Central Africa

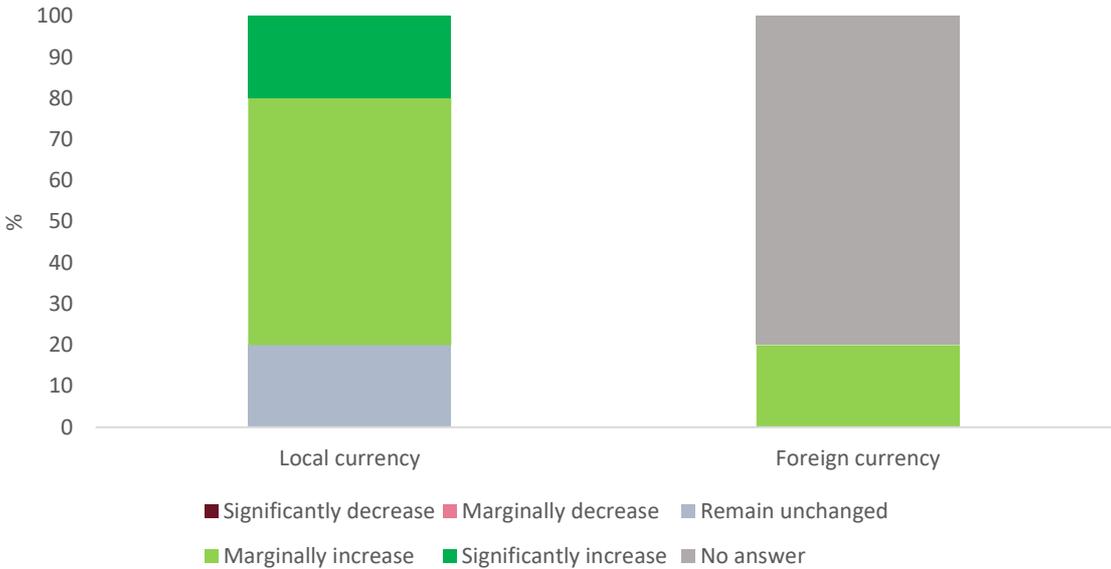
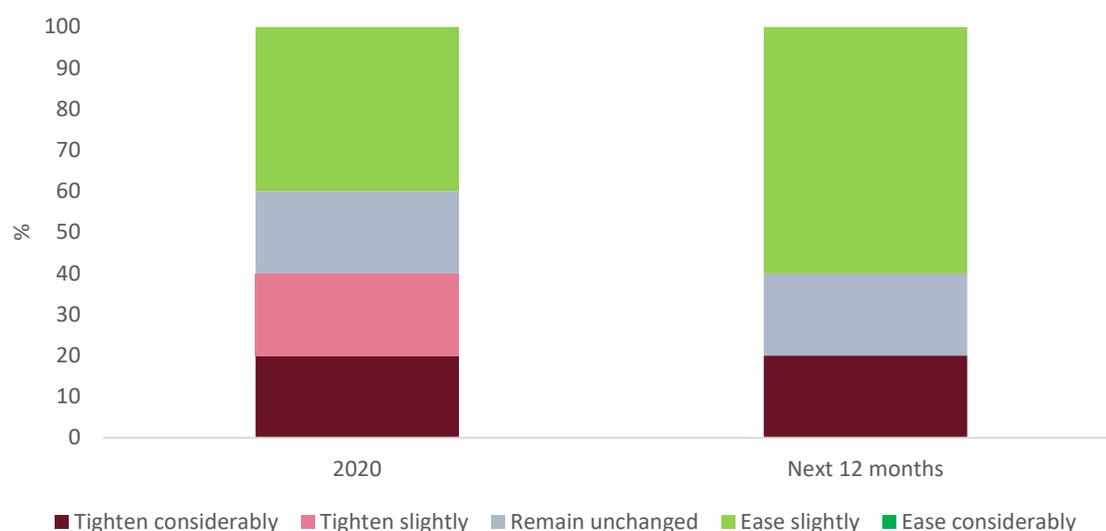


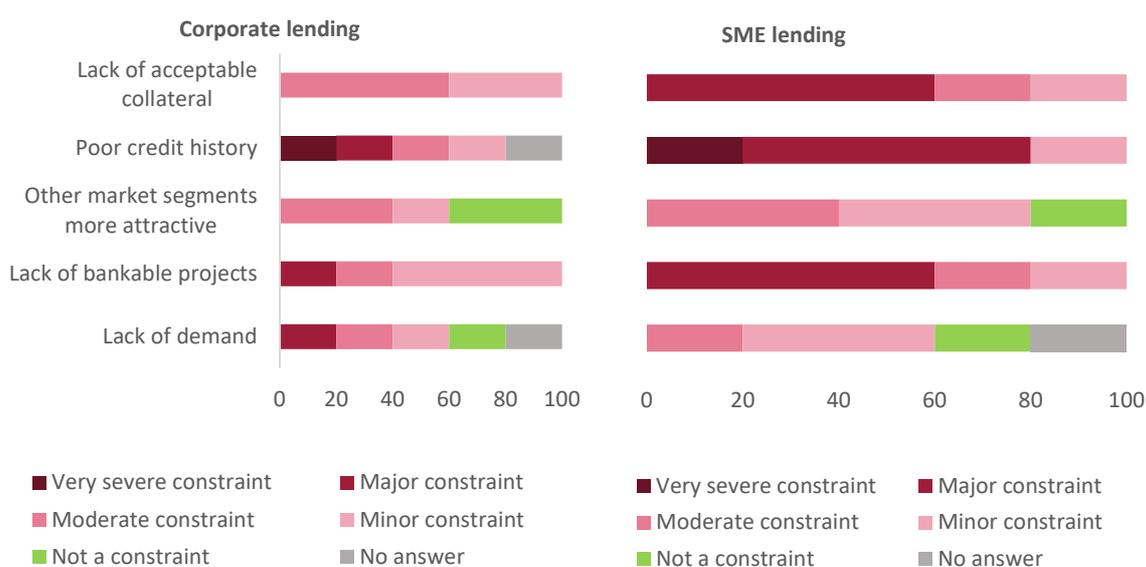
Figure 39: Expected change in credit standards over next 12 months (% respondents), Central Africa



Source: EIB Banking in Africa survey, 2021.

**Credit supply to Central African corporates and SMEs is most strongly constrained by a lack of acceptable collateral and poor credit history.** Insufficient collateral is seen as a minor constraint for corporate lending by three of the five banks that responded to this part of the survey, and as a more significant problem by the remaining two. For SMEs the picture was reversed – four of the five banks viewed collateral as a major or moderate constraint (Figure 40). Poor credit history also weighs heavily on credit supply: this factor was identified as a very severe or major constraint on corporate lending by three banks and on SME lending by four. For SMEs, the lack of bankable projects also seems to be a significant impediment, reflecting the lack of diversification and underdevelopment of the non-oil economy in many countries of this subregion. The reduction of lending constraints in Central Africa depends on the post-COVID-19 economic recovery, clearance of payment arrears, reduction of NPLs, and the successful implementation of measures to strengthen financial inclusion and increase diversification.

Figure 40: Factors constraining credit supply (% respondents), Central Africa



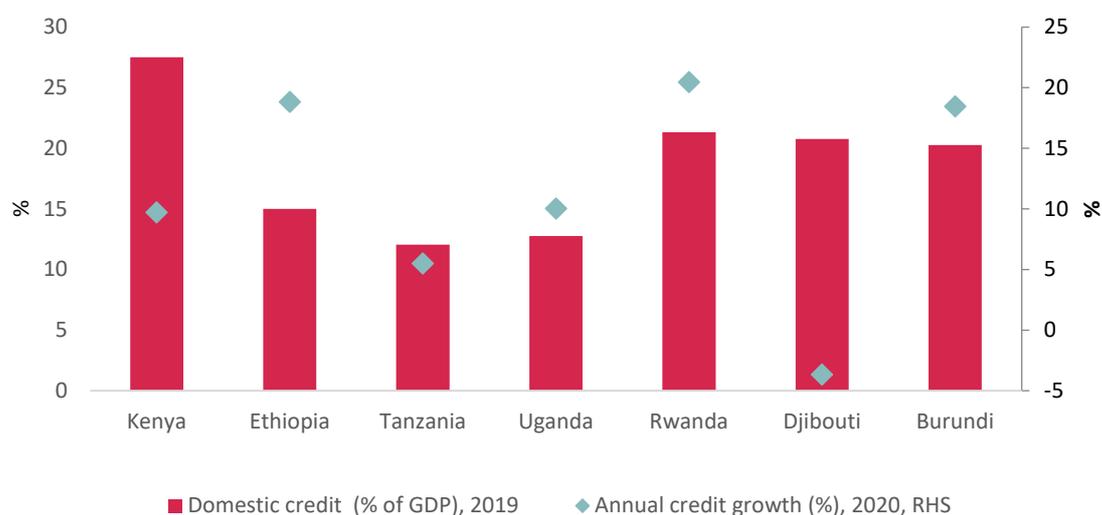
Source: EIB Banking in Africa survey, 2021.

## Banking in East Africa

**Based on average concentration across the seven countries in the subregion, East Africa is more competitive than Southern and Central Africa, but less so than the North and West subregions.** East Africa has a total of 199 banks (Table 7 in the Annex) and the third lowest banking sector concentration of Africa’s subregions, as measured by the weighted average of the share of assets held by the three largest banks. This relatively high level of competition is driven by Kenya and Tanzania, which have relatively low market concentration and large numbers of banks. By contrast, Burundi, Djibouti and Ethiopia are concentrated markets, each with a small number of banks.

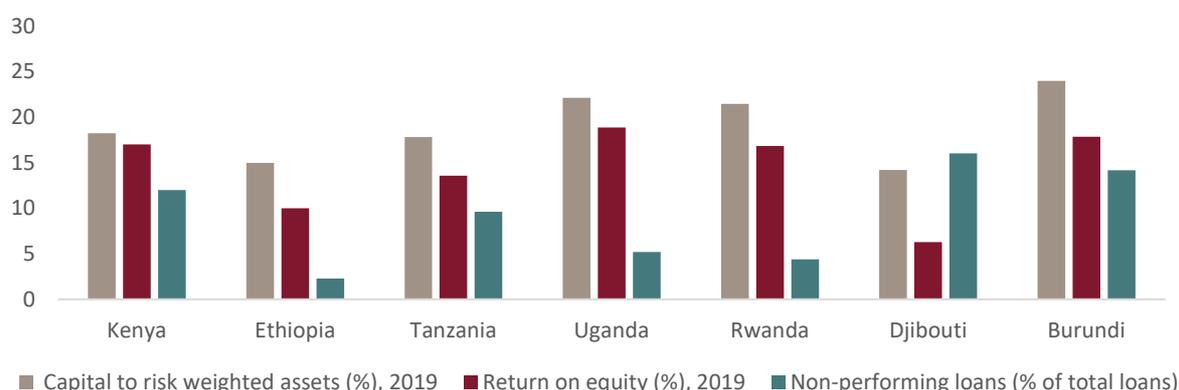
**The level of development of credit markets varies across the subregion (Figure 41).** Kenya has the highest share of credit to GDP, at 27%, which is above the African average (25%). Conversely, Ethiopia, Tanzania and Uganda have credit to GDP ratios below 15%. In addition, while average credit growth is close to 12% in nominal terms at the subregional level, the most recent figures for credit growth (2020) also show divergent trends. Specifically, Burundi, Ethiopia and Rwanda posted annual growth close to 20%, whereas credit expanded by 10% or less in Kenya, Tanzania and Uganda, and even decreased in Djibouti. Despite this recent solid credit growth, loan-to-deposit ratios still stand below 100% in all countries but Rwanda. This indicates that the risks of overheating are limited and that it may be difficult to expand access to finance in the wake of the crisis.

**Figure 41: Credit as % of GDP and annual credit growth, East Africa**



**Stability and soundness indicators suggest that the banking sectors of East African countries are relatively well placed to withstand the economic shock triggered by COVID-19 (Figure 42).** The subregional capital ratio stands at close to 19%, with only Djibouti reporting an aggregate ratio below 15%. In some countries (such as Burundi, Rwanda and Uganda), total capital accounts for over 20% of risk-weighted assets. Profitability remains solid—particularly for a subregion with controlled inflation—with a subregional average ROE of 15.4%. Djibouti displays the weakest profitability, with average ROE of 6.3%, followed by Ethiopia (10%). Asset quality varies across countries, reflecting differences in policy measures implemented during the pandemic, as well as different situations predating the crisis. In mid-2020, the ratio of NPLs to total credit was over 10% in Djibouti, Burundi and Kenya, but 5% or less in Ethiopia, Rwanda and Uganda. Construction and agriculture, particularly in the countries most affected by droughts and locust plagues, are the sectors with the highest share of NPLs.

Figure 42: Solvency, profitability, and asset quality indicators, East Africa

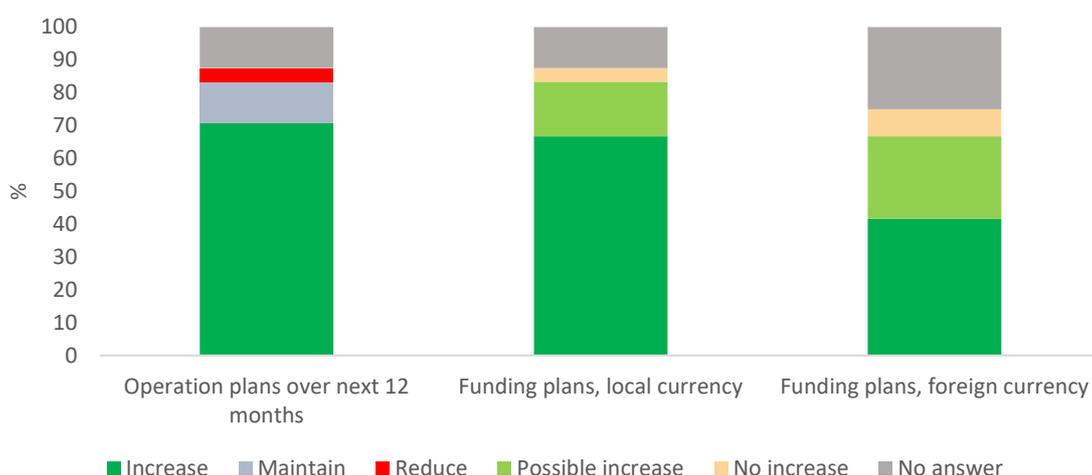


Sources: IMF<sup>63</sup>, World Bank<sup>64</sup> and BankFocus<sup>65</sup>.

**Central banks, governments and supervisors in East Africa responded proactively to the COVID-19 crisis to limit its impact on their banking systems.** Measures included increases in liquidity provisioning, channelled to the sectors more seriously affected by the pandemic, and policy rate cuts by most central banks (the National Bank of Ethiopia was the main exception, keeping the policy rate unchanged during the crisis). Although East African governments have used fiscal measures, the extent of the stimulus has been limited (as elsewhere in Africa) by the rising public debt burden. The governments of Uganda and Rwanda also provided public guarantees for loans to corporates and SMEs in the most affected sectors, such as tourism. In addition, national regulators in Uganda and Tanzania approved loan moratoriums, which have been extended until the end of summer 2021.

**Going forward, of the 24 East African banks that responded to the EIB Banking in Africa survey, 2021, 71% expect to expand their activities over the next 12 months (Figure 43).** This expansion is expected to bring an increase in funding, although more pronounced in local currency (83% of respondents planning or considering an increase) than in foreign currency (66%).

Figure 43: Plans over the next 12 months (% respondents), East Africa



Sources: EIB Banking in Africa survey, 2021.

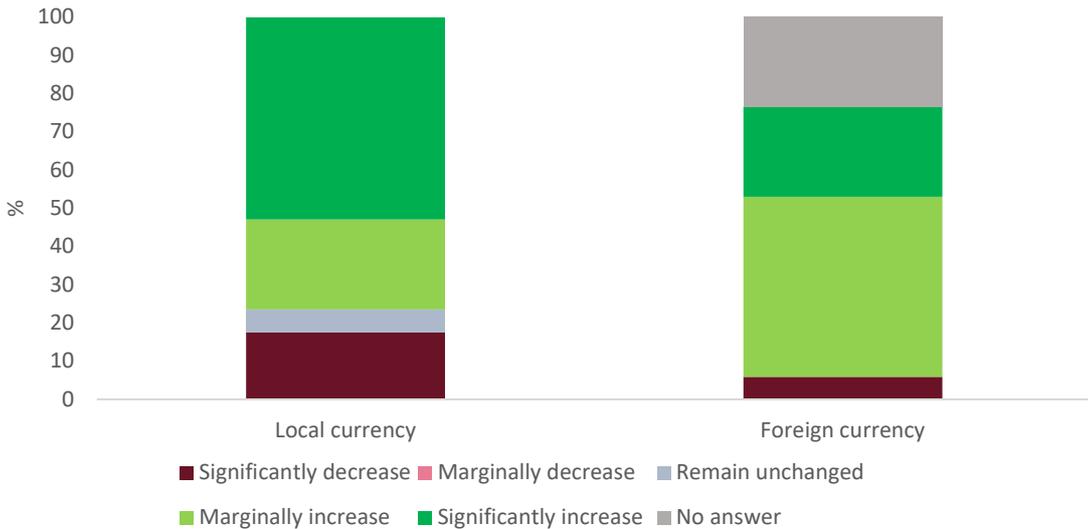
<sup>63</sup> IMF Financial Soundness Indicators, available at <https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA>.

<sup>64</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.

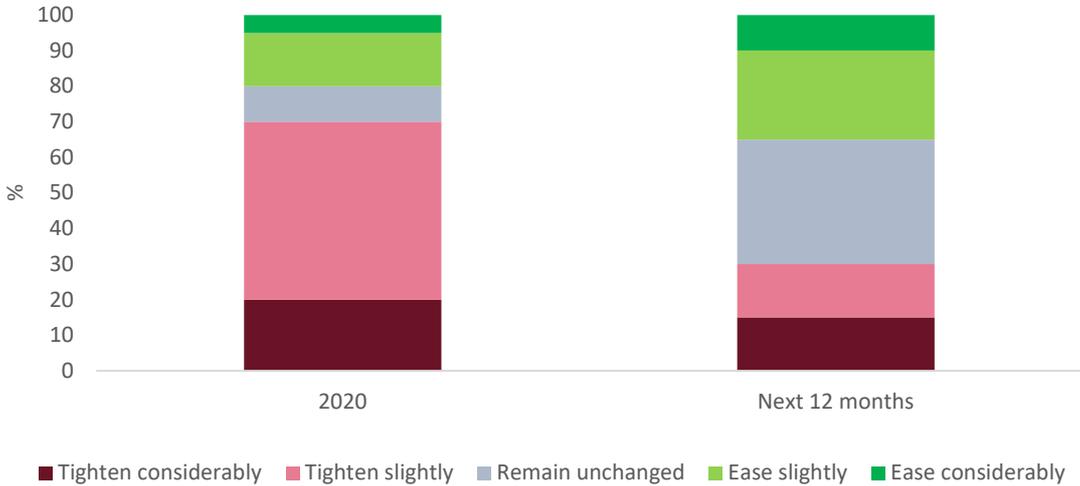
<sup>65</sup> Moody's Analytics BankFocus combines content from Bureau van Dijk and Moody's Investors Service, with expertise from Moody's Analytics. The data are available to subscribers at [https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EA1aIQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9\\_D\\_BwE](https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EA1aIQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9_D_BwE).

**Credit demand, particularly from SMEs is also expected to increase, but banks will remain relatively cautious** (Figure 44 and Figure 45). Banks are expecting increased demand for loans in both foreign and local currency. However, the responses of the banks when asked about planned changes to credit standards suggest that they may not be ready to fully accommodate an increase in demand. Although East African banks expect to relax credit standards relative to 2020 (when standards were tightened by over 60%, and eased by below 20% of survey respondents), they do not project a major loosening. The proportion of banks expecting to ease their credit standards over the next 12 months (35%) is only marginally higher than the proportion expecting to tighten them (28%), implying that the impact of the COVID-19 shock on lending conditions will be relatively long term.

**Figure 44: Expected change in credit demand from small and medium-sized enterprises over next year (% respondents), East Africa**



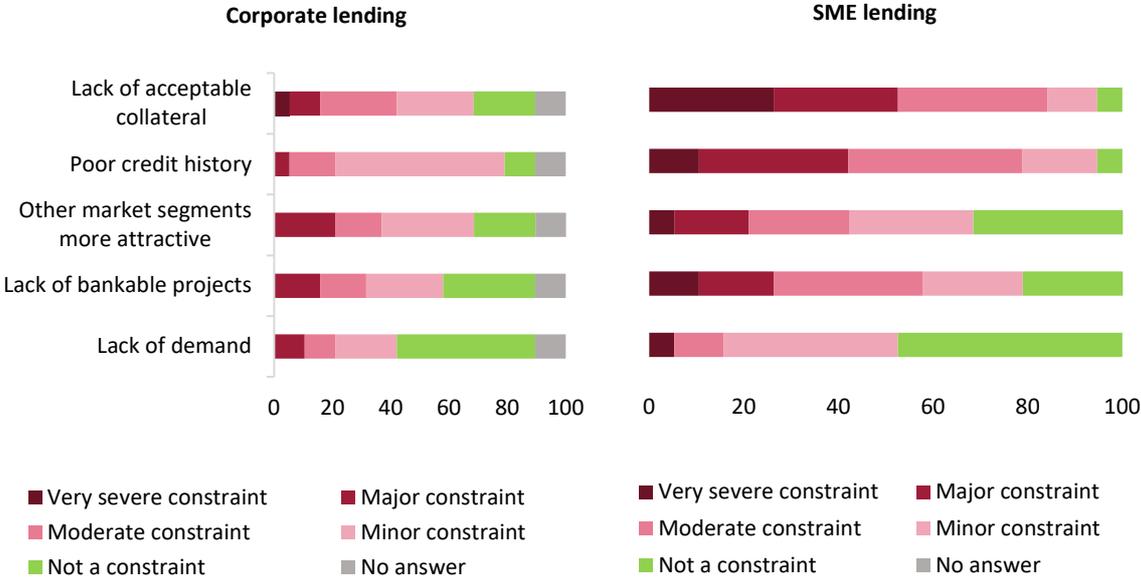
**Figure 45: Expected change in credit standards over next 12 months (% respondents), East Africa**



Sources: EIB Banking in Africa survey, 2021.

The main factors constraining credit supply to corporates and SMEs are a lack of acceptable collateral and poor credit history (Figure 46). Both are structural, demand-side reasons, suggesting that normal credit growth might resume once the economic impact of the pandemic fades. However, these findings also imply that more structural policy measures might be needed to improve credit supply to companies, particularly SMEs. This need will likely be even stronger if the impact of COVID-19 exacerbates these constraints at the firm level.

Figure 46: Factors constraining credit supply (% respondents), East Africa



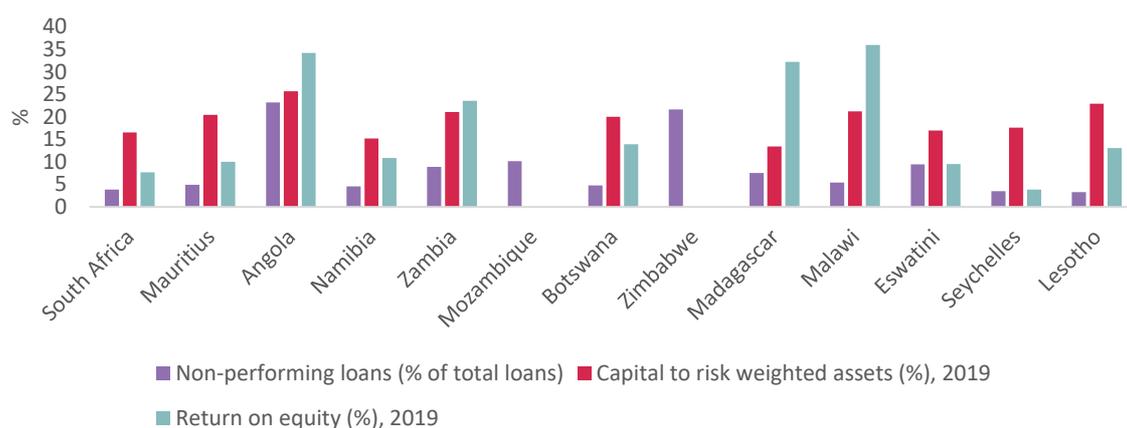
Sources: EIB Banking in Africa survey, 2021.

### Banking in Southern Africa

The banking sector in Southern Africa is well developed but differences across countries are large (see key indicators in Table 8 in the Annex). The financial sectors of Mauritius and South Africa are sophisticated and integrated with the international financial architecture. South African banks are active throughout Southern Africa and beyond, often raising the bar in terms of standards for domestic banks. Meanwhile, Mauritius is actively changing its image from tax haven to financing hub, focused particularly on serving Africa. However, in several Southern African countries the banking sectors remain small and domestic credit as a share of GDP is still low. Moreover, the number of banks is rather limited in many countries, and the top three banks tend to hold a large market share—on this measure, Southern Africa is the continent’s least competitive subregion.

Banks in Southern Africa have remained in relatively good financial shape, partly because of their high capitalisation before the pandemic. Banks entered the COVID-19 crisis relatively well capitalised and with relatively good profitability and asset quality, based on standard indicators (Figure 47). This has helped them withstand lower profitability during 2020. Several country-specific developments and policy measures further mitigated the impact of the crisis on capital ratios. For example, net interest margins held up better than expected in South Africa, where regulatory adjustments to the treatment of loans restructured because of COVID-19 reduced the amount of capital required to be held for provisioning. In Zambia, the downgrade of sovereign debt to default status caused accounting losses, while the deteriorating economic situation is weighing on the private sector’s ability to service its debt. However, the impact was mitigated by excluding the sovereign paper held by banks from the default.

Figure 47: Solvency, profitability and asset quality indicators, Southern Africa



Sources: IMF<sup>66</sup>, World Bank<sup>67</sup> and BankFocus<sup>68</sup>.

**Central banks implemented various measures to enhance financial stability in the subregion.** Several cut policy rates and most increased their provision of liquidity to the banking sector. Some temporarily relaxed prudential requirements. For instance, the South African Reserve Bank reduced the capital requirement for all banks by 1 percentage point, and also reduced liquidity ratio requirements. In addition, various central banks allowed for different regulatory treatment (forbearance) of loans restructured as a result of COVID-19. The flexibility on classifying these loans meant that banks did not have to create the provisions that would normally have been required against these loans. Fitch estimates that moratoriums covered some 20% of the loans in South Africa (Fitch Ratings, 2021a). These moratoriums could help to address the direct fallout of the pandemic on bank balance sheets, but there is a risk of merely delaying, rather than avoiding, a large rise in NPLs, particularly if the recovery is slow. In Lesotho, the implementation of Basel II.5 was delayed to avoid deleveraging from banks in response to higher capital requirements.

**At the same time, central banks continued to strengthen the regulatory and supervisory framework and to enhance the efficiency of monetary policy.** Reforms to strengthen the resolution framework for financial institutions and to introduce a deposit insurance scheme are currently being discussed in the South African parliament, although implementation will not be immediate. In Zambia, rules concerning the foreign currency interbank market were changed with the aim of reducing depreciation, while Zimbabwe introduced various measures to align the official and black-market exchange rates. Several measures were implemented in Eswatini to modernise the liquidity management strategy, including the reintroduction of weekly auctions of short-term bills and a reduction in the costs of overnight lending facilities.

**In the wake of the pandemic, several risks have emerged or intensified.** Before the COVID-19 crisis, public debt levels were increasing across the subregion. A large share of issued debt ended up on banks' balance sheets (especially in Zambia), although mainly in local currency. Now, with governments running larger budget deficits to support the domestic economy, the sovereign-banking nexus has become even more important (Attout et al., 2021, forthcoming). Risks are exacerbated by the deteriorating creditworthiness of sovereigns, as reflected by the numerous sovereign downgrades across the subregion. Private sector debt also poses risks, having increased in many countries. In some countries (for instance South Africa), non-financial corporate sector debt is at historically high levels, while in other countries (such as Botswana) household debt is worryingly high. The longer the economic recovery takes, the more pronounced these risks will grow. Some pre-existing country-specific risks, such as the high concentration of lending to corporates in Eswatini, Lesotho and Malawi, could also amplify any negative impact of the crisis.

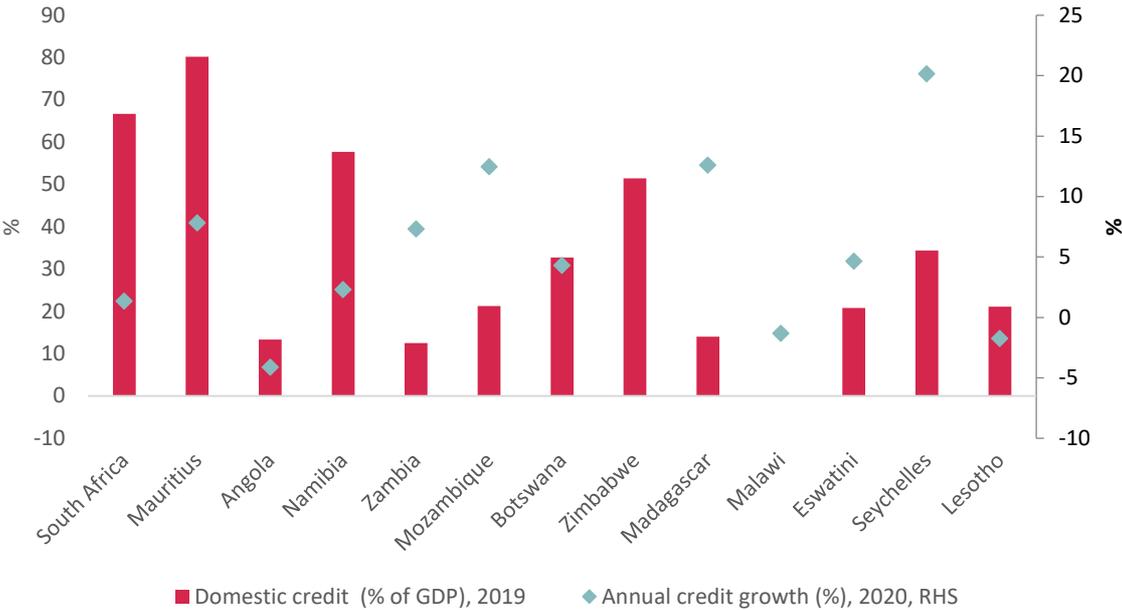
<sup>66</sup> IMF Financial Soundness Indicators, available at <https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA>.

<sup>67</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.

<sup>68</sup> Moody's Analytics BankFocus combines content from Bureau van Dijk and Moody's Investors Service, with expertise from Moody's Analytics. The data are available to subscribers at [https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9\\_D\\_BwE](https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9_D_BwE).

During the pandemic, banks' lending volumes have evolved differently across the subregion. Loans have continued to expand in various countries, including South Africa, albeit at a slow pace (Figure 48). However, in some other countries, deteriorating economic conditions have held back growth, at least in real terms. In Zambia, for example, loans to the private sector increased by 8.5%, compared to annual inflation of 16%, while inflation also trumped loan growth in Zimbabwe. The economic outlook remains highly uncertain, which weighs on the prospects of repayment and hampers lending. If recovery prospects strengthen, however, banks may relax standards and expand lending to avoid missing out on lucrative future business. As Figure 49 shows, banks' baseline scenario is an increase in credit demand. Of the Southern African banks that completed the *EIB Banking in Africa survey, 2021*, around half expect to be able to relax credit standards to meet this increased demand, but a similar proportion reported planning further tightening (Figure 50).

Figure 48: Credit as % of GDP and annual credit growth, Southern Africa



Sources: IMF<sup>69</sup>, World Bank<sup>70</sup> and BankFocus<sup>71</sup>.

<sup>69</sup> IMF Financial Soundness Indicators, available at <https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA>.  
<sup>70</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.  
<sup>71</sup> Moody's Analytics BankFocus combines content from Bureau van Dijk and Moody's Investors Service, with expertise from Moody's Analytics. The data are available to subscribers at [https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9\\_D\\_BwE](https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EAlalQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9_D_BwE).

Figure 49: Expected change in credit demand from small and medium-sized enterprises in 2021 (% respondents), Southern Africa

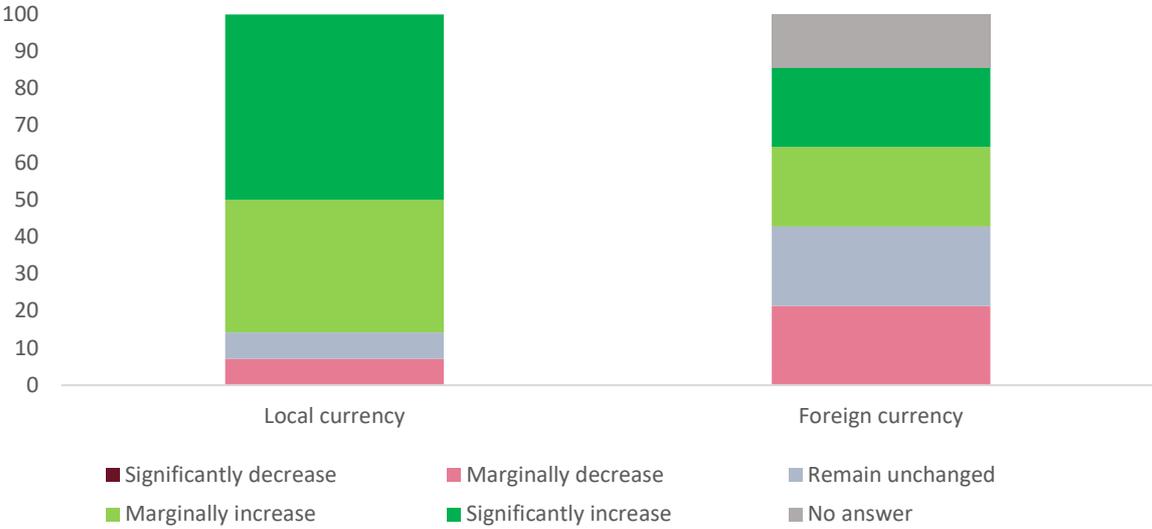
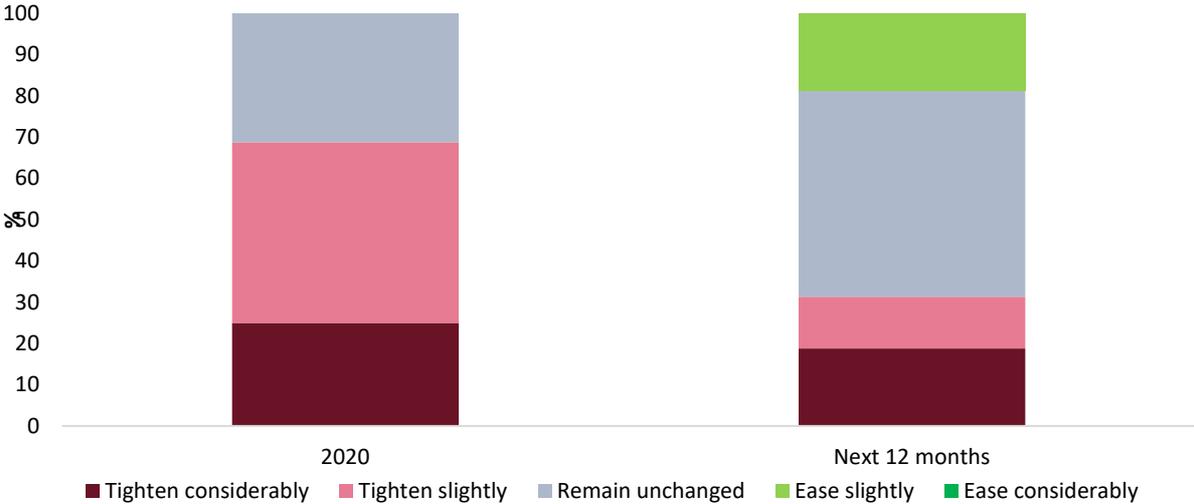


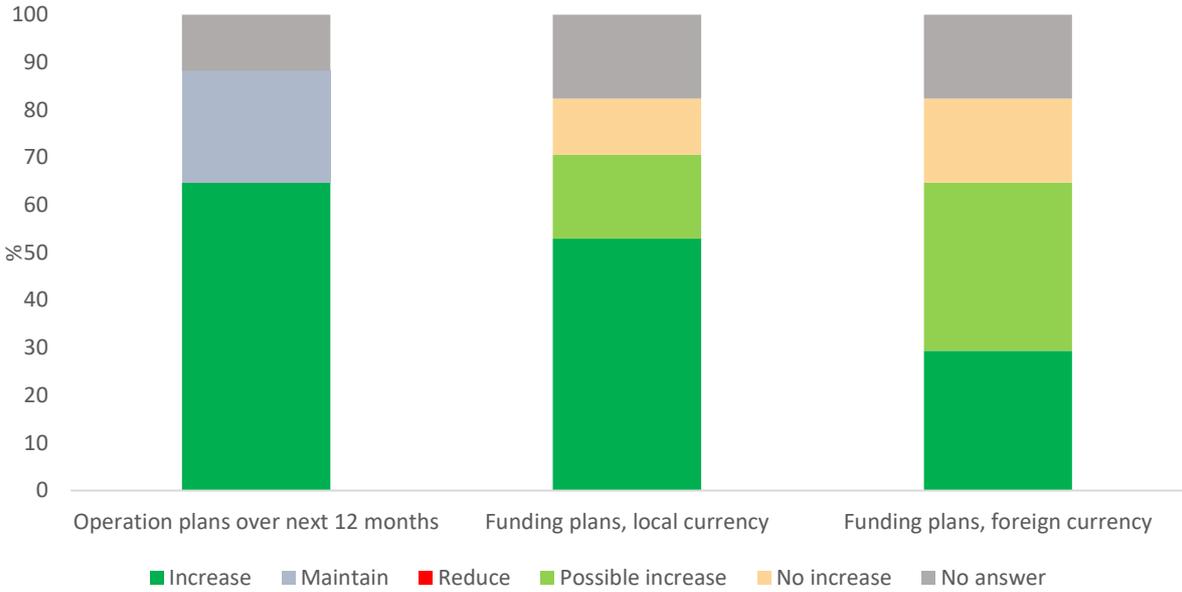
Figure 50: Expected change in credit standards in 2021 (% respondents), Southern Africa



Source: EIB Banking in Africa survey, 2021.

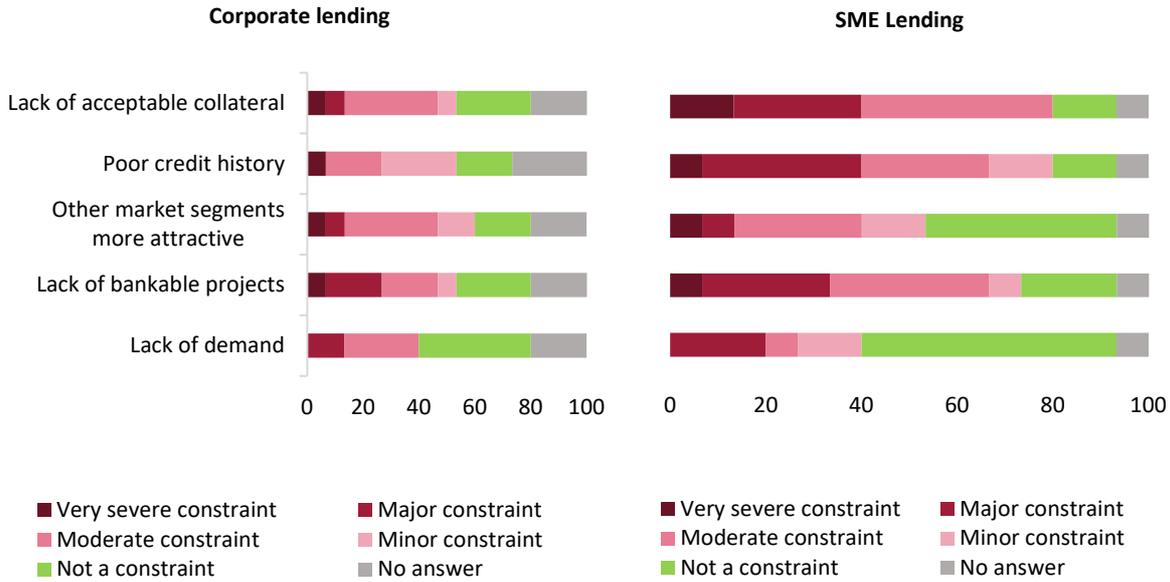
**Against this backdrop, banks are starting to look ahead.** Of the banks that replied to the *EIB Banking in Africa survey, 2021*, 65% plan to or are considering increasing funding, especially in local currency (Figure 51). This can be seen as preparatory to stepping up intermediation – around two-thirds of banks are expecting to increase operations in the next year. Figure 52 shows that the banks replying to the survey did not report a lack of demand as a bottleneck, although the existence of bankable projects is a factor constraining lending. As in previous years (EIB, 2020), the lack of good collateral and poor credit history hold back lending, and are reported to be greater constraints on SME lending than on corporate lending, suggesting that SMEs may have more difficulties accessing finance in Southern Africa.

Figure 51: Plans over next 12 months (% respondents), Southern Africa



Source: EIB Banking in Africa survey, 2021.

Figure 52: Factors constraining credit supply (% respondents), Southern Africa



Source: EIB Banking in Africa survey, 2021.

## Conclusions

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**African banks have been severely hit by the COVID-19 crisis<sup>72</sup>.** The impacts of the COVID-19 pandemic and the measures implemented to contain it have set back prospects for Africa's economies and enterprises and, therefore, for the financial sector. In 2019, most African banking groups surveyed by the EIB were cautiously optimistic about the prospects for development of African financial markets. They expected a gradual improvement of growth prospects and stability, following a period of relatively low growth between 2015 and 2019 (growth rates averaged below 4% for continental Africa and below 3% for sub-Saharan Africa throughout this period)<sup>73</sup>. The COVID-19 crisis changed this picture. In early 2021, almost two-thirds of banks surveyed across sub-Saharan Africa had tightened their credit standards in response to the difficult economic situation. Over 80% had increased the use of restructuring or loan moratoriums to deal with deteriorating asset quality.

**Africa's banking sectors remain, in most cases, well capitalised and profitable. However, deteriorating asset quality poses risks and may set back lending during the recovery.** In 2019, the EIB's banking survey showed that non-performing loans were coming under control in most banking groups. In early 2021, by contrast, the majority of banks had at least 5% of NPLs among their portfolios, and half of the banks reported that at least 5% of their SME portfolio was under moratorium. 40% had at least 5% of SME loans under some form of restructuring. Corporate loans show a similar picture. As the economic recovery is expected to be gradual, some of these loans will ultimately default, impacting capital adequacy and profitability. Banks will need to absorb losses while preserving capital buffers, which will reduce their capacity and willingness to support the recovery by lending to the private sector. The macroeconomic impacts of the crisis, in particular the accumulation of public debt, could also push up funding costs, making it challenging for banks to lend to the private sector.

**The impacts of the crisis could put progress in boosting financial inclusion and access to finance at risk.** Data from the World Bank Enterprise Surveys indicate that around 62% of the SMEs in sub-Saharan Africa that say they need a loan cannot access one, either because their loan application is rejected (3.2% of cases) or, more commonly, because they are discouraged from applying in the first place. The same holds for around 59% of the SMEs that report needing a loan in North Africa<sup>74</sup>. According to the SME Finance Forum, the formal funding gap for SMEs averaged 17% of GDP across the 43 African countries surveyed in 2017<sup>75</sup>. A lack of collateral, poor credit history and a lack of bankable projects are much more commonly reported with respect to SME loans than for corporates. For example in the *EIB Banking in Africa survey, 2021*, about 41% of the banks highlighted SMEs' poor credit history as a major constraint affecting access to finance, compared to 12.3% for corporates. The same set of factors had been cited by banking groups interviewed by the EIB in 2019 as constraints on lending to SMEs. The importance of these structural barriers is likely to increase in the aftermath of the crisis, as increased risk aversion among banks will most severely impact lending to firms and individuals perceived to be higher risk, such as SMEs.

**Policymakers will need to gradually and carefully unwind the support measures that have helped firms and banks through the crisis period while continuing to address structural barriers to support a return to SME lending.** Although prospects remain subject to significant downside risk, banks surveyed by the EIB were optimistic about opportunities during the recovery. 80% of sub-Saharan African banks who responded to the *EIB Banking in Africa survey, 2021* were expecting to expand their activity over the next 12 months. This expansion in activity is expected to be supported by an increase in funding, primarily in local currency (90% of the banks). Addressing structural barriers could help ensure that any pickup in lending also benefits smaller firms. Measures that have been shown to support access to finance in other contexts include establishing credit bureaux and collateral registries, reforming collateral frameworks to allow firms to use movable assets as collateral, improvements to property laws and the development of land registries and electronic registries for pledging assets.

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<sup>72</sup> The banks surveyed accounted for around 30% of total banking assets in sub-Saharan Africa.

<sup>73</sup> EIB, 2020.

<sup>74</sup> EBRD-EIB-World Bank Enterprise Surveys, most recent data, available at <http://www.enterprisesurveys.org>.

<sup>75</sup> Calculated by MFW4A based on the data described in International Finance Corporation (IFC), 2017.

**Expanding the range of products and services to serve SMEs is also important for private sector development.** Non-bank debt and equity financing options are often at nascent stages of development in Africa. Leasing and factoring activities and private equity and venture capital can benefit SMEs, and microfinance is an important source of finance for the smallest firms. Chapters 2 and 3 review how microfinance institutions and private equity and venture capital funds have fared during the COVID-19 crisis and the roles they can play during the recovery.

**As it faces the impacts of the COVID-19 crisis, the financial sector is adapting to the digital revolution, becoming increasingly aware of the risks arising from climate change, and starting to grasp the opportunities of climate finance.** African banking groups surveyed in 2019 were already making investments in e-banking and mobile banking services, including data analytics and blockchain technology. In 2021, almost all (89%) of the surveyed banks reported that the pandemic had accelerated the digital transformation of their internal processes, and the majority of surveyed banks believe the shift to digital services will be permanent. The ongoing digitalisation of the banking sector, and its implications, are discussed in more detail in Chapter 4. Chapter 5 demonstrates that climate change is already changing the conditions facing financial institutions, bringing significant risks. On the other hand, there is evidence that financial institutions, including banks, are increasingly grasping opportunities in the growing area of green finance.

**International financial institutions like the EIB are important partners for African financial institutions, and these partnerships can help support a smart, green and inclusive recovery.** Chapter 6 describes the way in which the EIB partners with financial sector institutions in Africa to support African firms, aiming to combine financial sustainability with positive impacts on development and the environment. The chapter outlines the way in which the EIB has increased its support during the crisis period, as part of Team Europe, to help African partners deal with the immediate health emergency and address the economic fallout. The EIB recognises the importance of the private sector for job creation, poverty reduction and development in Africa. As this chapter has outlined, Africa's private sector has faced significant challenges during the crisis period. The smallest firms have often been hardest hit by lockdown measures and other economic impacts of COVID-19. The banks that serve them have also been impacted and may struggle to restart lending. The EIB therefore continues to support local private sector firms, targeting MSMEs in particular, by working with banks and other financial institutions.

## Annex: Tables

Table 2: Policy measures implemented to support small and medium-sized enterprises and promote or facilitate the use of mobile money

African countries	Mobile money			SME policy assistance				
	Reduced transaction fees	Increased balance & transaction limits	Flexible Know Your Customer onboarding	Debt moratoriums	Loan guarantees	Financial assistance	Lower interest rates	Tax relief
Botswana		Yes		Yes	Yes	Yes		
Cabo Verde				Yes				
Cameroon	Yes							
Chad								Yes
Côte d'Ivoire						Yes		
Egypt				Yes		Yes	Yes	
Equatorial Guinea								Yes
Eswatini								Yes
Gabon						Yes		
Ghana	Yes	Yes	Yes			Yes		
Guinea					Yes			
Kenya	Yes	Yes						
Lesotho	Yes	Yes			Yes	Yes		
Liberia	Yes	Yes				Yes		
Malawi	Yes			Yes				
Mali					Yes			Yes
Mauritania						Yes		
Mauritius				Yes	Yes	Yes	Yes	
Morocco				Yes	Yes		Yes	
Mozambique	Yes	Yes						
Nigeria						Yes		
Rwanda	Yes	Yes						
Sierra Leone						Yes		
South Africa						Yes		
Tanzania		Yes						
Uganda	Yes					Yes		Yes
West African Economic and Monetary Union	Yes							
Zambia	Yes	Yes						
Zimbabwe						Yes		

Source: IMF Financial Access Survey, African countries only, available at <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>.

Table 3: Key banking sector indicators, African subregions

Region	Number of banks (2019)*	Banking concentration (top 3 banks)*	Credit to the private sector (% of GDP) 2019 <sup>†</sup>	Annual credit growth (%) 2020*	Loans to deposits (%) 2019 <sup>†</sup>	Non-performing loans (% of total loans) 2019 <sup>†</sup>	Capital to risk - weighted assets (%) 2019 <sup>†</sup>	Return on equity (%) 2019 <sup>†</sup>
<b>Africa</b>	<b>806</b>	<b>71</b>	<b>26.3</b>	<b>6.4</b>	<b>78.1</b>	<b>12.1</b>	<b>17.4</b>	<b>16.2</b>
North Africa	114	58	44.3	9.9	77.6	9.6	17	13
Southern Africa	197	75	35.5	5.5	70.5	8.6	18.6	16.1
West Africa	238	64	21.3	5.6	77.5	13.9	14.9	23.0
East Africa	199	70	17.5	9.4	74.3	9.9	18.8	14.5
Central Africa	58	90	13.1	1.71	90.1	23.5	13.8	11.7

Sources: \*BankFocus<sup>76</sup>, <sup>†</sup>World Bank<sup>77</sup>, <sup>‡</sup>IMF<sup>78</sup>.

Table 4: Key banking sector indicators, North Africa

Country	Number of banks (2019)*	Banking concentration (top 3 banks)*	Domestic credit (% of GDP) 2019 <sup>†</sup>	Annual credit growth (%) 2020*	Loans to deposits (%) 2019 <sup>†</sup>	Capital to risk - weighted assets (%) <sup>a,b,c,d</sup>	Return on equity (%) <sup>a,b,c,d</sup>	Non-performing loans (%) <sup>a,b,c,d</sup>
<b>North Africa</b>	<b>114</b>	<b>62</b>	<b>34</b>	<b>15</b>	<b>61</b>	<b>17</b>	<b>13</b>	<b>16</b>
Egypt <sup>a</sup>	39	62	24	25	53	19	15	4
Morocco <sup>b</sup>	19	63	63	5	70	16	9	8
Algeria <sup>c</sup>	21	67	26	3	50	19	22	13
Tunisia <sup>d</sup>	22	35	64	7	137	13	13	13

GDP weighted average, where relevant.

Sources: \*BankFocus, <sup>†</sup>World Bank, <sup>a</sup> Central Bank of Egypt, Q1 2021; <sup>b</sup> Bank Al-Maghrib, Q4 2019, or Q2 2020 if available; <sup>c</sup> IMF, latest available data for Algeria refer to 2018; <sup>d</sup> Central Bank of Tunisia, Q4 2019, or Q3 2020 if available.

<sup>76</sup> Moody's Analytics BankFocus combines content from Bureau van Dijk and Moody's Investors Service, with expertise from Moody's Analytics. The data are available to subscribers at [https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EA1aIQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9\\_D\\_BwE](https://www.bvdinfo.com/en-us/our-products/data/international/bankfocus?gclid=EA1aIQobChMI8Ja5xY6a8gIV0eF3Ch0CdA4uEAAAYASAAEgLw9_D_BwE).

<sup>77</sup> World Bank Databank, available at <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.

<sup>78</sup> IMF Financial Soundness Indicators, available at <https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA>.

Table 5: Key banking sector indicators, West Africa

Country	Number of banks (2019)*	Banking concentration (top 3 banks)*	Domestic credit (% of GDP) 2019 <sup>†</sup>	Annual credit growth (%) 2020 <sup>†</sup>	Loans to deposits (%) 2019 <sup>†</sup>	Capital to risk-weighted assets (%) most recent data <sup>‡</sup>	Return on equity (%) most recent data <sup>‡</sup>	Non-performing loans (% of total loans) most recent data <sup>‡</sup>
Nigeria	27	43	10	12	88	15	25	6
Côte d'Ivoire	24	45	20	3	92			8
Ghana	23	36	11	0	49	22	21	16
Burkina Faso	14	59	28	9	83			8
Senegal	24	37	29	-1	98			13
Mali	12	51	24	5	122			11
Benin	15	62	18	-9	78			19
Togo	8	100	35	1	90			18
Cabo Verde	8	72	58	5	64			11
Niger	13	60	11	9	113			16
Mauritania	18	49	23	8	101			26
Guinea	14	62	7	34	54	9	90	10
The Gambia	9	70	8	14	18	31	21	5
Sierra Leone	11	83	6	7	27			13
Liberia	7	91	?	-5	82			24
Guinea-Bissau	3	100	15	-2	64			20
<b>West African Economic and Monetary Union</b>	<b>148**</b>	<b>52.3</b>	<b>22.5</b>	<b>2.3</b>	<b>95.4</b>	<b>12.1**</b>	<b>15.3<sup>††</sup></b>	<b>11.4**</b>

Sources: \*BankFocus, <sup>†</sup>World Bank, <sup>‡</sup>IMF, \*\* IMF data for mid-2020; <sup>††</sup>IMF data for 2019, except for: Ghana: the number of banks reflects the number registered by the Bank of Ghana. NPLs and capital to risk-weighted assets refer to April 2021, taken from the May 2021 statement of the Monetary Policy Committee of Ghana. ROE (December 2020) and the credit-to-deposit ratio (July 2020) are both taken from the financial soundness indicators disclosed on the Bank of Ghana's website. Nigeria: The number of banks reflects the number registered by the Central Bank of Nigeria. NPLs and capital to risk-weighted assets are taken from the Central Bank of Nigeria, 2021.

Table 6: Key banking sector indicators, Central Africa

Country	Number of banks (2019)*	Banking concentration (top 3 banks)*	Domestic credit (% of GDP) 2019†	Annual credit growth (%) 2020*	Loans to deposits (%) 2019†	Capital to risk-weighted assets (%) 2019†	Return on equity (%) 2019†	Non-performing loans (%)†
<b>Central Africa</b>	<b>58</b>	<b>74</b>	<b>11</b>	<b>15</b>	<b>83</b>	<b>19</b>	<b>13</b>	<b>15</b>
Cameroon	14	52	14	20	95	11	25	13
Democratic Republic of the Congo	16	66	6	34	64			19
Gabon	8	100	13	-17	70	19	24	13
Congo, Republic	6	100	14	3	86	22	5	23
Chad	6	100	9	-13	112	5	3	23
Equatorial Guinea	3	100	16	7	116	-3	3	49
Central African Republic	2	100	11	-20	95	28	10	14
São Tomé and Príncipe	3	100	21	1	82			34

Sources: \*BankFocus, †World Bank, ‡IMF FSI.  
GDP weighted average.

Table 7: Key banking sector indicators, East Africa

Country	Number of banks (2019)*	Banking concentration (top 3 banks)*	Domestic credit (% of GDP) 2019†	Annual credit growth (%) 2020†	Loans to deposits (%) 2019†	Capital to risk-weighted assets (%) 2019†	Return on equity (%) 2019†	Non-performing loans (%)†
<b>East Africa</b>	<b>199</b>	<b>58</b>	<b>18.2</b>	<b>11.7</b>	<b>75.0</b>	<b>19.2</b>	<b>15.4</b>	<b>7.2</b>
Kenya	43	40	27.5	9.7	90.5	18.2	17.0	12.0
Ethiopia	15	70	15.0	18.8	58.7	17.0	10.0	2.3
Tanzania	39	50	12.0	5.5	79.2	17.8	13.6	9.6
Uganda	19	50	12.8	10.0	77.4	22.2	18.9	5.2
Rwanda	12	60	21.3	20.5	114.1	21.5	16.8	4.4
Djibouti	10	90	20.8	-3.7	32.2	14.2	6.3	16.0
Burundi	8	80	20.3	18.4	79.0	24.0	17.9	14.2

Sources: \*BankFocus, †World Bank, ‡IMF FSI.

Table 8: Key banking sector indicators, Southern Africa

Country	Number of banks (2019)*	Banking concentration (top 3 banks)*	Domestic credit (% of GDP) 2019†	Annual credit growth (%) 2020*	Loans to deposits (%) 2019†	Capital to risk-weighted assets (%) 2019†	Return on equity (%) 2019†	Non-performing loans (%)‡
<b>Southern Africa</b>	<b>197</b>	<b>78</b>	<b>52</b>	<b>2</b>	<b>93</b>	<b>8</b>	<b>18</b>	<b>14</b>
South Africa	43	85	67	1	111	17	8	4
Mauritius	22	82	80	8	96	20	10	5
Angola	20	55	13	-4	53	26	34	23
Namibia	16	50	58	2	101	15	11	5
Zambia	18	66	12	7	61	21	24	9
Mozambique	15	72	21	12	65			10
Botswana	13	62	33	4	79	20	14	5
Zimbabwe	23	77	51		56			22
Madagascar	7	73	14	13	70	13	32	8
Malawi	8	79		-1	50	21	36	5
Eswatini	4	86	21	5	75	17	10	9
Seychelles	4	97	34	20	41	18	4	3
Lesotho	4	91	21	-2	59	23	13	3

Sources: \*BankFocus, †World Bank, ‡IMF FSI.  
GDP weighted average.

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# Microfinance and COVID-19

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This chapter was jointly produced by the EIB and CGAP. CGAP is a global partnership of more than 30 leading development organisations, housed at the World Bank, that works to advance the lives of poor people through financial inclusion. Using action-oriented research, CGAP tests, learns and shares knowledge intended to help build inclusive and responsible financial systems that move people out of poverty, protect their economic gains and advance broader development goals.

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## Introduction

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**The COVID-19 crisis destabilised the financial conditions facing firms, individuals and households around the world, with the poorest, the most vulnerable and the smallest firms often among the most impacted.** As discussed in Chapter 1 of this report, over 30 million Africans may have fallen into extreme poverty in 2020 (Gerszon Mahler et al., 2021), including many of the low-income people who access finance through microfinance institutions. In a financial health household survey conducted in late May 2020 by BFA Global (BFA Global, 2020) in eight low- and lower-middle-income countries including Nigeria, Kenya, South Africa and Ghana, respondents indicated that they were quickly running through their financial cushions, having used up more than half of stored emergency funds. About two-thirds of the African respondents had tapped into funds earmarked for future planned or opportunistic use, using up more than half of those funds on average. Income had decreased and expenses increased for half of the survey respondents. The COVID-19 situation is also pushing some borrowers to sell productive assets, which reduces their recovery potential. VisionFund International<sup>3</sup>, a network of microfinance institutions, reported in June 2020 that across eight African countries<sup>4</sup>, 3–17% of surveyed clients had sold off assets to cope with the effects of the pandemic.

**Africa has made considerable progress in expanding financial inclusion over the past decade, but significant gaps remain.** The World Bank Global Findex data (World Bank Group, 2018)<sup>5</sup> show that, in sub-Saharan Africa, the percentage of adult population holding an account with a financial institution or a mobile money provider rose from 23% in 2011 to 43% in 2017 (the most recent observation). Survey results for North Africa show more muted progress over the same period, with major variations across countries. Egypt leads the way in account ownership, which rose from 10% in 2011 to 33% in 2017. However, close to 57% of African adults were still unbanked even before the COVID-19 crisis. Even as account ownership continues to grow, inequalities persist: women, poor households in rural areas and people outside the formal workforce are most likely to be unbanked.

**The ability of microfinance providers to help the poor to weather and recover from the crisis will depend on the providers' resilience, the nature of their response, and the support they receive.** The COVID-19 pandemic is the latest in a series of crises to hit microfinance institutions in recent decades. Others include global or regional crises such as the 2007–2008 global financial crisis and the Ebola outbreaks in West Africa, as well as political and economic disruptions affecting particular countries. According to a recent analysis of 16 case studies conducted by Rozas, 2021, supported by the Center for Financial Inclusion and the European Microfinance Platform, microfinance institutions displayed high levels of resilience to crises. The analysis identified only four institutions that failed but probably would have survived in the absence of a crisis<sup>6</sup>. However, severe crises can have serious long-term effects. Analysis of several performance indicators (including the percentage of loans more than 90 days overdue, as well as cumulative provisions and write-offs) indicate that most of the eight surviving institutions took at least five years to recover to pre-crisis levels. The case studies underscore the importance of crisis preparedness for microfinance institutions, particularly having a sufficient equity cushion in place, above the specific minimum required under prudential regulations. The analysis also identifies several lessons on best-practice responses once a crisis hits. Particularly important are prioritising smart liquidity management to retain the confidence of key stakeholders such as depositors, and taking a balanced and proactive approach to portfolio management.

**This chapter reviews how Africa's microfinance providers have responded to the COVID-19 crisis and the sector's readiness to support the recovery.** COVID-19 is a challenge of unprecedented scale, affecting Africa's small to medium-sized microfinance institutions particularly severely<sup>7</sup>. Microfinance providers have displayed significant resilience, and the feared liquidity crisis in the microfinance sector does not appear to have

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<sup>3</sup> <https://www.visionfund.org/>.

<sup>4</sup> Democratic Republic of Congo, Ghana, Kenya, Malawi, Rwanda, Tanzania, Uganda and Zambia.

<sup>5</sup> The World Bank's Global Findex survey provides information on access to and usage of finance among around 150 000 households across 140 countries. The survey covers account holdings, credit and savings activities, and whether wages or government transfers are paid directly into accounts. The first round of the Findex survey was conducted in 2011, and rounds have been conducted every three years since (except in 2020 due to the pandemic). The data and more information about the survey are available at <https://globalfindex.worldbank.org/>.

<sup>6</sup> The other institutions that failed had either been taken over for political reasons (as assessed by the author) or had been subject to extreme levels of fraud.

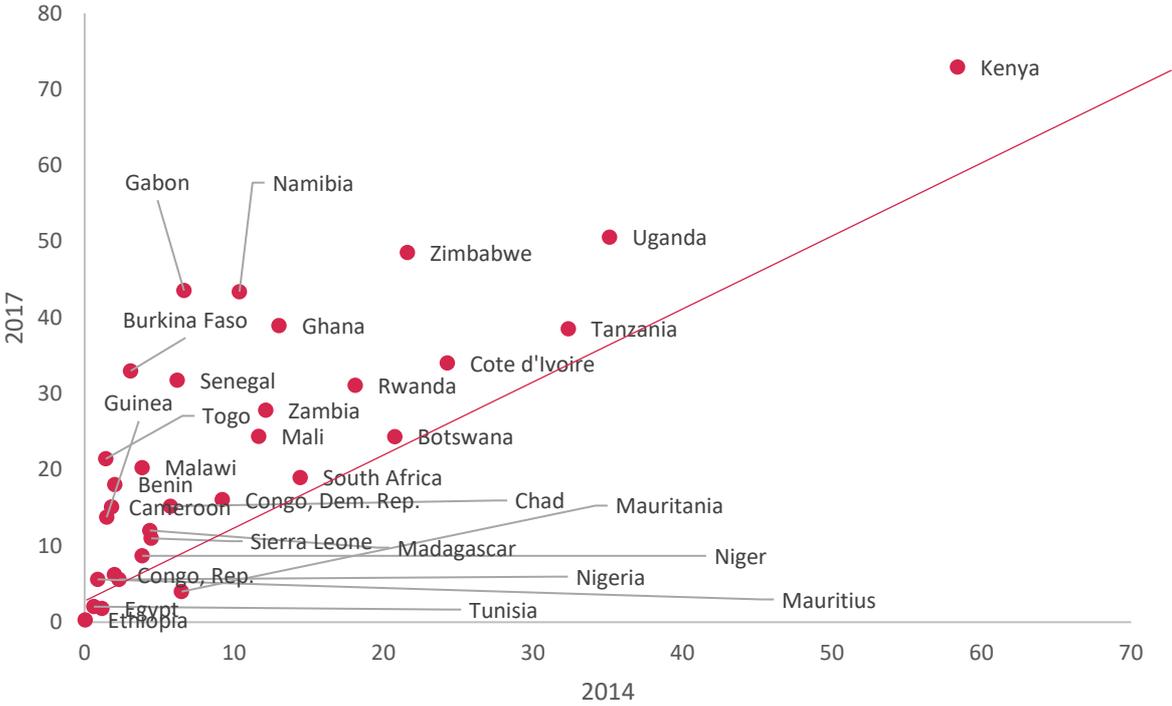
<sup>7</sup> Commonly referred to as Tier 2 and Tier 3 institutions.

materialised so far. However, the pandemic has caused significant stress to many microfinance institutions and their borrowers, leading to heavy deterioration in asset quality. As of September 2021, Africa is facing a major third wave of infections and the vaccination rollout is likely to remain slow unless international support ramps up significantly. Economic recovery prospects are muted and uncertain. As such, the effects on the microfinance sector are yet to fully materialise and will likely be long-lasting.

## Financial inclusion in Africa

**Adults in Africa use a range of tools to save, borrow and juggle financial risk, but relatively few rely on formal financial institutions such as banks.** According to the World Bank, sub-Saharan Africa is the only region where the share of adults with a mobile money account exceeds 10% (World Bank Group, 2018). This was also true in 2014. At that time, East Africa was the region’s mobile money hub. However, mobile money accounts have since spread to new parts of sub-Saharan Africa. Figure 1 shows the share of adults with a mobile money account in 2017, against the share in 2014. All countries apart from Mauritania are to the left of the 45 degree line, indicating that the share with an account rose across the continent over this period. The share of adults with a mobile money account has now surpassed 30% in Côte d’Ivoire and Senegal, and 40% in Gabon.

Figure 1: Adults with a mobile money account (%)



Source: World Bank Group, 2018.

### Box 1: Definitions of financial inclusion and financial access

**Financial inclusion is defined as access to “useful and affordable financial products and services” that meet the needs of users and are delivered in a responsible and sustainable way<sup>8</sup>.** Access to financial products such as payments and transfers, savings, credit and insurance, at a cost affordable to poor people, is critical for Africa’s growth and development. Access to accounts is a particularly important first step towards broader financial inclusion. Through banking transactions, people are able to store money and to send and receive payments. Having an account helps families and businesses plan for everything from long-term goals to unexpected emergencies, helping them weather financial and non-financial shocks and improve their living conditions. Once people hold accounts, they may use other financial services, such as credit and insurance, to start and expand businesses and to invest in education or health. Moving from access to increased usage is the next step for countries like Kenya, which already have relatively broad and in-depth access. This move can be facilitated by reforms, private sector innovation, and a push to open low-cost accounts, including mobile and digitally enabled payments.

**As mentioned above, Africa has been a trailblazer in expanding access to digital financial services, which has driven the expansion of financial inclusion.** Chapter 4 of this report provides a detailed review of the role of digital financial services in expanding financial inclusion in Africa, demonstrating that the rapid adoption of mobile money accounts has been a particularly strong driver of the increase in financial inclusion. Digital channels improve access to and use of financial services by lowering costs for financial institutions (through reducing the need for brick-and-mortar branches) and for customers (through reducing transaction costs), increasing transaction speed, improving service quality, and making it possible to cover a larger geographical area<sup>9</sup>. Mobile money is a pay-as-you-go digital medium of exchange and storage of value, offered by a mobile network operator or another entity that partners with mobile network operators, independent of the traditional banking network. A bank account is not required to use mobile money services — the only prerequisite is a basic mobile phone<sup>10</sup>. Data from the Global Findex Database 2017 (World Bank Group, 2018) indicate that in ten sub-Saharan African economies, more adults have a mobile money account than a financial institution account<sup>11</sup>. According to GSMA, 2021, registered mobile money accounts in Africa comfortably surpass the half billion mark. Sub-Saharan Africa accounted for the largest proportion (43%) of new accounts globally in 2020. North Africa accounts for a smaller proportion of new accounts globally (3% for the Middle East and North Africa) but usage is growing there too. Data reported in a recent IMF Working Paper (IMF, 2020) show there is not necessarily a strong negative correlation between adoption of mobile money and use of conventional bank accounts. In many cases, traditional players such as microfinance institutions are partnering with FinTech companies to reach clients and reduce transaction costs in locations where traditional banks have struggled, allowing them to achieve higher rates of growth. In other words, digital financial services can often complement, rather than substitute for, services by other providers such as banks.

## The microfinance industry in Africa

**Microfinance in Africa is provided by a diverse group of players, including commercial banks, microfinance institutions and newer digital financial service providers.** Analysis by the International Finance Corporation (IFC) and the Consultative Group to Assist the Poor (CGAP) in 2014 shows that while commercial banks in Africa generally offer a full range of banking products and services, including microloans, these banks have tended to focus on larger firms and wealthier retail clients, leaving 57% of the African population unbanked (as reported by Global Findex (World Bank Group, 2018)). Non-bank financial institutions, both formal and informal, have stepped into this gap to serve excluded individuals, households, and small and medium-sized enterprises (SMEs). These non-bank institutions include traditional microfinance institutions and various other players, such as digital

<sup>8</sup> This definition was taken from <https://www.worldbank.org/en/topic/financialinclusion/overview>.

<sup>9</sup> Digital financial services are delivered through digital channels such as the internet, mobile phones, automated teller machines and point-of-sale devices.

<sup>10</sup> The explanation of mobile money accounts in this paragraph comes from the explanation available for the IMF’s Financial Access Survey (IMF, 2021).

<sup>11</sup> The ten countries are Burkina Faso, Chad, Côte d’Ivoire, Gabon, Kenya, Mali, Senegal, Tanzania, Uganda and Zimbabwe. People with a mobile money account were identified by asking respondents about their use of specific mobile money services available in their economy, such as M-PESA, MTN Mobile Money, Airtel Money and Orange Money. The question about mobile money was asked only in the countries which were included, at the time of the survey, in the Mobile Money for the Unbanked database of the GSMA.

financial service providers. Agent networks also play an important role in enabling the underserved, particularly those in hard-to-reach areas, to access financial services<sup>12</sup>. They drive the uptake and use of digital financial services (CGAP, 2019), especially in communities where cash prevails.

**The African microfinance sector has professionalised and commercialised over the last two decades.** In the early 2000s, few African microfinance institutions of any type demonstrated financial sustainability. This left the sector struggling to scale up as required to meet the needs of large numbers of unbanked households and enterprises. In response, a number of global holding companies and investors — supported by investments from development finance institutions including the European Investment Bank — supported the launch of so-called greenfield microfinance institutions. These well-managed, sustainable and commercially oriented formal financial institutions offer a range of financial products through a scalable operating model. This effort to set up these greenfield institutions focused on sub-Saharan Africa in particular and succeeded in expanding the commercial end of the spectrum with regulated, mostly deposit-taking institutions targeting low-income individuals, microenterprises and small businesses. Today, a range of players provide microfinance services in Africa. These include commercial microfinance institutions (most of which are regulated), non-governmental organisations, informal, non-regulated microfinance providers and a range of other non-bank financial institutions, cooperatives and government institutions (such as postal banks).

**For Africa’s microborrowers, the importance of each type of financial market player varies between and within regions and countries, reflecting their economic and social diversity.** According to CGAP and MIX, 2011<sup>13</sup>, prior to the recent rapid expansion of digital banking, West and Central Africa relied relatively strongly on financial cooperatives. These cooperatives have strong outreach to non-bank clients but tend to have weak risk management capacities, as reflected by poor performance on indicators such as portfolio at risk and write-offs. Microfinance institutions and other non-bank financial institutions dominated East Africa, with a growing number reaching large scale. This sub-region has also led the way on adoption of digital financial services, with various mobile money providers now playing an important role alongside these institutions. The relative importance of microfinance institutions is lower in Southern and North Africa than in the other sub-regions, as commercial banks account for the majority of depositors and borrowers in these markets.

**Microfinance institutions are now reaching almost 8 million borrowers across Africa.** According to analysis of the latest available data from MIX Market<sup>14</sup>, microfinance institutions in sub-Saharan Africa that reported data to the MIX reached 6.3 million borrowers in 2018 and almost 1.5 million borrowers in North Africa. Microfinance institutions in sub-Saharan Africa reported a total gross loan portfolio of \$9.4 billion in 2018, accounting for around 8% of the total outstanding loan portfolio of microfinance institutions reporting to MIX worldwide, and deposits of \$13.0 billion. North African institutions reported total gross loan portfolio of \$0.7 billion (no data on deposits were available). In the sub-Saharan Africa and the North Africa regions, 64% of active borrowers were female (with an identical percentage for both regions) and 60% and 51%, respectively, were based in rural areas, indicating that microfinance is filling market gaps to support women’s economic empowerment and the inclusion of harder-to-reach populations.

**In the past decade, international funders have been prioritising sub-Saharan Africa for investment in financial inclusion, including digital financial services.** Based on CGAP data<sup>15</sup>, in 2019 sub-Saharan Africa received more financial inclusion funding than any other region for the first time, with \$7.6 billion in active commitments. This represents 18% growth on an annualised basis since 2015. In North Africa, Egypt and Tunisia show the largest

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<sup>12</sup> Agents are individuals or companies contracted by financial service providers to act as a customer interface. Agents can offer a range of services, such as opening e-money accounts and helping customers load or withdraw funds from these accounts (cash-in cash-out services).

<sup>13</sup> The Microfinance Information Exchange (MIX) is the leading global data resource focused on inclusive finance. Founded in 2002 and now housed at the Center for Financial Inclusion, MIX has served as a trusted data partner to the microfinance industry.

<sup>14</sup> MIX Market is web-based platform created by MIX and widely used because of its extensive standardised financial and outreach information on microfinance institutions, conforming with microfinance industry reporting standards. This platform ended its data collection in September 2019; its legacy datasets are stored at the World Bank: <https://datacatalog.worldbank.org/dataset/mix-market>. Data in this paragraph for sub-Saharan Africa are as reported in the Microfinance Barometer 2019 (Convergences, 2019). Since this publication does not contain information for North Africa, separate from the Middle East, the data for North Africa were calculated by the authors, using data retrieved from the MIX legacy datasets stored by the World Bank, for Egypt, Tunisia and Morocco.

<sup>15</sup> Available at <https://www.cgap.org/research/data/funding-explorer-interactive-data-2019-cgap-funder-survey>.

investment flows, amounting to \$2 billion in total. The high penetration of mobile money in sub-Saharan Africa affords unique opportunities to expand, improve or build on digital foundations and make inroads in financial inclusion for other development goals. Of all commitments dedicated to digital financial services in 2019, 35% targeted sub-Saharan Africa, more than any other region in that year.

## The COVID-19 crisis and the African microfinance sector

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**During the COVID-19 crisis, African microfinance institutions have faced liquidity pressures and concerns about their long-term solvency, hampering their ability to lend to those in need.** The CGAP Global Pulse Survey of Microfinance Institutions (CGAP, 2020a) gave the financial inclusion community its first insights into the pandemic's initial impact on the microfinance sector at global and regional levels. Over 150 African microfinance institutions participated in seven rounds of data collection between June and December 2020. Although the small and varying sample size means that the data — and especially changes over time — should be interpreted cautiously, the responses of participating institutions recorded in early to mid-2020 clearly demonstrate their concerns about liquidity and solvency, as borrowers struggled to make repayments and new lending contracted. The respondents reported that group loans were particularly severely affected by restrictions on the movement of people, which made it difficult to organise group meetings. Loans to microentrepreneurs in the cities were also badly hit, whereas agricultural loans were reported to be the least affected.

**African microfinance institutions adopted a range of measures to cope with the COVID-19 crisis.** The respondents to the CGAP survey reported that they had tightened credit standards and were lending mostly to well-known customers, potentially affecting the most vulnerable borrowers (CGAP, 2020a). Data collected in 2020 and in the first quarter of 2021 by Symbiotics — described in a series of CGAP and Symbiotics reports (see CGAP and Symbiotics, 2021a, 2021b and 2021c) — indicate there was little formal intervention by the regulators in the countries covered. However, microfinance institutions offered a wide range of solutions to their clients, such as moratoriums and payment holidays, supported by their funders. The majority of the moratoriums were of limited duration in line with the expected duration of containment measures at the time, and reflecting the short tenor of underlying loans. Box 2 provides an example of how South African microfinance institutions faced the crisis.

**Microfinance institutions also made operational changes to deal with restrictions and control costs.** These included enabling homeworking, putting staff on unpaid leave and reducing staff numbers. CGAP research in Uganda as well as some non-African countries (CGAP, 2020c) revealed that some microfinance institutions had taken innovative measures, such as buying airtime for clients to keep in touch via text message, or hiring private transportation; most had bought personal protective equipment for staff that remained physically present in their branches during the crisis period. In other African countries, major microfinance institutions have maintained regular communication with clients, by phone and text message, to assess their financial situations; this should help them ensure high repayment rates when the economy restarts. In addition, some microfinance institutions have been able to take advantage of opportunities to assist governments with distributing social transfers during the crisis, drawing on their wide networks among the poor and their operational flexibility.

### Box 2: Supporting the resilience of South Africa's smallest firms during the crisis

**South Africa has reported more COVID-19 cases (over 2.5 million) than any other country in sub-Saharan Africa, alongside a major economic impact.** Despite heavy COVID-19-related business restrictions, SMEs have exhibited strong resilience thanks to digital business capabilities and some policy support. Microentrepreneurs showed agility by lowering overhead costs and implementing flexible business models, thereby adjusting more rapidly to the changing environment. However, the crisis has still had a negative impact on the very smallest firms. South African microfinance institutions in the Symbiotics portfolio responded by reviewing their credit underwriting policies, leveraging technology and focusing on the more resilient sectors of the economy. Consequently, portfolio quality remains manageable on average, although loan portfolio growth has not met expectations. South Africa recently implemented tighter restrictions on movement and economic activities in order to contain the pandemic, but the Symbiotics portfolio is expected to withstand the situation as microfinance institutions have been selectively avoiding the more vulnerable sectors over the past 12 months.

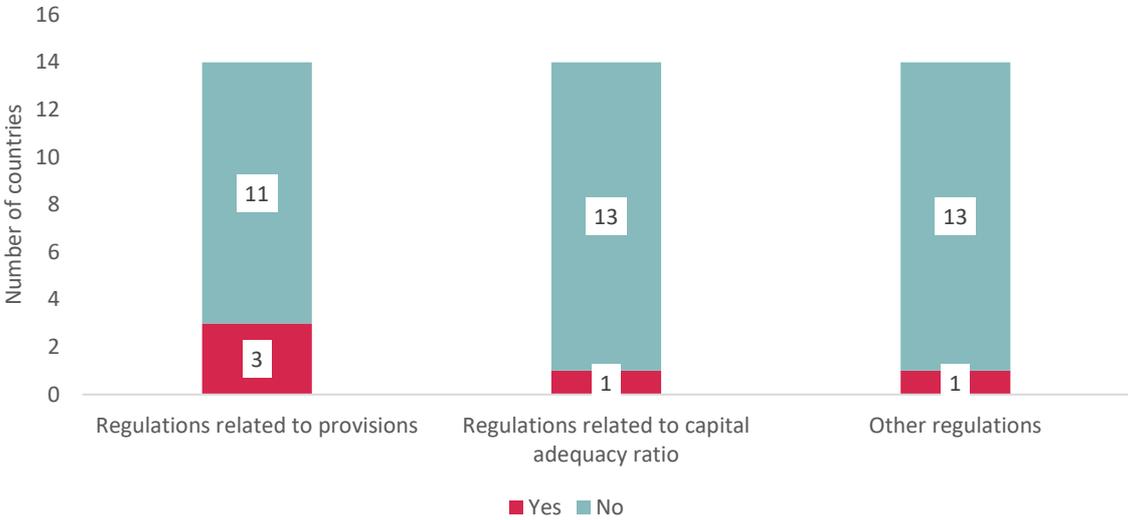
**Digital financial services have helped microfinance institutions and their customers to weather the storm.**

According to the State of the Industry Report on Mobile Money (GSMA, 2021), COVID-19 triggered a widespread shift in the adoption of digital tools. Restrictions on movement and the potential risks of handling cash led consumers to quickly turn to digital payments as a safer and more accessible option. In 2020 the number of registered mobile money accounts grew by 12.7% globally, with over 136 million added in just one year. As mentioned above, sub-Saharan Africa accounted for the largest proportion of growth (43% of all new accounts), reaching more than half a billion accounts in total. According to the CGAP Global Pulse Survey of microfinance institutions (CGAP, 2020a), those microfinance institutions that had adopted digital channels before the crisis were better placed to cope than their peers. Use of digital channels allowed them to continue collecting payments, to earn fees from digital payments and to give their clients access to savings and withdrawals throughout the crisis. By contrast, institutions without digital service channels saw their operational costs increase. Elsewhere, low levels of digitisation and weak links to mobile money services in some countries left many clients with no access to microfinance services during lockdowns.

**Policymakers and regulators implemented various measures to support microfinance institutions and borrowers.**

Based on the responses of microfinance institutions from 14 African countries in a survey conducted by Symbiotics in December 2020, regulatory measures to protect the sector during the pandemic were less extensive than on other continents (as described by CGAP and Symbiotics, 2021b). The survey responses suggest that African regulators intervened mainly in larger countries with more mature financial sectors and focused largely on regulated entities. The exact set of measures implemented varied across sub-regions and markets, but included moratoriums, debt-restructuring measures and relaxation of required capital adequacy ratios to avoid liquidity constraints (Figure 2)<sup>16</sup>. For example, the Bank of Uganda gave microfinance institutions the discretion to offer moratoriums or restructuring on a case-by-case basis anytime between 1 April 2020 and 30 March 2021, with up to two reschedulings permitted on any loan. Interest accrual was allowed, including interest capitalisation (interest conversion into principal or interest-on-interest), while fees had to be “reasonable”. Only loans in good standing were initially eligible, but the Bank of Uganda later permitted moratoriums even for loans with some arrears.

**Figure 2: Microfinance institutions in Africa reporting different types of special regulations, 31 March 2021, number of countries where measures are reported**



Source: Symbiotics MFI Africa survey, April 2021. Sample: 14 countries.

**While policy measures helped the microfinance industry face the crisis, most moratorium policies ultimately increased total costs for borrowers through interest accrual (and sometimes fees).** Borrowers may end up paying more interest and losing access to new loan finance (CGAP, 2020b). The pandemic experience also offers important lessons on how to better prepare for the next crisis by tailoring response measures such as

<sup>16</sup> Unregulated non-governmental organisation may have benefited, in some cases, from broader policy measures such as fiscal support.

moratoriums to the specific needs of microfinance institutions and their clients. CGAP suggests five principles to guide regulators on taking a client-centric approach as they respond to COVID-19's impact on the microfinance sector (Box 3).

**Box 3: CGAP's guiding principles for regulators responding to the impact of COVID-19 on the microfinance sector**

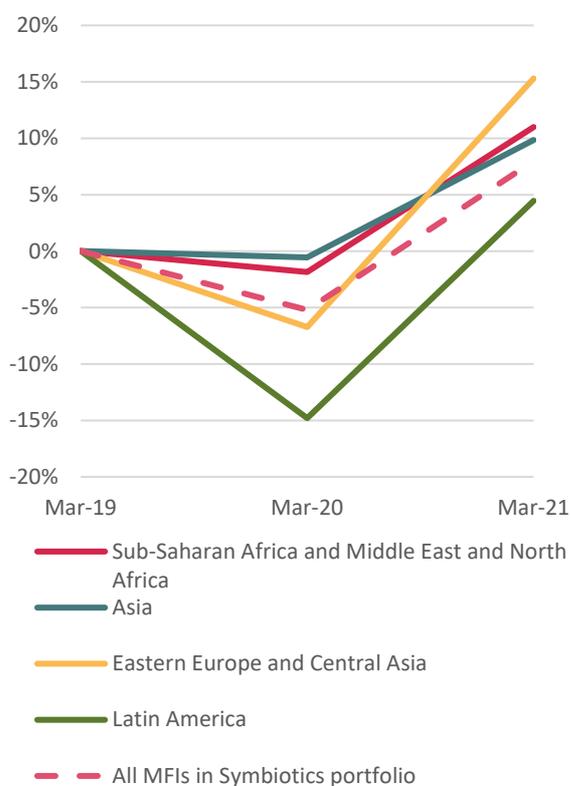
- 1. Pro-poor.** Poor customers should benefit from effective relief and continued access to services, and be protected.
- 2. Clear and predictable.** Response measures should have a clear timeline, scope of application and exit strategy.
- 3. Broad coverage.** Response measures should cover all regulated microfinance providers.
- 4. Preserve the safety and soundness of microfinance providers.** Response measures should balance the benefits and risks of regulatory changes.
- 5. Adjust supervision.** Response measures should reduce supervisory burdens while enhancing risk-based monitoring.

## A path towards recovery?

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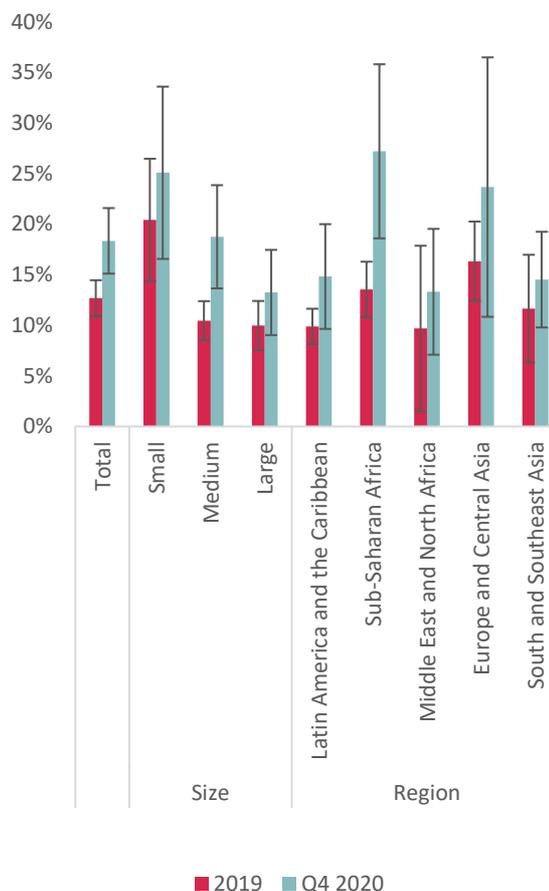
**African microfinance portfolios have contracted and credit risk has risen significantly, so recovery will likely be challenging.** The CGAP and Symbiotics surveys (CGAP, 2021) indicate that lending volumes contracted significantly at the start of the crisis (Figure 3). Figure 3 presents the growth trajectory of microfinance disbursements for the Symbiotics portfolio, contrasting pre-crisis data for 2019 with data at the onset of the pandemic in March 2020, and with March 2021. Although the volumes disbursed began to rise in 2020, they still have not recovered their 2019 value in real terms.

Figure 3: Nominal growth in average monthly disbursements relative to March 2019



Source: Symbiotics.

Figure 4: Mean credit risk ratio



Source: Analysis by CGAP and MicroFinanza Rating (MFR) (CGAP, 2021d).

Note: Defined as the mean value of (portfolio at risk 39 days or more + loans less than 30 days overdue but restructured + loan write-offs) / mean gross outstanding portfolio).

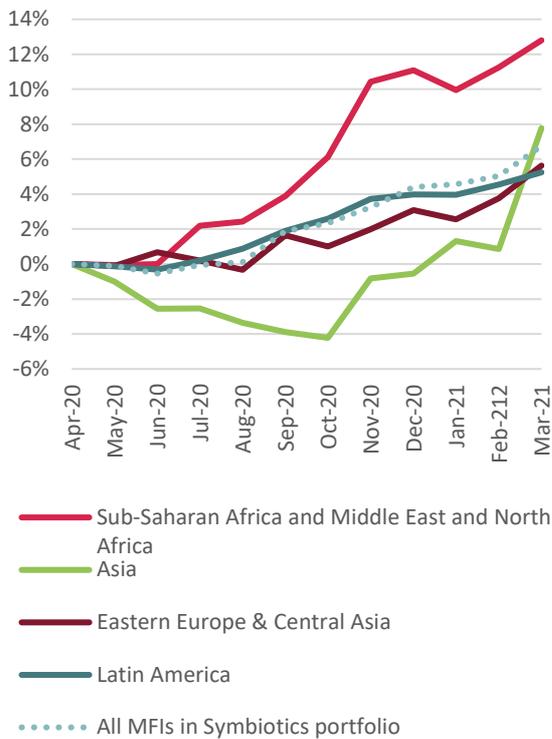
**The relatively gradual recovery in disbursements partly reflects institutions’ wariness of heightened portfolio risks.** Figure 4 compares the mean credit risk ratio observed in 2019 with the situation in the fourth quarter of 2020 based on data from CGAP and MicroFinance Rating (MFR). The deterioration in portfolio quality has been more severe in sub-Saharan Africa than in other world regions. Taking into account the region’s muted and uncertain macroeconomic prospects, further deterioration is probable. If a significant proportion of borrowers default, this will ultimately put pressure on capital adequacy. The need to preserve and restore capital buffers will make it difficult for microfinance institutions to relaunch lending, which could have a deep impact on recovery prospects, particularly for the most vulnerable. Low-income households and micro, small and medium-sized enterprises (MSMEs) in Africa, including the very poor, hard-to-reach populations, generally rely on microfinance institutions as their sole source of external finance.

**Prospects vary between different types of microfinance provider, with the smallest institutions (also known as Tier 2 and 3 institutions) most vulnerable.** Figure 4 indicates that although risk has risen in all the categories examined, the increase has been most marked among small to medium-sized microfinance providers. CGAP analysis indicates that the biggest risks lie with Tier 2 and 3 microfinance institutions, mainly comprising small to medium-sized institutions, which are generally slightly less mature and less profitable, as well as startup microfinance institutions and small non-governmental organisations. Serving poorer populations that have been severely affected by the pandemic, this vulnerable group of financial institutions is likely to require greater

support to recover from the crisis. There is likely to be consolidation across these institutions, as some may not be capitalised strongly enough to deal with the impact of the pandemic. By contrast, larger institutions tended to have better risk management and business continuity plans in place pre-crisis; many had strong equity cushions that have allowed them to weather the storm. These institutions will be better placed to recover, and to drive recovery with continued lending. However, institutions with pre-existing structural weaknesses will struggle to make it through the crisis and restart lending.

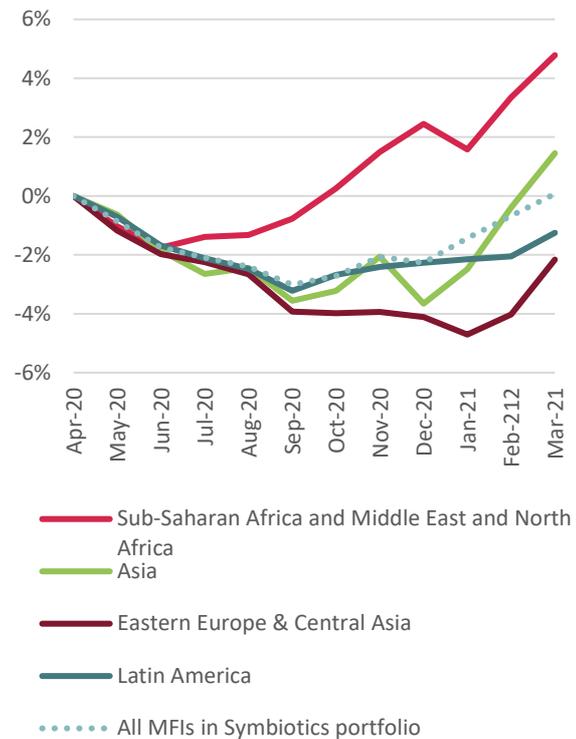
**Tier 1 microfinance institutions seem to be recovering faster in Africa than in other regions, but the full impact of the pandemic will take time to materialise.** Symbiotics recently surveyed over 40 microfinance institutions in Africa, with data as of March 2021 summarised in the latest CGAP and Symbiotics report (CGAP and Symbiotics, 2021c). Growth in portfolio size and number of borrowers is shown in Figures 5 and 6, respectively. Overall, larger (Tier 1) microfinance institutions seem to be recovering more strongly than similar microfinance institutions in other regions in terms of number of borrowers, disbursements and profitability. However, from an asset quality perspective, both portfolio at risk and the moratorium ratio are higher than in some other regions, which could set back the recovery. On the other hand, this portfolio displayed higher risk prior to the crisis than the portfolio in the other regions due to the size and nature of the microfinance institutions.

Figure 5: Portfolio growth, up to 31 March 2021



Source: Symbiotics.

Figure 6: Growth in number of borrowers, up to 31 March 2021



Source: Symbiotics.

**There is an opportunity to learn from the pandemic experience to improve both preparedness for future crises and services for clients.** Once the situation stabilises, microfinance institutions will hopefully use the lessons of the pandemic to strengthen their underwriting; improve their distribution channels, especially digital services; and be more client-centric to help accelerate the breadth and depth of financial inclusion. Strengthening the use of formal savings products could improve development outcomes and help people better manage economic emergencies. The challenge for formal financial service providers is to offer fair, affordable and transparent products that satisfy customer needs.

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# Private equity and venture capital

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The views expressed here are those of the author and do not necessarily reflect those of the European Investment Bank. All remaining errors are the responsibility of the author.

## Introduction

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**Africa can only achieve a sustainable, smart and inclusive recovery from COVID-19 if the continent's financial sector plays a strong and effective role.** The financial sector can support sustainability and inclusion by channelling finance to private sector firms that are creating and sustaining jobs and providing services and products that address development challenges. For example, support is needed for firms in the renewable energy sector that contribute significantly to tackling climate change. However, as outlined in Chapter 1 of this report, many African firms struggle to access finance, with smaller and younger firms and those with innovative products and business models often facing the highest hurdles. These are often the firms with the highest potential to address climate and development challenges.

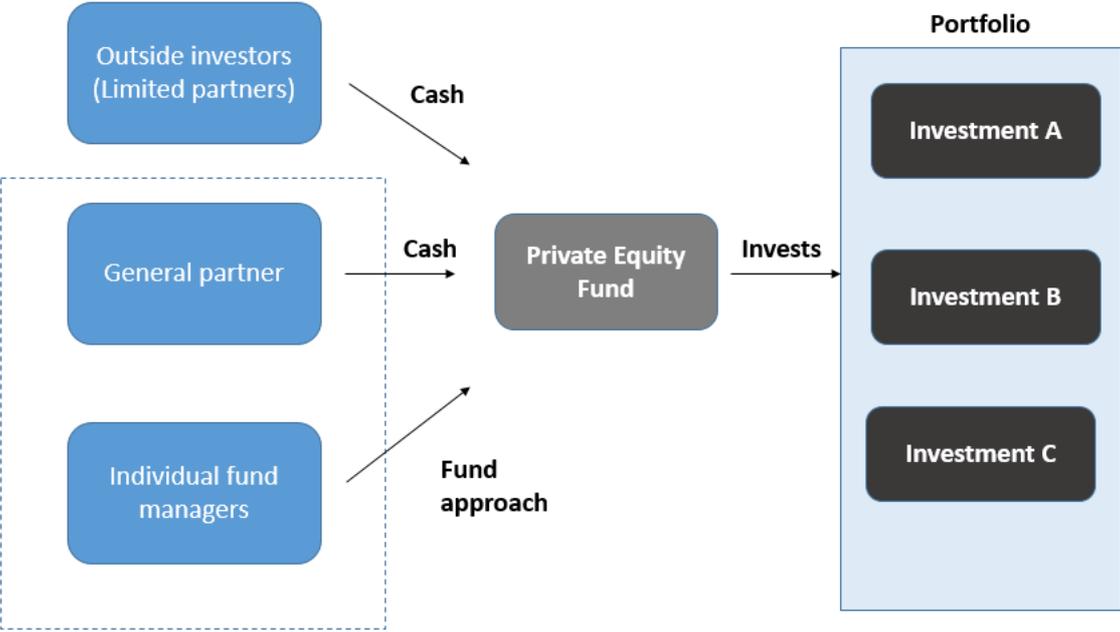
**In this context, private equity and venture capital have an important role to play. They provide patient, risk-absorbing finance,** which is particularly important for startups and innovative businesses. They also offer an important funding alternative for companies with limited traditional financing opportunities such as obtaining a bank loan or issuing a bond. Private equity and venture capital investors typically become shareholders in the company, which makes such funding options similar to offering equity on a public stock market, except that the transaction is private, with the company either not listed on a public stock market or being delisted as part of the deal. Small and young firms are generally not large enough to be listed on a stock exchange and may be considered too high a lending risk by commercial banks. In addition, whereas private equity investors in North America and European markets depend upon bank leverage for acquisition financing, many private equity and venture capital transactions outside these markets are unleveraged. This means that, especially in Africa, this type of investment is made without any recourse to bank finance.

**Private equity and venture capital investments are typically made into businesses with growth potential: equity is provided to be invested in the business with the goal of increasing its value over time.** This requires a patient approach to financing. Venture capital is a form of private equity investment that focuses on startups and younger, often technology-enabled companies. Investors normally take a minority stake in the target company and the investment is quite risky because the business model is generally less proven, so the expected growth may not be achieved.

**Private equity and venture capital investment is typically of a strategic nature and investors tend to sit on the company's board and participate in making major decisions.** Private equity funds often take a significant minority stake when they invest in a company. Firms seeking equity investment cede more control compared to traditional bank financing, but gain managerial expertise and guidance from the fund. A family business, for example, might be seeking more than just a financing solution: it may need a partner providing strategic advice and international experience to facilitate expansion outside the company's home market. This is where private equity differs from bank finance.

**A private equity firm brings together individual fund managers that form a general partnership. While the general partners contribute a small amount of capital, the firm has to engage in fundraising to build a pool of funds from its investors (known as limited partners).** The resulting fund is invested in private companies and the firm generally charges its limited partners management and performance fees. Private equity firms typically have a medium-term investment horizon of three to eight years, making it a stable financing source that allows investee companies to grow. The firm makes a profit by eventually divesting its stake in the investee business, using a variety of exit strategies. Profits are distributed to limited partners, net of any performance fees.

Figure 1: Private equity structure



Source: [JobSearchDigest.com](http://JobSearchDigest.com).

**Data on the effectiveness of private equity investment are mainly limited to advanced markets.** Davis et al., 2019 find that private equity investment in the United States is associated with a 7.5% increase in productivity at target companies relative to control firms. In addition, more than 80% of the productivity increase is attributable to revenue growth, rather than workforce reductions. Biesinger et al., 2020 study 1 580 buyouts between 1992 and 2017 across European countries and find significant long-run increases in labour productivity (20%), capital intensity (27%) and total factor productivity (4%). For venture capital specifically, Pavlova and Signore, 2019 find that venture capital-backed firms achieve revenue levels ranging from 19% to 97% higher than the control group at one year and five years after treatment, respectively. Pavlova and Signore, 2021 also find a positive association between this backing and increased innovation, measured by a doubling of the likelihood of patenting. These studies point to the value added by private equity funds, but the magnitude of improvements likely differs somewhat in Africa.

## Private equity and venture capital in Africa: An industry overview

To track fundraising and investment activity in Africa, we use data from the **Global Private Capital Association (GPCA), formerly EMPEA, a non-profit global industry association for private capital in Asia, Africa, Latin America, the Middle East, and Central and Eastern Europe**<sup>2</sup>. The data capture private capital activity—including private equity, venture capital, private credit, and infrastructure and natural resource strategies—by region, country and industry. In GPCA terminology, fundraising is classified geographically based on the fund’s geographic mandate, which specifies where the funds are planned to be invested. Thus, Africa-focused fundraising refers to funds earmarked for Africa, and not to the domicile of the fund’s manager or investors<sup>3</sup>. GPCA data on investment (deal activity) refer to the location of the investee company’s headquarters or primary operating area. As fundraising occurs before investment, the deal/investment volumes in a given country will be influenced by the fundraising volumes, albeit with a lag.

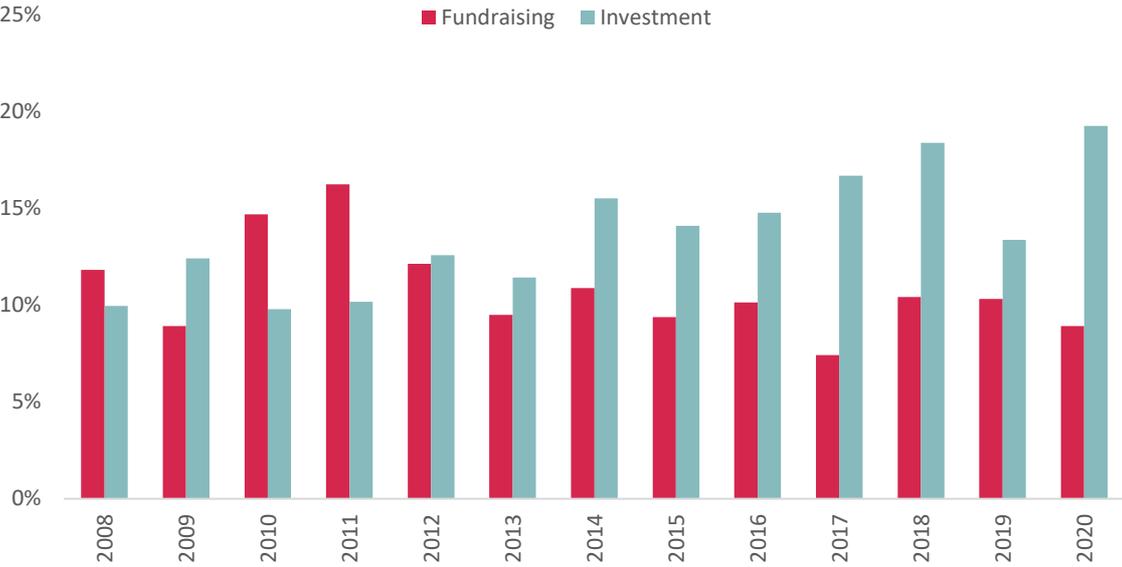
<sup>2</sup> EMPEA rebranded to become the Global Private Capital Association in June 2021. For more information visit [www.GlobalPrivateCapital.org](http://www.GlobalPrivateCapital.org).

<sup>3</sup> A fund’s geographical mandate is contractually specified in the agreement between the limited partners and fund managers.

**The bulk of private equity investments target advanced economies, especially in North America and Europe.**

Typically, just over 10% of private fundraising globally targets emerging markets and developing economies (EMDE), as represented by the red bars in Figure 2. However, fundraising has grown robustly in both EMDE and advanced markets since 2012, with fundraising targeting the former rising from \$49 billion that year to \$85 billion in 2019 (a 77% rise). The pandemic set this fundraising back to \$79 billion in 2020, through a combination of liquidity concerns among investors, EMDE currency depreciation and difficulties performing due diligence remotely. Nonetheless, the level of fundraising in emerging markets and developing economies still remained higher than at any level before 2018.

Figure 2: Emerging and developing markets’ share of global private fundraising and investment

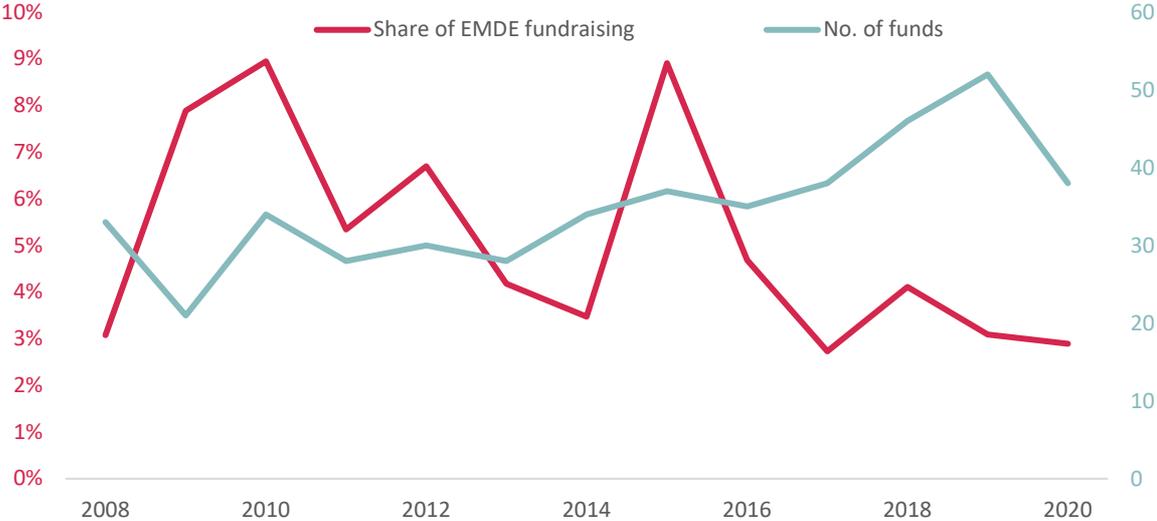


Sources: GPCA, author’s calculations.

**Over the past five years, Africa has typically accounted for only 3–4% of emerging market and developing economy fundraising (Figure 3), which is dominated by Asia—the target of more than 80% of funds for these markets over this period.** The fall in the share of African fundraising from 2015 has coincided with a sharp increase in fundraising for Asia, which only accounted for 65% of funds raised from 2008 to 2015. Despite its relatively small share of EMDE fundraising, Africa receives more than the Middle East and Central and Eastern Europe/Russia but less than Latin America.

**In absolute terms, Africa-focused funds raised \$2.6 billion in final and incremental closes in 2016, and this figure climbed gradually to \$3.6 billion in 2019. This rise was driven by increasing numbers of funds (represented by the green line in Figure 3) while fund size declined.** The average fund size in a given year depends partly on the split in fundraising between different types of funds: venture capital funds are generally smaller than private equity funds. Accordingly, the higher numbers of funds reflect the growing importance of the venture capital sector. The pandemic reversed the upward trend, with African fundraising dropping to \$2.3 billion in 2020, a 34% reduction from 2019.

Figure 3: African share of emerging and developing economy fundraising and number of funds



Sources: GPCA, author’s calculations.

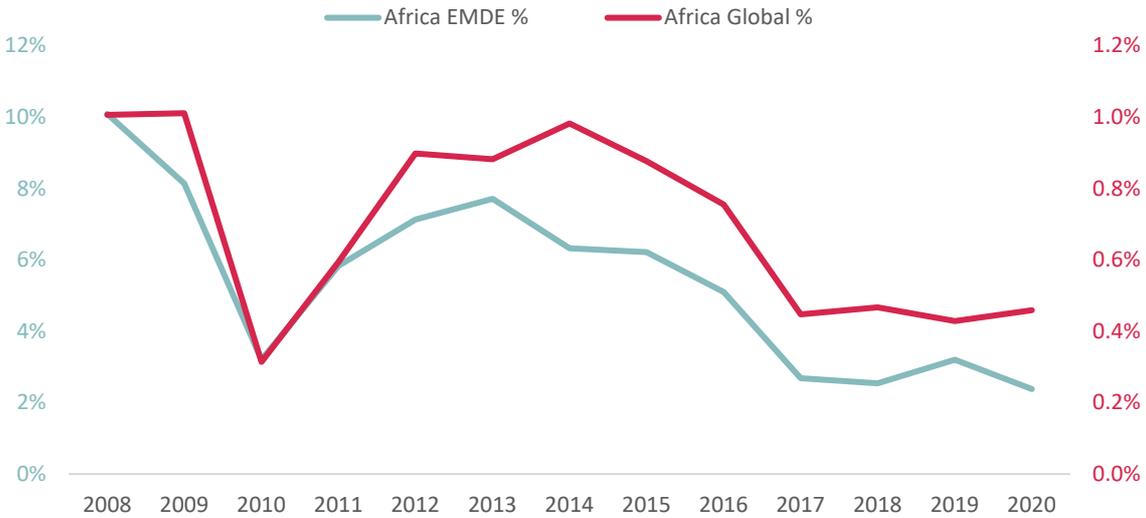
**Katz, 2021 reports that the drop in African fundraising in 2020 was more acute among newer fund managers, whereas those with a longer track record demonstrated more resilience.** Travel restrictions make it difficult to perform due diligence on the ground, especially for new fund managers. Consequently, there was increased focus on completing existing transactions and doing business with known fund managers. The backlog of existing transactions is likely diminishing and travel restrictions in Africa may remain in place for some time given the slow pace of vaccination. Thus, while data for 2021 are not yet available, continued weakness in fundraising activity would not be surprising.

**Another key facet of African funding is the critical role played by development finance institutions (DFIs), even though fund managers have successfully attracted more local investors such as pension funds in recent years.** The role of development finance institutions is greater in Africa than in other EMDE regions, and has been especially pronounced during the pandemic. In addition to being a key source of funding in Africa, these institutions are often the early investors. Their participation signals to other investors that due diligence has been satisfied and opens up opportunities to join subsequent closings, thereby crowding in the private sector. DFI financing tends to be counter-cyclical but the pandemic led to a pause in flows from some institutions—another contributory factor to weak fundraising in 2020.

**Another feature of the African fundraising market is the domination by regional funds, meaning funds that plan to invest capital across the continent rather than in a specific, single country.** About three-quarters of funds for Africa have been raised by regional funds. As many African markets are relatively small, there may not be sufficient investment opportunities unless a regional approach is taken. This also allows investors to diversify risk across different markets. If funds market themselves as investing in a single country, they are constrained to that market even in a downturn. Therefore, the regional approach offers scale, flexibility and risk-management benefits.

**The share of global investment in emerging markets and developing economies climbed from 10% in 2008 to 18.4% in 2018 (Figure 2, green bars).** Although this share backslid in 2019, mainly due to a fall in investment in emerging Asia (the largest EMDE market), it rebounded to 19.3% in 2020 as Asian investment activity recovered. Private capital investment into African companies is small as share of total emerging market and developing economy investment (Figure 4), though its ranking among these markets in terms of investment mirrors that of fundraising. Globally, the small size of the African market is even starker, accounting for about 0.5% of global private capital investment since 2017.

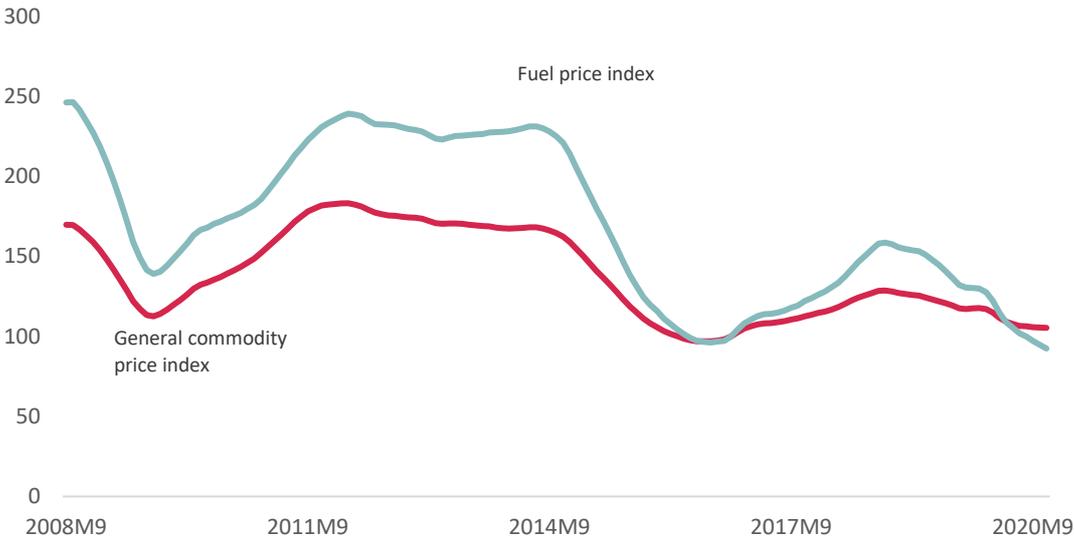
Figure 4: Private capital investment in Africa (% of EMDE total and % of global total)



Source: GPCA.

Looking further back, Africa’s share of global private investment dipped following the global financial crisis, as risk appetite diminished and investments were pulled from emerging markets and developing economies. The post-crisis period from 2012 to 2014 witnessed stronger growth in relative gross domestic product (GDP) for Africa, supported by a rebound in commodity prices, which was sustained until late 2014 (Figure 5). Against the backdrop of an “Africa Rising” narrative, African private investment largely regained its pre-crisis global market share between 2012 and 2014. However, from 2015, commodity prices weakened and African growth began to slow<sup>4</sup>. The falling share of private investment in Africa from 2015 to 2018 marks a decoupling from the broader EMDE upward trend in the share of global investment (Figure 2). Some of the reasons for this are discussed in the final section on challenges faced by the private investment market in Africa.

Figure 5: IMF global commodity price indices

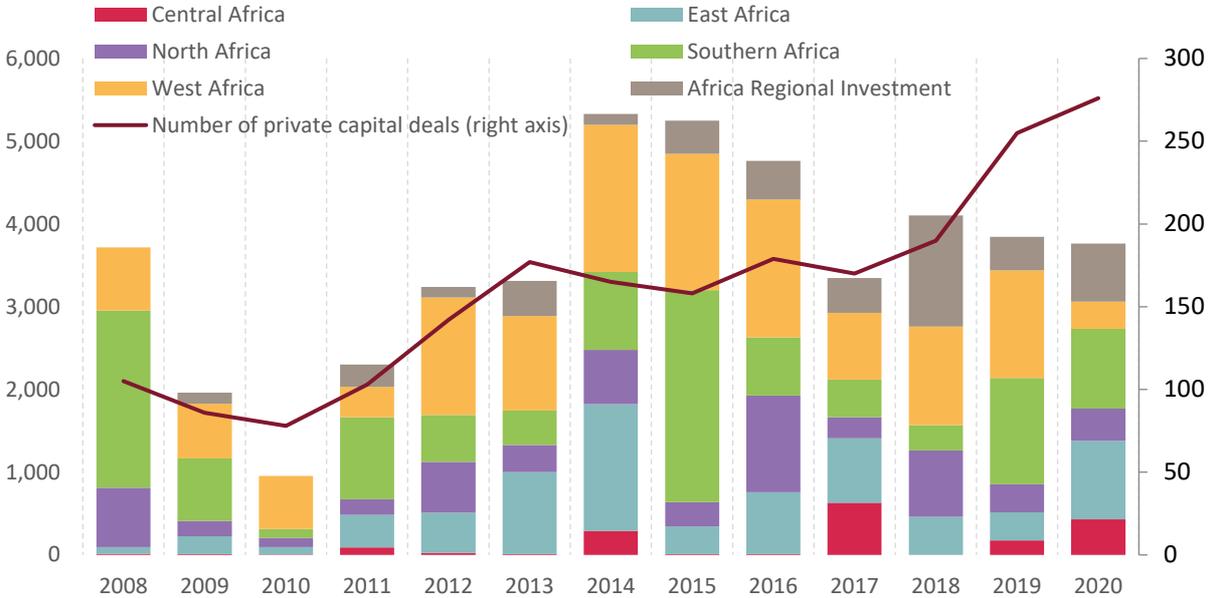


Source: IMF.

<sup>4</sup> See Diop, 2018 for more details.

**Africa’s declining share of global private investment from 2015 onwards was mirrored by a reduction in absolute investment value, as the bars in Figure 6 demonstrate.** Deal value peaked at \$5.3 billion in current prices in 2014 but slipped to \$3.8 billion in 2019, a fall of 30%. By contrast, the number of private capital investment deals (represented by the line in Figure 6) continued to grow between 2015 and 2019. This rise was driven by increases in the number of venture capital deals, while the number of traditional private equity deals trended sideways.

**Figure 6: Total private investment in Africa by region (\$ million)**



Source: GPCA.

**The impact of the pandemic on deal value was small in 2020**, and this modest decline was accompanied by an increase in the number of deals, ostensibly mirroring recent trends. However, there is generally a lag between fundraising and investment, so if a prolonged reduction in fundraising materialises, it would eventually lead to downward pressure on investment. Recent years have seen a rise in co-investing with traditional fund managers, whereby corporates, development finance institutions and institutional investors provide capital for specific deals, rather than investing in private equity funds. This activity is not captured in the fundraising data and could support investment; however, the size of this type of funding is not easily quantified and may not be enough to offset a decline in traditional fundraising.

## Regional and sectoral trends

**Regarding the evolution of private equity investment across Africa, one important caveat is warranted: as there are relatively few deals each year, regional market shares can be dominated by outliers and there are large fluctuations from year to year.** Nonetheless, some trends are evident in the data. The early dominance of Southern Africa and West Africa in attracting private equity investment has waned somewhat over time (Figure 6). South Africa attracts almost all investment in Southern Africa but, unusually, Botswana accounted for half of the Southern Africa deal value in 2019. Despite a modest decline over time, West Africa still has the largest market share when aggregated over the last three years. Nigeria is the region’s largest market, normally accounting for at least half of private investment, with Ghana ranked second.

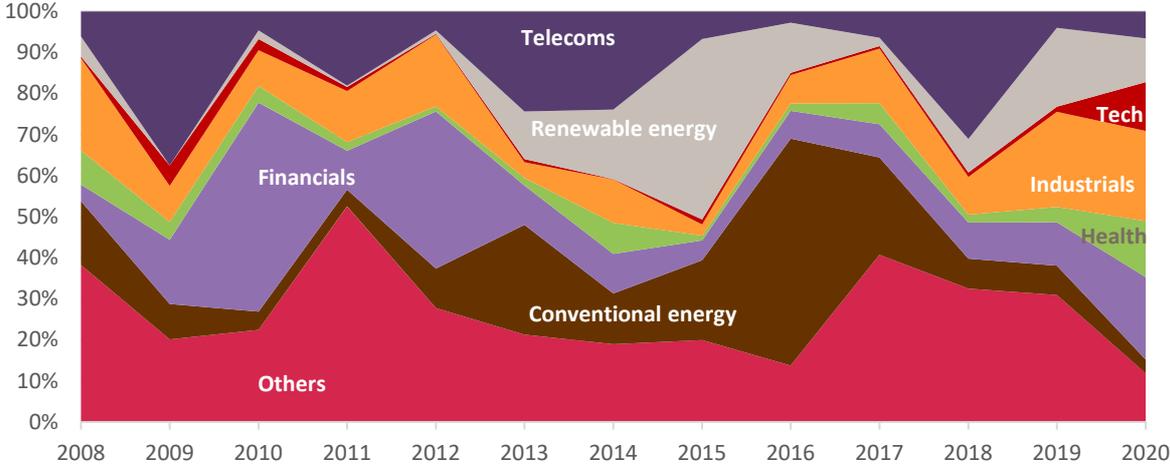
**North Africa typically accounts for less than 15% of continental private investment, despite having some middle-income economies such as Morocco and Egypt and accounting for 28% of African GDP in 2019.** East Africa’s market share grew following the global financial crisis but has been volatile since then, despite fairly

steady growth in most of the region’s large countries. The East African market is more fragmented than other regions but also has the largest number of countries that consistently contribute to investment activity. The largest market is Kenya, which has received half of private investment in the region since 2008. Mauritius is the next largest market with a 12% market share, followed by Zimbabwe at 6%, again since 2008. Ethiopia accounted for 5% of private investment, despite being one of the region’s largest economies. While Central Africa lags behind the other regions with a market share of less than 1% for most years prior to 2017, it has seen market share in excess of 10% in both 2017 and 2020.

**The importance of African regional investment has grown over time but, except for 2018, its share of the private investment market has remained below 20%.** Regional investment refers to investments from private equity funds into companies that are usually based outside the region but either exclusively or primarily target African markets. In this sense, interest in African markets from overseas investors has increased in recent years. One final point to note regarding the market shares quoted in this section is that the dataset is not exhaustive because not every deal is disclosed in each market.

**Turning to the key target industries for investment, the relatively small size of the African market again means that industry shares are volatile from year to year.** Energy investment in both the conventional and renewable sectors has frequently accounted for a significant share of private investment (Figure 7). The shares of both sectors expanded around 2014/2015 due to some large deals, but conventional energy has subsequently attracted less investment, possibly because development finance institutions have increasingly prioritised environmental issues. Although the market share of renewable energy also declined, partly due to weak performance in 2017, this sector appears more resilient than conventional energy as investors continue to support the green agenda.

Figure 7: Industry shares of African private investment spending



Sources: GPCA, author’s calculations.

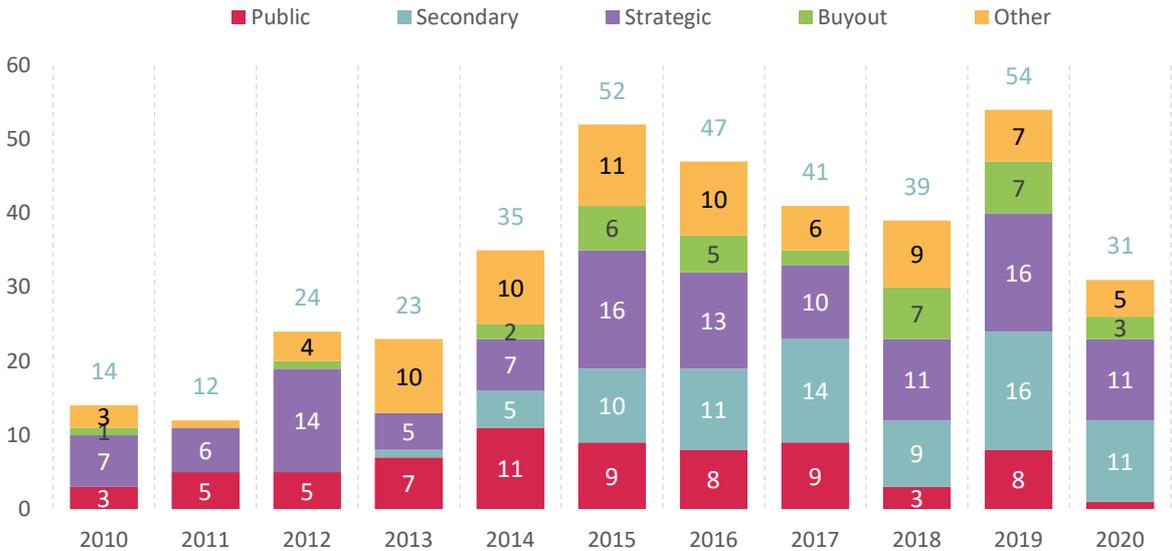
**Financial services saw strong investment in the early part of the sample period, with some large investments in 2010 and 2012.** However, the sector’s market share subsequently did not exceed 11% in any individual year until 2020, when it jumped to 20%. The absolute sums invested in financials actually increased somewhat but the broader market expanded more quickly. There has also been a shift from traditional financials to FinTech, leading to a big increase in deal number but a fall in deal value, as FinTech appears to be characterised by smaller deals compared to traditional investment in banking, insurance and asset management. The three-year average for deal value peaked in 2014 at \$25 million, but this declined to \$10 million in 2019. In an analysis of the African FinTech market, Katz, 2020 notes that payments processors and digital lenders have accounted for the bulk of FinTech investment.

While the pandemic had little impact on total investment value in 2020, it does appear to have affected sectoral investment choices. In healthcare, the three-year average market share was 4% from 2016 to 2019 but the one-year share jumped to 14% in 2020, its largest ever share. Information technology, which had a market share of 1% (or less) in each individual year between 2011 and 2019, also saw its share jump to 12% in 2020. As already mentioned, the financial services market share grew in 2020. Accordingly, private equity investment can help to facilitate a quick reallocation among sectors as circumstances change.

## Exit strategies

For private investors, generating returns on investment depends on the availability of suitable exit opportunities. The main exit strategies are strategic sales, secondary sales, public markets and management buy-back. A strategic sale occurs when the private equity or venture capital investor sells its stake in the company to another industry player with a strategic interest in acquiring it. A secondary sale occurs when the stake is sold to another private capital fund investor to support a further expansion phase. This category includes sales to any other financial investors that do not manage traditional funds. A public market exit entails listing or selling the company on a public market, typically via an initial public offering, follow-on offering or direct listing without a public offering. Finally, management buy-back involves selling the equity back to the original owner or existing managers.

Figure 8: Total exits by exit type



Source: GPCA.

The most common exit type in Africa over the last 13 years has been strategic sale to other industry players, accounting for 122 of 389 exits. Secondary sales to other funds or financial companies was the next most common exit strategy, with 79 exits. There were 72 public sales but less than half involved initial public offerings, which typically account for just three or four exits per year. Management buy-back was the exit strategy in 35 cases. The remaining 81 exits fall under the “other” category, which includes share buy-backs, repayment of preference shares and undisclosed exits.

The pandemic appears to have impacted exits, which fell from 54 in 2019 to 31 in 2020 (Figure 8). While 2019 was characterised by an unusually high number of exits, the number in 2020 is still lower than in 2017 and 2018, which saw 41 and 39 exits, respectively. Interestingly, public sales and management buy-backs both dropped very sharply, with just four exits across these two categories in 2020. Most sales were strategic or secondary, with both numbers close to 2017/2018 levels.

Secondary sales were rare before 2014 but the growing size of the private equity industry in Africa has supported sales between private equity firms in line with the different development stages of investee companies. However, the level of fundraising indicates the size of the potential secondary market, so if fundraising does not recover from the pandemic, exit opportunities for existing funds could be further constrained. The numbers of public sales were greatest between 2013 and 2017, but have been lower in recent years. The sharp fall in total exits in Africa in 2020 contrasts with an 8% rise across all emerging markets and developing economies.

**There are limited opportunities to exploit public market exits in Africa, which deters private equity investment.** The broad trend of declining exits (notwithstanding the spike in 2019) comes against a background of rising deal numbers, as shown in Figure 6. This indicates that investment holding periods are lengthening, which cannot persist indefinitely. Private investment values are linked to public equity valuations; unless there are opportunities to exit when valuations are favourable, investment inflows are likely to become constrained.

## Challenges and opportunities

### Challenges

**Understanding the challenges confronting the African private equity and venture capital market might help to halt the recent decline in the continent's share of global private investment.** Groh et al., 2018 conducted the latest in a series of studies by the IESE Business School that attempts to rank countries globally on the attractiveness of their private equity and venture capital markets. Countries are ranked on *Economic Activity* (14%), *Depth of Capital Markets* (32%), *Taxation* (5%), *Investor Protection and Corporate Governance* (14%), *Human and Social Environment* (14%), and *Entrepreneurial Culture and Deal Activity* (23%), with the weight of each component in the overall index shown in brackets. The study also constructs regional rankings, as shown in Table 1.

Table 1: Venture capital and private equity regional attractiveness

Region	VC/PE index	Economic Activity	Depth of capital market	Taxation	Investor protection and corporate governance	Human and social environment	Entrepreneurial culture and deal making
North America	96.8	95.4	96.5	103.2	99.0	99.6	94.1
Australasia	89.2	84.8	82.8	107.8	104.6	98.5	83.9
Western Europe	78.7	78.5	70.6	112.7	85.3	83.0	78.9
Asia	69.1	88.8	65.1	95.9	69.6	61.0	64.9
Middle East	60.5	71.1	54.6	93.2	64.1	65.3	53.8
Eastern Europe	57.5	73.8	46.7	100.1	63.2	58.6	57.2
Latin America	51.5	72.0	45.9	88.6	53.0	46.5	46.2
Africa	43.0	62.9	31.2	82.8	54.8	46.1	39.0

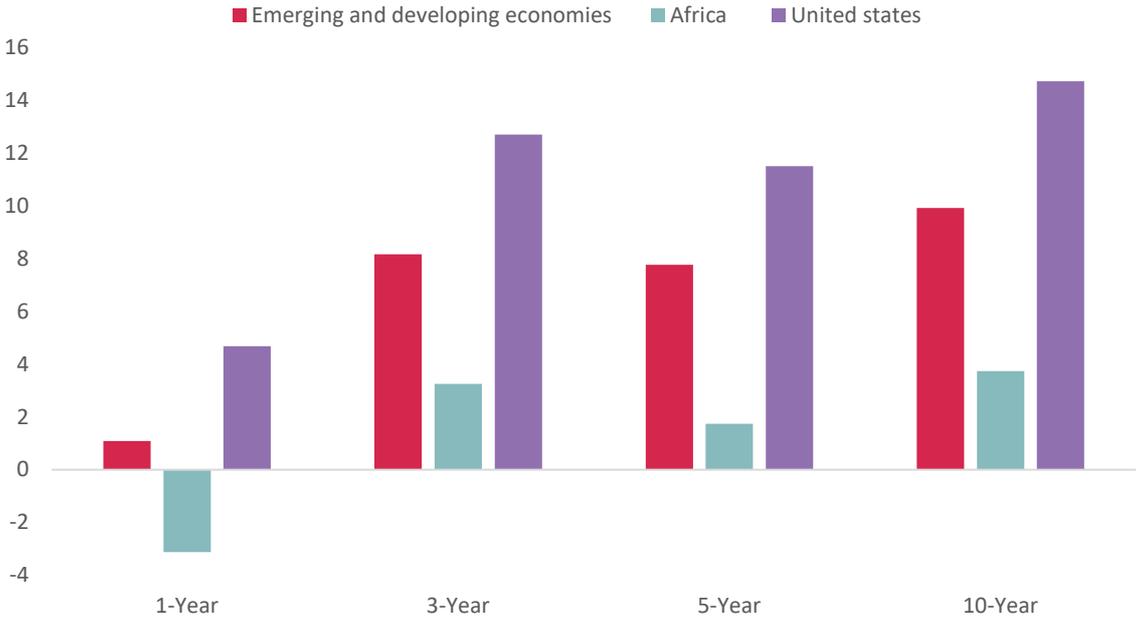
Source: Table reproduced from Groh et al., 2018.

**Of the eight global regions, Africa ranks last on all indicators except for Investor Protection and Corporate Governance, where it is fractionally ahead of Latin America (Table 1).** It trails other regions by the greatest margins in *Depth of Capital Markets* and *Entrepreneurial Culture and Deal Opportunity*, which have the largest weights in the index. *Entrepreneurial Culture and Deal Opportunity* is measured using indicators of innovation, ease of starting or closing a business, and research and development activity; without these elements, new companies that may ultimately become the targets of private equity and venture capital are less likely to be created. *Depth of Capital Markets* is measured using indicators of stock market size, initial public offerings (which allow private equity investors to exit their investments and realise gains), access to finance and financial sector performance. However, as mentioned earlier, leverage is much lower in African deals and this might be driven by smaller deal size, rather than financing constraints. The small size of public equity markets may also incentivise

private equity funds to gain exposure to sectors not represented in public markets. In this sense, there are likely some idiosyncrasies in the African market that need to be borne in mind.

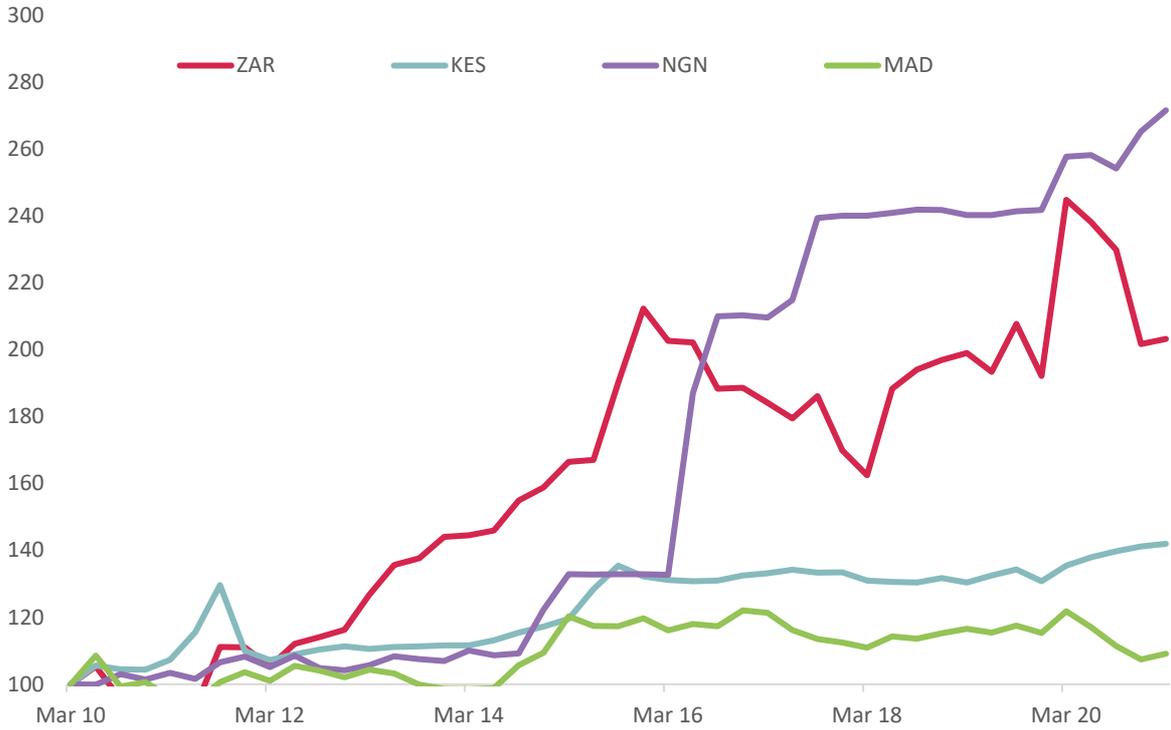
**Beyond the factors highlighted by Groh et al., 2018, lower returns on private equity investment in recent years likely impact the relative attractiveness of private investment in Africa.** Irrespective of the investment horizon, advanced markets yield higher returns than emerging markets and developing economies (Figure 9). However, African returns over three to ten years range from 2–4%, substantially below the 8–10% of EMDE as a whole. Unfavourable currency movements have hurt returns (Figure 10), with several major African currencies depreciating significantly in the last ten years. Until currency risk is lessened, some investors will likely remain hesitant to enter the African market.

Figure 9: Investment returns (\$) on private equity and venture capital by region (end-to-end, %)



Sources: Cambridge Associates LLC, included with special permission from Cambridge Associates.

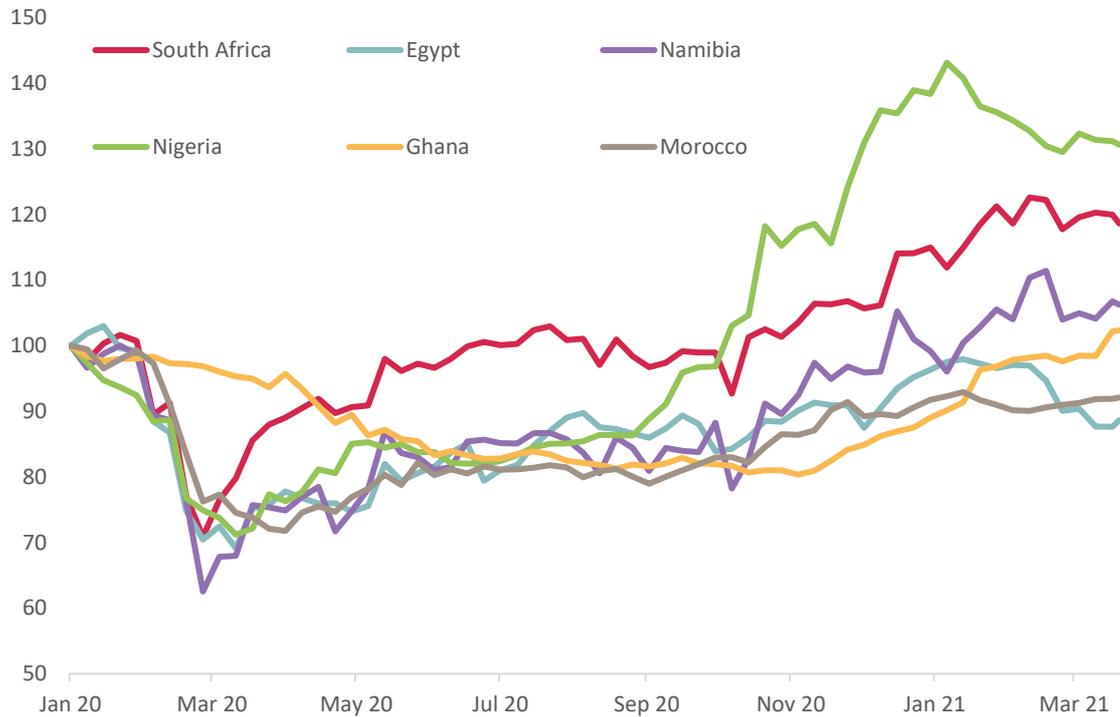
Figure 10: Selected currencies versus \$ (index: 2010 = 100; higher values indicate depreciation)



Sources: Bloomberg, author’s calculations. Note: ZAR is South African rand, KES is Kenyan shilling, NGN is Nigerian naira and MAD is Moroccan dirham.

**An additional problem facing all regions globally is that valuations are generally high, as evidenced by the swift rebound in stock market valuations following the emergence of the pandemic.** Figure 11 shows equity market indices for selected African countries. Most equity markets are already either at or above pre-pandemic levels. The public equity markets of South Africa and Nigeria, two of Africa’s largest markets for private finance inflows, have seen respective price increases of 19% and 31% between January 2020 and April 2021. Two exceptions to the recovery trend are Egypt and Morocco, where stock prices are down 11% and 8%, respectively, relative to January 2020. Given that public and private equity valuations tend to be highly correlated, high market valuations make it more difficult for investors to identify profitable opportunities.

Figure 11: Equity market indices for selected countries (Jan. 2020 = 100)



Sources: Bloomberg, author's calculations.

## Opportunities

**Increasing the size of the private equity market in Africa will require greater local and international participation.** Local investors do not face foreign exchange hurdles and may be biased towards local assets. Notwithstanding the pandemic-related setbacks to per capita growth in 2020, the combined growth in populations, urbanisation and middle classes has generated increased pools of pension fund assets under management that could provide funding to the private equity and venture capital markets. Irving, 2020 reports that total assets under management in Nigeria's pension sector (the second largest in sub-Saharan Africa after South Africa) increased by more than 9.5 times from year-end 2006 to reach an estimated \$33.3 billion by year-end 2019. Other countries including Kenya, Namibia, Botswana and Ghana have also experienced large growth in this metric, up to 30% per year in some cases. In Nigeria and Kenya, domestic assets represented 99% of assets under management as of year-end 2019. If a strong home bias persists as pension funds grow, African private equity should stand to benefit.

**In the United States, a 1987 ruling allowing pension funds to invest in private equity for the first time was a critical enabler for growth of this market.** Rules have also been loosened in some African countries to either allow investment in private equity or increase the permissible allocation of assets to the industry. Barry, 2017 notes that Nigerian pension regulations have been amended to include private equity as a specified asset class for pension fund investment, while South Africa has increased the percentage of total assets that pension funds can invest in private equity from 2.5% to 10%.

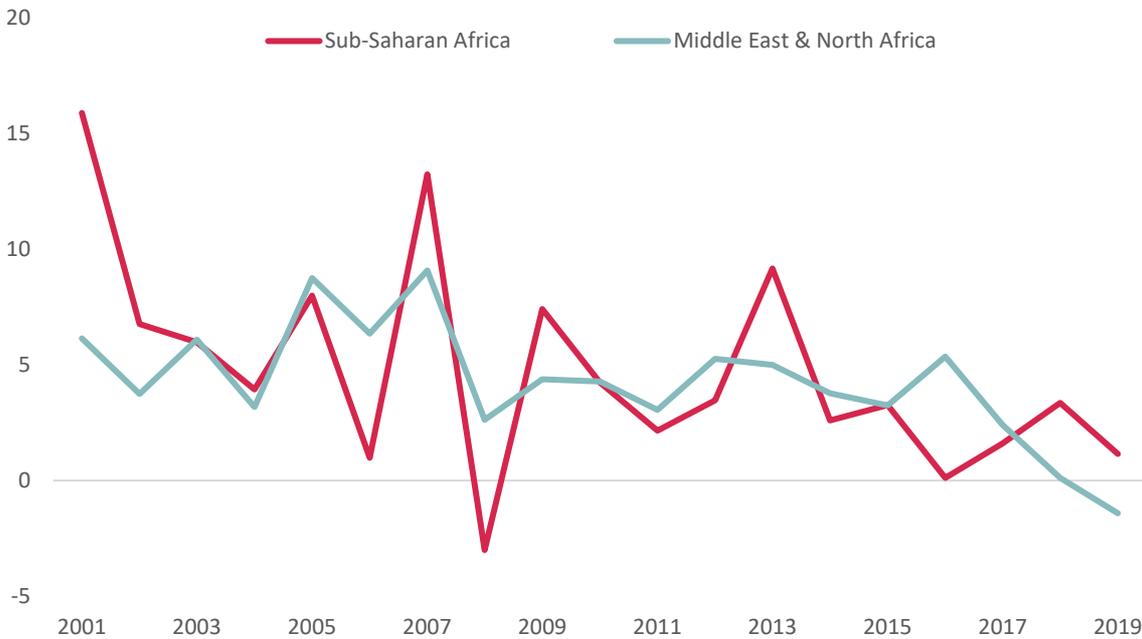
**In general, ESG (environmental, social and governance) considerations are an important aspect of private equity investment in Africa, partly thanks to the role of development finance institutions in founding and fostering this industry on the continent.** These banks placed early emphasis on ESG investment, so it has been part of the private equity investment strategy since the industry's inception. In an International Finance Corporation (IFC) survey of South African pension funds in 2020, 119 of the 139 respondents reported some

investment in private equity. The survey also reveals that it is routinely used by pension funds for green investment. In a broader survey of ESG-related private equity investing by the Africa Venture Capital Association in 2017 covering 28% of all private equity-backed companies, 60% of private equity firms in the sample reported to investors on ESG issues. In addition, 80% of the investee companies had ESG considerations in their processes from the inception of investment. These findings compare favourably with those of a 2016 global study by PwC with a European bias (66% of surveyed private equity firms were Europe-based), albeit with slightly different survey questions: 60% of respondents reported screening target companies for ESG risks and opportunities pre-acquisition.

**This commitment to environmental, social and governance aspects may help to attract more inward private equity investment to Africa and complement local fundraising.** In Europe, the EU Taxonomy is a new classification system for environmentally sustainable economic activities. If investors are forced to disclose the share of investments into sustainable assets, such investment is likely to increase. African private equity may benefit from investors in developed markets focusing more on ESG considerations. Efforts are also ongoing to promote a similar taxonomy in South Africa, which will reduce the cost of tracking ESG investment, identified in the IFC, 2020 survey as a key hurdle to green investment by pension funds. The United States recently moved in the opposite direction, with the US Department of Labour issuing a ruling in November 2020 that discourages use of non-financial principles when choosing pension investments (Bain, 2020). However, the new momentum behind the green agenda following the election of President Biden may eventually lead to US investors similarly considering environmental, social and governance criteria.

**Recent evidence also points to solid returns on ESG investments.** Cole et al., 2020 review equity investments by the IFC (a member of the World Bank Group) across emerging markets and developing economies, including exposure to very poor countries with real GDP per capita less than \$1 000. The review finds that cumulative returns were 15% higher than those of the S&P 500 over the 1957–2019 period, with more populous economies having higher returns. Interestingly, while macro factors such as growth and currency depreciation affected returns, country risk factors such as political risk, perceived corruption and ease of doing business at the time of investment had no significant impact.

Figure 12: Household consumption expenditure (annual % growth)



Sources: IMF.

**Another incentive for investment in Africa has been the increasing size of the consumer class.** Quantifying the size of consumer markets in African countries is made difficult by official measures excluding the large share of income derived from informal sources. Nonetheless, between 2000 and 2019, growth in household consumption expenditure averaged 4.8% in sub-Saharan Africa and 4.3% in the Middle East/North Africa, albeit with a noticeable slowdown even ahead of the pandemic. The persistent consumption growth over 20 years translates into an expanding consumer class, which has supported venture capital growth in African private capital markets in recent years. Although the pandemic has triggered an unwelcome descent into poverty for millions, the businesses most likely to benefit from private funding in the near term are those that are nimble and able to adapt their business model to the current environment, including an enhanced role for digitisation. The increasing industry shares in 2020 of health, IT and financial/FinTech show that the consumer class remains at the heart of private investment and underline the need for policies that support economic growth and reverse income declines.

## Summary

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**Equity is an important source of funding for companies, and the demand for capital in Africa is still underserved.** Private equity and venture capital funds play a critical role in addressing this demand but the pandemic has created a difficult environment for fundraising, with a 34% drop in funds raised in 2020 compared to 2019. A key factor has been difficulties in performing due diligence as the pandemic has necessitated travel restrictions; this problem persists in 2021. Nonetheless, the level of deal activity in 2020 was broadly unchanged from 2019, as investments pivoted to the IT and healthcare sectors in response to the pandemic. There was a sharp drop in exits from the African market, as public offerings and management buy-backs fell. If fundraising remains under pressure, this could eventually lead to fewer secondary sales too.

**Beyond fundraising, other challenges confronting African markets include the low development level of the financial landscape, a history of returns on private investment that have been modest in relation to risk, and high equity valuations, which may make it difficult to identify sufficiently profitable investment opportunities in private markets.** There are also opportunities in African markets, with increasing domestic assets under management (some of which might be channelled to private capital), relatively strong performance of environmental, social and governance investing, and an emergent consumer class. To benefit from these opportunities, the threat posed by COVID-19 must be dealt with, as slow vaccine deployment will delay private investment and other economic activity—although this is, of course, secondary to the human consequences. The need for greater vaccine deployment in Africa must be met with greater urgency from developed countries, as it will benefit all nations.

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# Digital financial services

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## Introduction

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**The digitalisation of Africa's financial sectors has enormous potential to drive development and growth, although the accompanying risks must be appropriately managed.** The expansion of digital financial services on the continent, part of a broader move towards digitalisation across many areas of Africa's economies and societies<sup>4</sup>, has supported financial inclusion among previously unserved and underserved groups<sup>5</sup>, helping increase incomes and reduce poverty. For example, a 2016 study found that the mobile payment system M-PESA increased the consumption and financial resilience of Kenyan households by allowing them to save more and allocate their funds more efficiently. The authors of the study estimate that the introduction of M-PESA may have contributed to lifting almost 200 000 Kenyan households above the poverty line<sup>6</sup>. Small and medium-sized enterprises (SMEs) can also benefit disproportionately from the supply of cheaper, more efficient financial services as a result of digitalisation (Disse and Sommer, 2020; Sahay et al., 2020), enabling them to drive economic growth. For example, the lowering of administrative costs can make it more cost-effective for banks to reach out to smaller firms, while competition from new funding sources, such as crowdfunding platforms, can push lenders to reach out to small and medium businesses in order to compete (Benni, 2021; Disse and Sommer, 2020; Jurd de Girancourt et al., 2020). Furthermore, digitalisation of the financial sector can have broader positive effects on growth and development, for example by helping to bring small firms into the formal sector and thus increasing governments' capacity to earn revenues. It can also help financial institutions become more efficient by enabling more targeted service delivery and boosting the transparency and traceability of financial flows. Conversely, the digitalisation of financial services brings a number of new or accentuated risks. These include risks for individuals and households, which need to be addressed through adequate consumer protection, the risk that a digital divide could emerge if access to these services is unequal, and risks at the systemic level, discussed in more detail below. Given its catalytic role in promoting financial access and sustainable development, and the need for regulatory action and cooperation to mitigate risks, digitalisation ranks high on the policy agenda in Africa<sup>7</sup>.

**The COVID-19 crisis has accelerated the digitalisation of Africa's financial sectors.** In response to the pandemic, many policymakers have pushed for digital payments to reduce the use of cash and to enable businesses and households to cope with restrictions on movement and economic activity. This has reinforced an ongoing move towards cashless societies. For example, a digital identity infrastructure is being developed by the Nigerian government to scale up the country's digital economy. Digital identities improve some financial institutions' processes, such as know your customer (KYC) requirements and credit risk assessment<sup>8</sup>. For example, the Central Bank of Kenya lifted the cap on digital transfer volumes and the Central Bank of Ghana launched a universal QR code payment solution, connected to customers' bank accounts, for making payments in shops (GSMA, 2021a). The Central Bank of the Republic of Guinea eased the identification requirements for opening electronic money accounts and recommended reducing electronic service fees (IMF, 2020c). Many African financial service providers have also made adjustments during the crisis to promote and facilitate the use of digital channels. These adjustments include cutting transaction fees, raising transaction and balance limits, facilitating account opening and simplifying transaction procedures (Benni, 2021; IMF, 2020c; Sahay et al., 2020). Although during the crisis mobile money providers have suffered a significant decrease in revenues, which come mainly from customer fees (GSMA, 2021a), digital payment services have seen a spike in users and in transaction volumes, and the use of e-commerce by customers and suppliers has significantly increased (Benni, 2021; GSMA, 2020a; Kazeem, 2020; Sahay et al., 2020).

**Digitalisation was originally driven by new entrants into Africa's financial sectors, but the results of the European Investment Bank (EIB) *Banking in Africa survey, 2021* demonstrate that the banking sector is expanding its digital offering.** This move has been driven partly by customer demand and partly as a response to the challenges posed by COVID-19. The banking sector was not initially at the forefront of the digital finance

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<sup>4</sup> African Union Commission and OECD, 2021.

<sup>5</sup> Mobile money accounts are a key driver of financial inclusion, reaching the previously unbanked such as people in rural areas and women (Benni, 2021; Disse and Sommer, 2020; International Monetary Fund (IMF) & World Bank, 2019; Sy et al., 2019).

<sup>6</sup> Suri and Jack, 2016.

<sup>7</sup> See, for example, the African Union's *Digital transformation strategy for Africa (2020–2030)*: <https://au.int/en/documents/20200518/digital-transformation-strategy-africa-2020-2030>.

<sup>8</sup> <https://www.eib.org/en/projects/pipelines/all/20180298>.

revolution, which was pioneered mainly by mobile money providers. However, at the start of 2021 almost 90% of surveyed banks reported that the pandemic had accelerated the digital transformation of their internal processes, and 89% believe that the customer shift towards digital channels will persist after the pandemic ends. These findings are consistent with those of other recent surveys, in which bank executives in Africa and across the globe have indicated their belief that digitalisation is the key factor that will shape the industry (Deloitte, 2020; Economist Intelligence Unit, 2020; PwC, 2019). Non-bank players continue to fill gaps in digital finance and are increasingly cooperating with banks. Furthermore, the diffusion of smartphones can bring further changes to the provision of mobile financial services, with app-based services expected to increase opportunities for financial institutions as well as international payment platforms (Institute of International Finance, 2021).

**This chapter provides detail on the use of digital financial services in Africa, the roles played by different providers and the need for improved and updated regulation to mitigate risks.** It also summarises some of the opportunities in digital financial services, and the challenges that must be addressed to release the full potential of the digital revolution and improve the functioning of the financial sector. The findings of the module on digitalisation in the *EIB Banking in Africa survey (2021)* also informed the report *MSME Digital Finance: Resilience and Innovation during COVID-19* (SME Finance Forum, 2021, forthcoming) developed by the SME Finance Forum for the G20 Global Partnership for Financial Inclusion.

#### Box 1: What is FinTech?

**FinTech is the use of technological advances** such as access to mobiles and the internet, cloud computing and artificial intelligence to offer a range of financial services online or via mobile phones. These services include digital payments (such as mobile money) and savings products, InsurTech and WealthTech (such as robo-advisors), digital lending through digital marketplaces, capital raising through crowdfunding, and market provisioning services such as digital identities and alternative credit scoring (Cambridge Centre for Alternative Finance (CCAF) et al., 2020). Many digital products are in use in Africa, from transfer and payment services to e-trading platforms and InsurTech (Cambridge Centre for Alternative Finance (CCAF) et al., 2020).

**The number of FinTech companies and the range of services they provide has expanded rapidly since the launch of the mobile money provider M-PESA, the best known example of a FinTech in Africa.** M-PESA was created in 2007 by Vodafone and Safaricom in Kenya and Tanzania, and has since expanded to countries including Lesotho, Mozambique and Ghana. Mobile money providers are now active across Africa (such as MTN Mobile Money, Tigo and Airtel) and provide a wide range of services (Disse and Sommer, 2020; GSMA, 2021a), often through partnerships with banks, remittance services and insurance providers (Ahmad et al., 2020; GSMA, 2021a; Sy et al., 2019). M-PESA, for example, offers not only digital money transfers and payments but also savings, loans, health insurance and features for small business owners. Some FinTech companies also partner with governments or humanitarian organisations to administer social transfers, as illustrated by M-Birr and HelloCash in Ethiopia (GSMA, 2021a). FinTech companies have entered other areas of the financial sector, filling gaps in markets. Insurance providers such as MicroEnsure<sup>9</sup> and Inclusivity<sup>10</sup> use technology to make different insurance products available to low-income households by facilitating payment and data collection. Moreover, a number of African-focused crowdfunding platforms, such as Afrikwity (based in Paris), Fundkiss (based in Mauritius) and Thundafund (based in South Africa), are providing a new source of funding, which may benefit innovative or small initiatives and previously unserved and underserved groups<sup>11</sup>.

**Beyond financial services, the FinTech solutions being offered by a number of innovative firms could potentially revolutionise various sectors across the economy.** Jumia, the leading online marketplace in Africa, provides an e-commerce platform for sellers and offers payment, logistics and business solutions. Sokowatch provides data analytics services to informal businesses in large cities in Kenya, Tanzania, Uganda and Rwanda. Also in Kenya, Twiga is boosting the efficiency of the food supply chain by using digital solutions to connect food suppliers with vendors<sup>12</sup>.

**The financial sector has an important role in channelling finance to investment in digitalisation and innovation.** Private equity and venture capital funds play a particularly important role in providing long-term, risk-absorbing finance to young and innovative firms in this relatively new sector. The EIB supports the private equity and venture capital sector in Africa, including through the Boost Africa Initiative. This partnership with the European Commission and the African Development Bank focuses on boosting entrepreneurship and innovation across Africa, developing young entrepreneurs' skills, and supporting startups and innovative businesses in the digital sphere, focusing particularly on young entrepreneurs and women. The initiative aims to enable and enhance entrepreneurship and innovation across Africa in a commercially viable way by

<sup>9</sup> International Finance Corporation (IFC), 2016.

<sup>10</sup> <https://inclusivitysolutions.com/company/>.

<sup>11</sup> See [www.afrikwity.com](http://www.afrikwity.com), [www.fundkiss.mu](http://www.fundkiss.mu), [www.thundafund.com](http://www.thundafund.com).

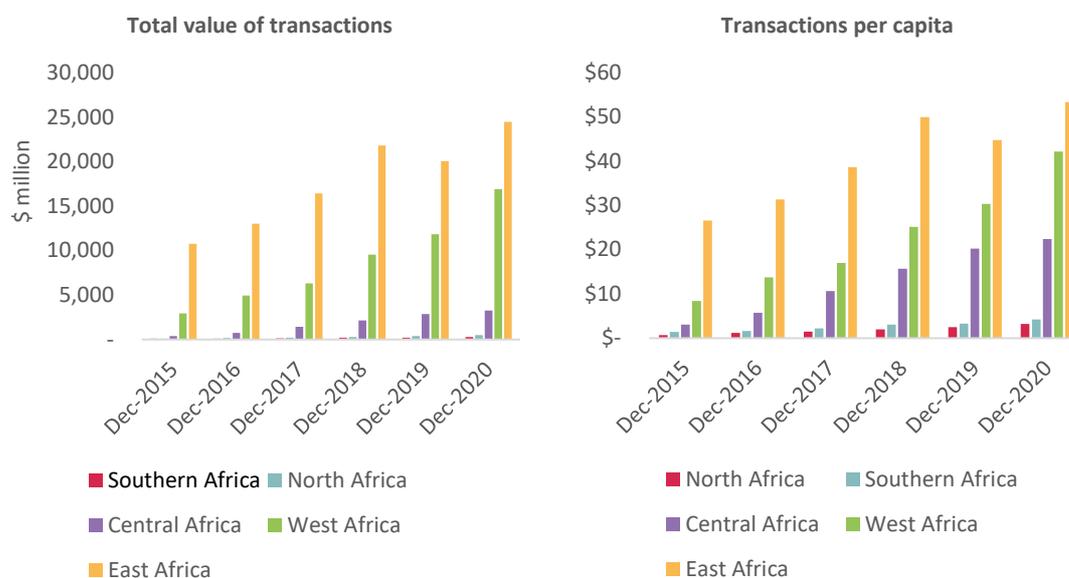
<sup>12</sup> See [www.group.jumia.com](http://www.group.jumia.com), [www.sokowatch.com](http://www.sokowatch.com), [www.twiga.com](http://www.twiga.com).

combining early-stage financing with access to local technical support mechanisms, skills development and networks to support local entrepreneurs. Support from the European Commission enables the Bank to make junior, risk-absorbing investments in high-impact venture capital funds and to provide technical assistance and training opportunities to the funds and the companies and entrepreneurs they support.

## Uptake of digital financial services in Africa

**The expansion of digital financial services has been a major driver of recent financial inclusion gains in Africa.** Between 2014 and 2017, digital financial inclusion<sup>13</sup> in sub-Saharan Africa<sup>14</sup> increased, while financial inclusion through traditional (non-digital) channels stalled (Sahay et al., 2020). By 2017, an average of 42% of the population aged 16 and over owned an account at a financial institution or a mobile money service provider in Africa, compared to just 30% in 2014 (World Bank, 2017). Africa now has 560 million registered mobile accounts, which mobilised almost \$0.5 trillion in 2020, representing 65% of total worldwide mobile transactions (GSMA, 2021a).

Figure 1: Value of mobile money transactions in Africa, 2017–2020, monthly data for December



Source: GSMA, 2021b.

**Mobile money is playing a key role in the development of digital financial services in Africa, by either complementing or supplementing existing financial service providers.** The use of mobile money increased by more than 200% across the continent between December 2015 and December 2020, with an increase every year in most regions (Figure 1). Sub-Saharan Africa is the world leader in mobile money accounts, with 53% of active mobile money accounts worldwide (160 million accounts) and almost two-thirds of the \$70 billion worth of worldwide transactions that were executed during December 2020 (GSMA, 2021a, 2021b)<sup>15</sup>. The success of mobile money in Africa can be partly attributed to its greater accessibility relative to traditional financial service providers: there were 109 times more active mobile money account outlets than commercial bank branches per 100 000 adults in 2019 (IMF, 2020a)<sup>16</sup>.

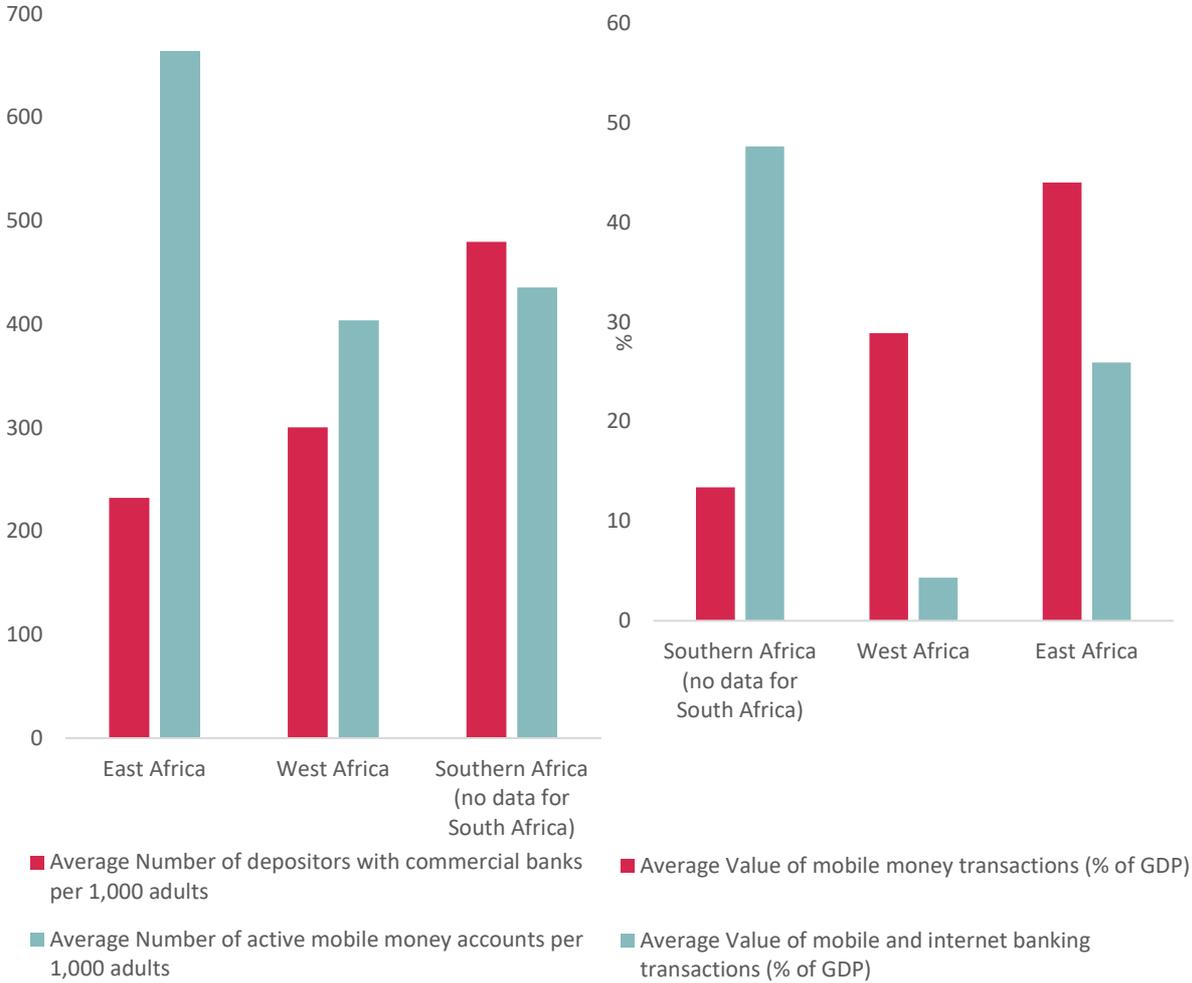
<sup>13</sup> Financial inclusion is measured as access and usage of financial services (IMF, 2020b).

<sup>14</sup> Khara et al., 2021 paper refers to Africa, but all the African countries it covers are in sub-Saharan Africa.

<sup>15</sup> Active refers to the accounts which have been active in the last 30 days (monthly data from December 2020).

<sup>16</sup> Based on average from latest available data on African countries.

Figure 2: Commercial bank depositors, active mobile money accounts, mobile money and internet banking transactions in 2019

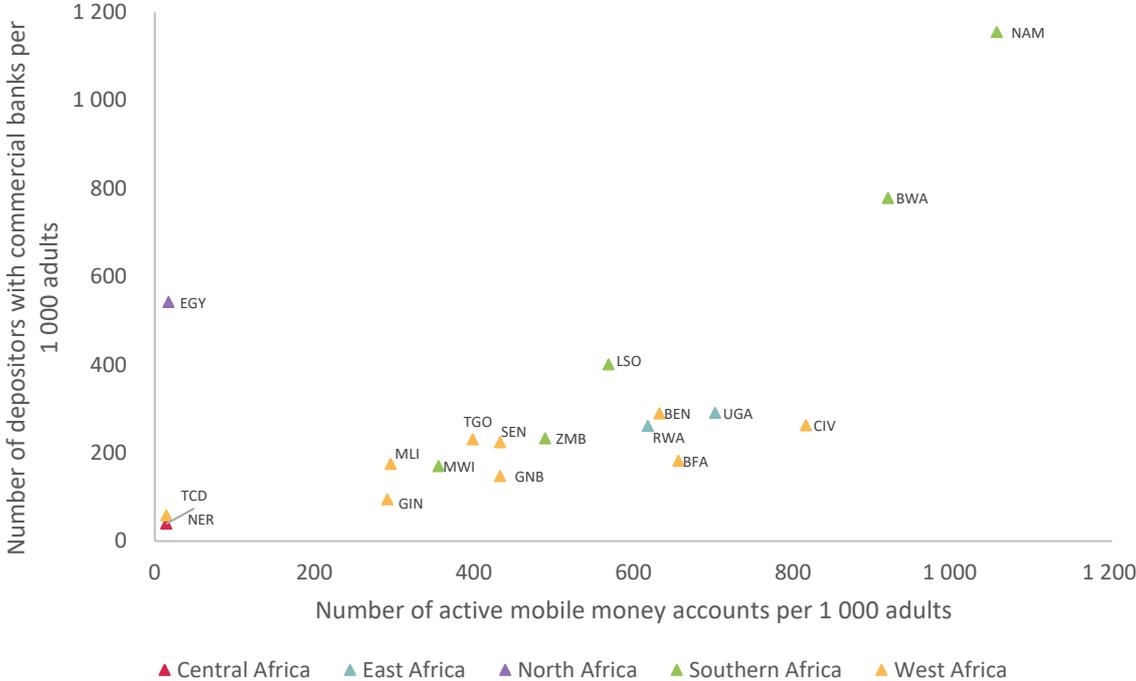


Source: IMF, 2020a<sup>17</sup>.

<sup>17</sup> Latest available data are used. North Africa and Central Africa are excluded due to limited by-country data. For Southern Africa, data on South Africa, Eswatini and Madagascar are unavailable. Angola and Lesotho are missing data for the value of mobile and internet banking transactions, while Angola is also missing data for the number of active mobile money accounts. For West Africa, data on Ghana, Nigeria and Sierra Leone are unavailable. Cabo Verde and Mauritania are missing data for the value of mobile money transactions. Benin, Burkina Faso, The Gambia, Guinea-Bissau, Liberia, Niger and Togo are missing data for the value of mobile and internet banking transactions. The Gambia and Liberia are also missing data for the number of depositors with commercial banks, while Cabo Verde and Mauritania are missing data for the number of active mobile money accounts. For East Africa, data on Burundi, Ethiopia, Sudan and Tanzania are unavailable. Djibouti, Kenya, South Sudan and Uganda are missing data for the value of mobile and internet banking transactions, while Djibouti and South Sudan are also missing data for the value of mobile money transactions. Kenya, Djibouti and South Sudan are missing data for the number of active mobile money transactions, while Kenya is also missing data for the number of depositors with commercial banks. In addition, data for Mauritius, Mozambique, Seychelles and Zimbabwe are not considered as they were extreme outliers in one or more variables.

**In many countries there is an uptake of mobile money services despite widespread access to traditional banking services; in some countries, though, mobile money is making up for weak access to traditional lenders.** On average, the correlation between access to commercial bank accounts and mobile money is positive, including in a number of Southern African countries such as Namibia and Botswana, which combine relatively high levels of access to traditional banks with high use of mobile money (Figure 3). In East and West Africa, by contrast, mobile money services appear to be remedying weak access to traditional finance. These regions are characterised by relatively large volumes of mobile money transactions, in total and on a per capita basis (Figure 1), and relatively weak access to accounts with traditional financial service providers (Figure 2). In countries such as Burkina Faso, Côte d’Ivoire and Rwanda, relatively poor access to commercial banking services has most likely driven the strong uptake of mobile money. The picture is different in North African countries and in South Africa, where a higher proportion of the population has access to traditional financial services. This may explain the limited uptake of mobile money, which in the case of South Africa drives the low per capita volume of mobile money transactions in Southern Africa (as seen in Figure 1).

**Figure 3: Commercial bank depositors and mobile money accounts, by country**



Source: IMF, 2020a<sup>18</sup>.

**Commercial banks also offer digital channels to their customers.** The available data are limited but suggest that Southern African banks even outside South Africa (but excluding the Seychelles and Mauritius) are already providing significant digital service offerings, with mobile and internet banking transactions accounting on average for almost 50% of gross domestic product (GDP) in 2019 (Figure 2). East and West Africa appear less advanced, although this could reflect the lack of data for the most developed markets (Nigeria and Kenya). It should be noted that the expansion of digital service offerings by traditional banks does not necessarily indicate reaching out to new customers — in many cases it more likely reflects increasing sophistication of the services offered to existing clients, who are already relatively well served.

<sup>18</sup> Latest available data are used. Mauritius, Mozambique, Seychelles and Zimbabwe are excluded because they were outlier data points. Algeria, Angola, Burundi, Cabo Verde, Cameroon, Central African Republic, Republic of the Congo, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Ethiopia, Gabon, The Gambia, Ghana, Kenya, Liberia, Madagascar, Mauritania, Mauritius, Morocco, Mozambique, Nigeria, Seychelles, Sierra Leone, South Africa, South Sudan, Sudan, São Tomé and Príncipe, Tanzania, Tunisia and Zimbabwe are not included because they are missing values for at least one of the two variables.

## Providers of digital financial services in Africa

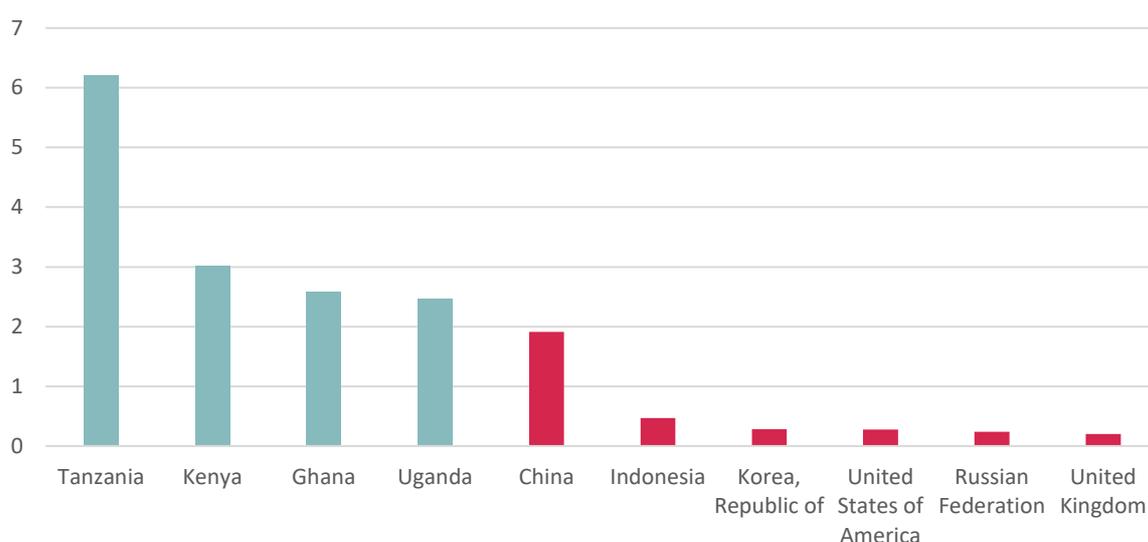
### Non-bank financial service providers: FinTech and BigTech companies

**Non-bank players pioneered the provision of digital financial services in most African markets.** Newer and often smaller FinTech companies are either competing or cooperating with established technology firms (BigTech companies) that have also begun to provide digital financial services. The importance of these new providers is increasing. Through offering an expanded range of services, these providers have been largely filling gaps of unmet demand, and so have not disrupted competition, particularly as traditional providers have invested heavily in or partnered with FinTech companies (Benni, 2021; Economist Intelligence Unit, 2020; He et al., 2017; Sahay et al., 2020).

**The services offered by mobile money are now diverse.** Until 2019, mobile money was mainly used for money transfers that were cashed out through an agent by the receiver, with sending and receiving remittances playing a large role (Ahmad et al., 2020; IMF, 2020b). In some cases, these growing operators may compete with traditional banks, which could pressure banks into expanding their own digital offering. However, FinTech companies will also continue to cooperate with traditional banks, particularly as regulation limits the services that either party can offer. Today, mobile money operators are increasingly seeking out partnerships with banks, government agencies, utility firms and merchants to increase their range of services and ensure interoperability between various services. In return they offer a well-established and wide agent network, universal mobile phone penetration and access to a larger customer base. There is still a large growth potential for mobile money and other FinTech solutions (Disse and Sommer, 2020; GSMA, 2021a; Sahay et al., 2020; Sy et al., 2019). For instance, in 2019 it was estimated that around 45% of the population in sub-Saharan Africa had a mobile phone and 26% used mobile internet. These numbers are expected to grow to 50% and 39%, respectively, by 2025. Furthermore, the mobile technologies and services contributed 9% of GDP in sub-Saharan Africa in 2019 (GSMA, 2020b).

**Alternative credit solutions, such as those offered by marketplace lending platforms and mobile money providers, are becoming increasingly important in some African economies.** In 2019, \$4.043 billion in alternative credit (excluding crowdfunding) was provided in African countries, with Kenya (51%), Ghana (24%) and Tanzania (15%) accounting for the majority of this sum. Cornelli et al., 2020 found that, in 2018, African countries recorded the world's four highest amounts of alternative credit as a percentage of total domestic credit: 6.2% in Tanzania, 3% in Kenya, 2.6% in Ghana and 2.5% in Uganda. China ranked fifth (1.9%).

Figure 4: Total alternative credit as percentage of domestic financial sector credit in 2018 (top ten countries)



Source: Cornelli et al., 2020. Alternative credit includes both FinTech and BigTech credit but excludes crowdfunding.

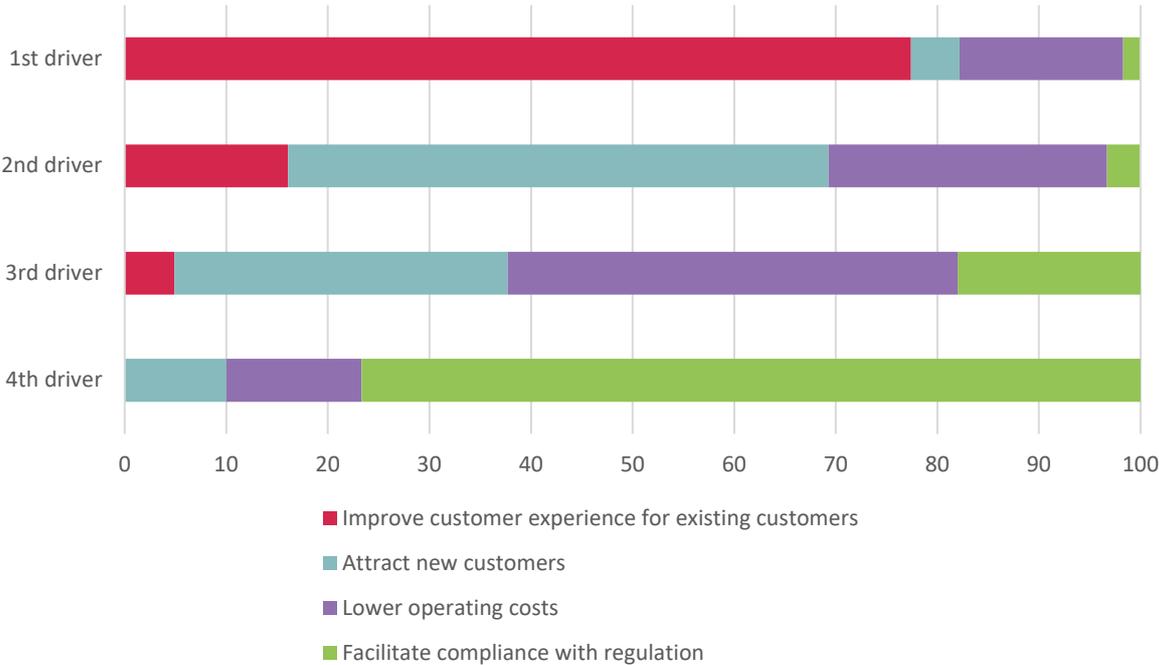
**Other digital financing sources are becoming more popular but still mostly serve households.** These include donation and reward-based crowdfunding, crowd-led microfinance, peer-to-peer lending models and property investments (Ziegler et al., 2018). Most (88%) alternative financing (including crowdfunding) invested in Africa is raised from platforms based outside the continent. Of the total alternative finance investments, only 32% (\$58.04 million) go to businesses (Ziegler et al., 2018, using data for 2016), with other finance raised benefiting, for example, individuals or charitable activities. Local providers of crowdfunding are more likely to adapt to local infrastructure, such as payments through mobile money, and focus more on financing for small and medium businesses (Disse and Sommer, 2020).

**Banks**

**The COVID-19 pandemic and the lockdown measures imposed in response spurred a shift towards digitalisation in Africa’s banking sector, as elsewhere.** In the *EIB Banking in Africa survey, 2021*, the majority of surveyed banks reported a shift towards digitalisation as a result of the pandemic, which most believe will be permanent. Banks recognise the importance of digitalisation and plan to invest to grasp the opportunities it brings. African banks reported plans to spend an average of \$5 million (equivalent to 1.26% of reported assets) on digitalisation over the next 12 months, with West and Central African banks expecting to invest more than this average. A number of banks also reported an interest in receiving support from international financial institutions for further digitalisation of products and processes, seeing this as a priority area where they could benefit from technical assistance.

**Improving customer experience for existing customers is the main driver for digitalisation,** with 77% of banks reporting this as the most important driver. Over half of surveyed banks cited attracting new customers as the second most important factor pushing them to digitalise, followed by lowering operating costs (ranked third most important by 44%). Facilitating compliance with regulation is ranked as the least important driver of digitalisation, although the discussion below indicates that new technologies could play a role here. Over 70% of surveyed banks offer their private and business clients information about digital services or advice and training on how to use the digital services on offer.

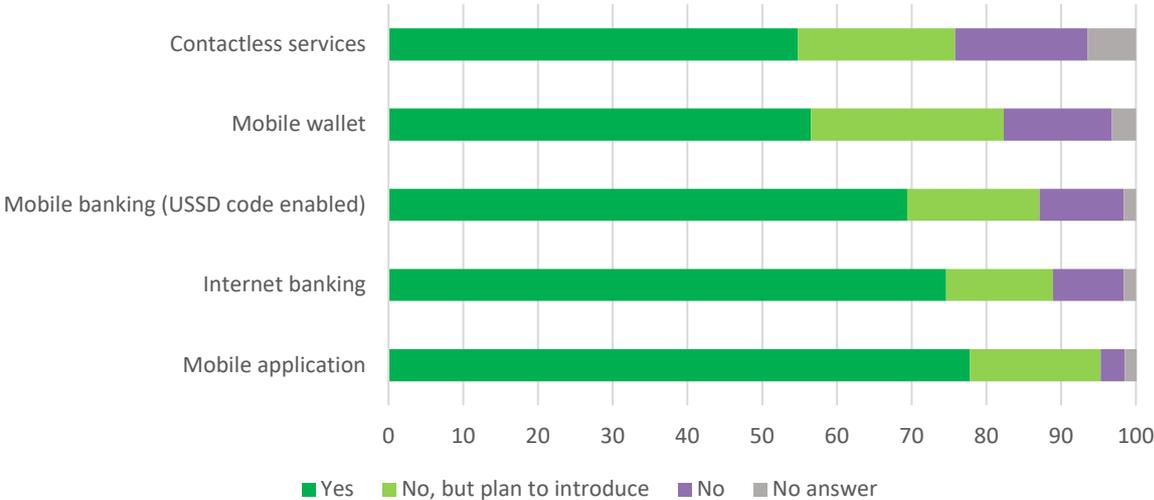
Figure 5: Drivers of digitalisation (% of surveyed banks)



Source: EIB Banking in Africa survey, 2021.

**Digital applications are widespread, with 93% of surveyed banks offering at least one digital application.** Around 80% of banks enable customers to access their traditional banking services digitally, either using their phone (mobile banking) or online (internet banking); 78% already offer their own mobile banking app. More than 50% of surveyed banks provide mobile wallets<sup>19</sup>. In West Africa, 87% of banks offer at least one digital application, the most common being either internet or mobile banking. Southern Africa has the largest proportion of banks offering digital applications, with approximately four out of five banks doing so, compared to around three out of five across sub-Saharan Africa. The service offering also differs by region. Southern Africa leads in contactless services (64.3% compared to 54.8% for the whole sample), mobile apps (85.7% compared to 77.8% overall) and mobile wallets (64.3% compared to 56.5% overall). In East Africa, mobile banking dominates the service offering, with 90% of banks providing this application (compared to 69.4% for the whole sample). Meanwhile, three out of the surveyed Central African banks offer internet banking only, and only one offers a mobile app, mobile wallet and contactless services.

**Figure 6: Provision of digital applications (% of surveyed banks)**

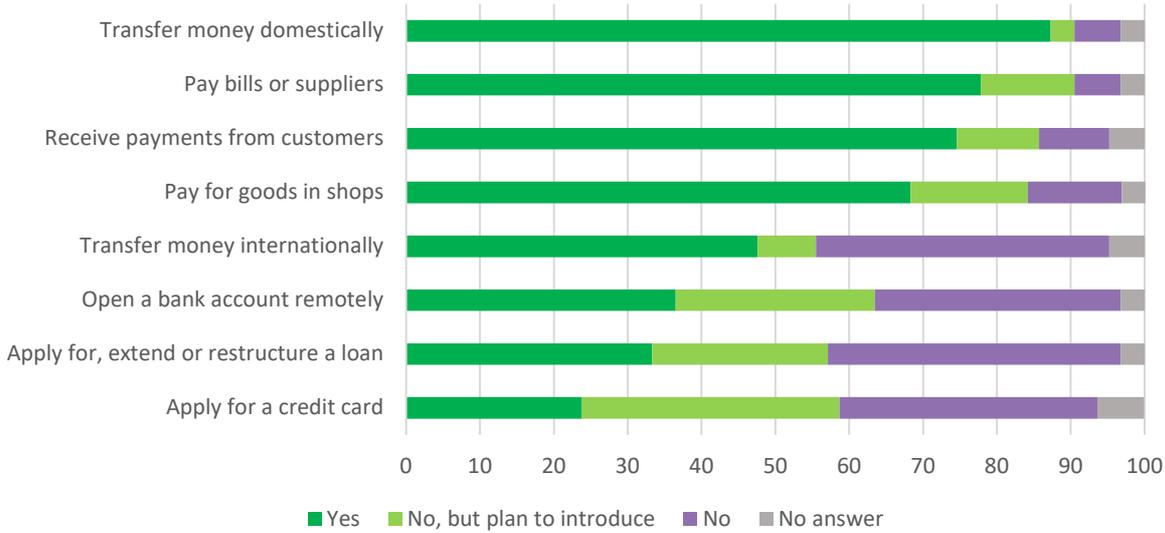


Source: EIB Banking in Africa survey, 2021.

**Banks in sub-Saharan Africa offer digital services to retail clients and to firms in support of economic activities.** Regarding the provision of digital services, transferring money domestically is the most common service offered to clients across all regions, provided by approximately 90% of surveyed banks. Looking at digital services for companies, around 80% of banks enable their clients to pay suppliers and bills as well as receive payment from customers. Services such as applying for a credit card, opening a bank account, and applying for or restructuring a loan are still not offered digitally by the majority of surveyed banks.

<sup>19</sup> Mobile wallets allow customers to store cash in an easily accessible yet secure, encrypted format, and can be used for payments and purchases. The money is generally held by a third party working in partnership with a bank.

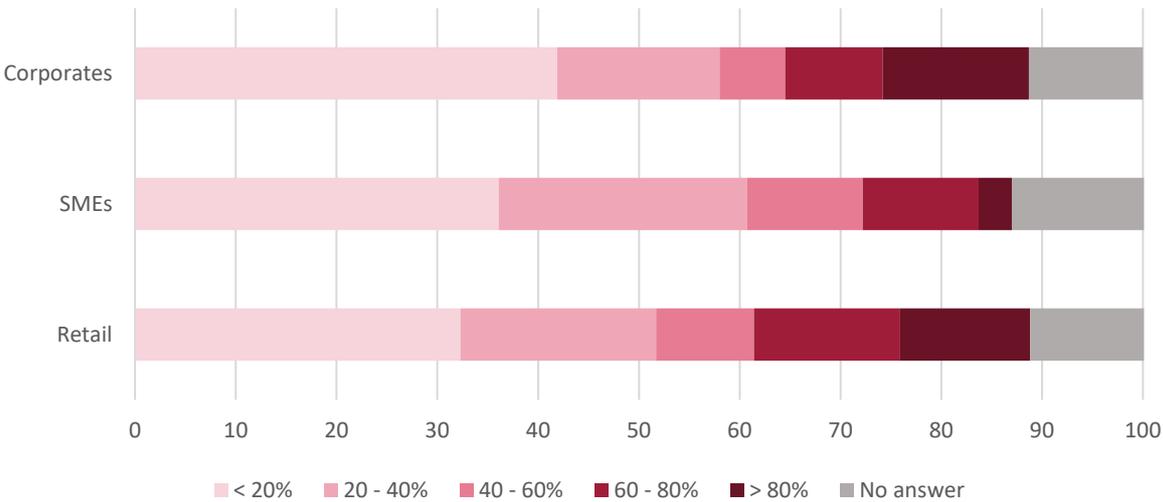
Figure 7: Provision of digital services (% of surveyed banks)



Source: EIB Banking in Africa survey, 2021.

**Physical transactions still account for the majority of money flows**, but surveyed banks reported that approximately 30% of transactions use digital channels. The retail sector is leading the integration of digital transactions, with over 40% of transactions now digital for more than 37% of surveyed banks, followed by the corporate sector (>40% of transactions for 31% of surveyed banks) and small and medium enterprises (>40% of transactions for 26% of surveyed banks). Banks in Southern Africa report higher volumes of digital transactions. Across customer groups, digital transactions are more common in middle-income countries than in low-income countries, and regional differences exist. For example, more than one-third of small and medium firms in Southern Africa conduct over 40% of their transactions digitally, compared to only one-quarter in West Africa.

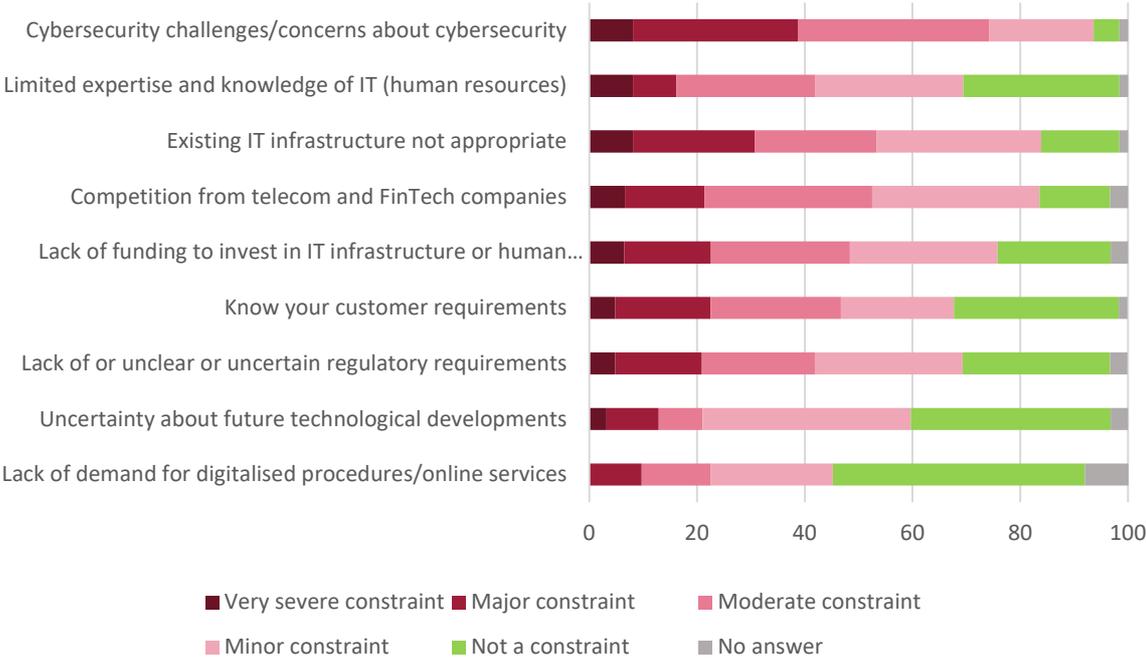
Figure 8: Customer transactions using digital channels



Source: EIB Banking in Africa survey, 2021.

**Going forward, addressing concerns around cybersecurity and improving information technology (IT) infrastructure are priorities to support digitalisation in the banking sector.** Cybersecurity is the most common constraint identified by surveyed banks across all regions: on average, more than 74% of surveyed banks believe it is at least a moderate constraint. Inappropriate existing IT infrastructure and competition from telecom and FinTech companies are identified by 53% of the surveyed banks as at least moderate constraints. Less than 50% of surveyed banks cite regulatory and know your customer requirements, human resources in IT, or lack of funding as constraints. Finally, lack of demand and uncertainty over future technological developments are perceived as constraints by only about 20% of the banks.

**Figure 9: Factors constraining digitalisation**



Source: EIB Banking in Africa survey, 2021.

The EIB survey findings are largely confirmed by other studies. For example:

- 98% of CEOs across Africa believe the pandemic will advance digitalisation (Deloitte, 2020).
- A worldwide survey of banking executives<sup>20</sup> found that improving customer experience is the main reason for banks implementing artificial intelligence (Economist Intelligence Unit, 2020). This is consistent with the EIB finding that improving the experience of existing customers is the main driver of digitalisation.
- The same survey reports that the main focus of technology investments is cybersecurity (prioritised by 35% of respondents), which confirms the concerns raised by sub-Saharan African banks in the EIB survey.
- A study by McKinsey & Company estimates that around 9% of personal loans are sold digitally in developing markets, compared to 53% in developed markets (Jurd de Girancourt et al., 2020). Similarly, the EIB study found that applying for, extending and restructuring a loan is not commonly offered as a digital service in sub-Saharan Africa.
- In OpenWay Consulting and Ovum, 2020 survey, 69% of banks and 75% of merchants in Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa and Tanzania indicated they will invest in payment infrastructure in the next two years.

<sup>20</sup> Of the surveyed executives, 16% are based in Africa and the Middle East.

## Adapting regulatory frameworks to digital financial services in Africa<sup>21</sup>

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**The development of digital financial services can lead to increased macrofinancial risks, which are not yet adequately addressed by regulation.** Key systemic risks are summarised in Table 1. The rise of FinTech brings new or heightened operational risks, including those related to cybersecurity and IT failures. It also changes market structures and the risk-taking incentives for financial institutions — both outcomes that can lead to systemic-level risk. FinTech business models offer innovative financial products and services, such as peer-to-peer (P2P) lending and mobile money transfers, which often fall outside existing regulations. Among African FinTech firms surveyed by a team from the Cambridge Centre for Alternative Finance in 2017, only 17% believed that the regulations in place for alternative finance were adequate and appropriate (Ziegler et al., 2018). Over half (51%) indicated that their country had no regulation in place for alternative finance, while 10% viewed existing regulations as excessive and too strict. As of 2021, only 33 African countries have comprehensive legislation on electronic transactions, 25 on consumer protection and 28 on data protection and privacy frameworks, while 39 countries have regulations that address cybercrime (United Nations Conference on Trade and Development, 2021.). The implementation of clear regulations would help protect consumers, promote effective competition and ensure financial stability by reducing macrofinancial risks. All of these outcomes would ultimately drive the development of digital financial services to enhance financial inclusion.

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<sup>21</sup> Arthur Minsat and Elisa Saint Martin, OECD Development Centre. This section draws on the findings included in African Union Commission and OECD, 2021.

Table 1: Overview of systemic risks associated with FinTech

Risk type	Risk subtype	Description
<b>Market structure risk</b>	Change in the risk behaviour of traditional financial institutions	Pressure on incumbent profits might incentivise them to increase risk-taking.
	Amplification of reputational risk	Non-sticky deposits mean that reputational shocks could hamper the funding stability of banks.
	Risks stemming from decentralisation and disintermediation	Smaller financial institutions with narrow business focuses might be less resilient than larger institutions, which have larger capital buffers and more diverse activities.
	Difficulty in regulating and coordinating small entities	Regulatory oversight of many small entities requires more resources and coordination, and is harder to achieve.
	BigTech firms' ability to achieve systemic scale	BigTech firms' capacity to use their networks to achieve systemic scale rapidly amid low regulatory coverage might pose a threat to financial stability.
<b>Excessive incentives to take risks</b>	Offloading of risk by peer-to-peer lending firms	FinTech lending platforms might not bear the risk of the loan they facilitate or originate because of their business model. This could create excessive credit growth.
	Winner-takes-all market structure	A FinTech platform's funding structure might be geared towards quick growth rather than sustainability.
	Regulatory arbitrage within jurisdictions	Regulatory loopholes might give an unfair advantage to FinTech platforms by enabling avoidance of macroprudential measures.
	Financial illiteracy and increased access to financial products	Increased access to financial products might lead to excessive risk-taking if consumers are not aware of the associated risks.
<b>International cooperation</b>	Regulatory arbitrage between jurisdictions	The cross-border scope of FinTech firms might lead to irregularities in supervisory and regulatory coverage; some jurisdictions might have less strict macroprudential standards than others.
<b>Operational risks</b>	Cybersecurity and IT failure	Increased reliance on digital technologies might increase vulnerability to IT failures of systemic scale.
	Outsourcing	Increased reliance on third-party service providers may pose a threat to financial stability because of market concentration in the provision of certain digital services and a lack of regulatory access.
	Algorithmic herd behaviour	Algorithmic trading platforms, or automated asset managers, might increase volatility because of feedback loops between similarly built algorithms that optimise investment decisions based on live market conditions.

Source: OECD, 2021.

**Setting up an enabling regulatory environment can strengthen the adoption of digital financial services and reduce associated risks.** Policymakers need to find the right balance between meeting various policy goals (such as promoting innovation, protecting consumers and ensuring macroprudential policy) and avoiding regulatory overload for smaller companies. Evidence from 22 developing countries demonstrates that a balanced approach to regulation strongly influences the success of mobile money (Evans and Pirchio, 2015). Ghana offers a useful illustration: in 2015 the country revised its previously restrictive regulations on e-money issuers, triggering the acceleration of investment by mobile operators. Ghana's regulators also introduced a risk-based approach to know your customer requirements<sup>22</sup>, making it possible for individuals with little to no formal means of identification to be included in the formal financial sector. Consequently, between 2014 and 2017, mobile money penetration tripled in Ghana, from 13% to 39%, while overall account access increased from 41% to 58% (Izaguirre and Mazer, 2018; Mattern, 2018; Bank of Ghana, 2015).

<sup>22</sup> For this purpose, accounts have been categorised into three levels. For minimum know your customer accounts (such as those with a maximum balance limit of GHS 1 000 (Ghanaian cedi), aggregate daily transaction limit of GHS 300, and aggregate monthly transaction limit of GHS 3 000), customers must provide their name, date of birth, residential address, telephone number and any type of photo ID that can reliably identify them. Proof of address is not required.

## Regulation at the national level

**Adopting a test-and-learn approach to digital financial services regulation through regulatory sandboxes.** Regulatory sandboxes allow live piloting of innovative financial services and business models under regulatory oversight. These initiatives can enhance regulatory capacity and knowledge while also signalling to the market that the authorities plan to encourage innovation, providing grounds for the creation of financially inclusive products (Wechsler et al., 2018). According to a survey across 111 jurisdictions worldwide, regulatory sandboxes help regulators improve their understanding of new financial technologies and build stronger relationships with innovators in the sector (World Bank and CCAF, 2019). Multiple regulatory sandboxes already operate in African countries, such as Egypt, Kenya, Mauritius, Mozambique, Rwanda, Sierra Leone and Tunisia. To meet their potential, regulatory sandboxes should have a clear thematic focus and policy objectives and the processes and requirements for allowing companies to access them should be transparent and standardised.

**Enhancing consumer protection and financial literacy to reduce excessive credit growth and risk-taking.** Given the limited consumer protection laws and financial literacy in developing countries, the rise of FinTech may lead to challenges such as over-indebtedness among consumers or predatory lending behaviours from FinTech platforms. In Kenya, for instance, the rapid growth of digital credit has been associated with high default rates and late repayments (Izaguirre and Mazer, 2018). Regulators can foster more responsible digital credit in line with recommendations from the G20/OECD Task Force on Financial Consumer Protection, 2018 by (i) setting up requirements to improve transparency on loan terms and conditions; (ii) providing guidance to strengthen credit risk assessment; and (iii) enhancing information sharing between financial institutions and regulators. Digital financial service providers can also assist populations with low financial literacy to improve their understanding of financial products and reduce risky borrowing behaviours. In Tanzania, for instance, the deployment of an interactive SMS system on financial literacy content improved saving and borrowing behaviours among smallholder farmers. On average, users took out larger loans, repaid them faster and had larger first payments (Dyer et al., 2017).

**Harnessing digital technologies to strengthen regulatory oversight.** Regulatory technologies (RegTech/SupTech) harness the potential of technologies such as cloud computing and big data to assist authorities in monitoring financial activities. These technologies can boost the effectiveness and efficiency of financial regulation related to the traditional financial sector, but they hold particular promise for filling the above-described gaps in regulation of the FinTech sector. The National Bank of Rwanda, for instance, uses an electronic data warehouse to automate and streamline the supervision of over 600 financial institutions, including banks, microfinance institutions, and savings and credit cooperative organisations. The system automatically monitors data every 24 hours or even every 15 minutes for mobile money operators (Broeders and Prenio, 2018). Elsewhere, the Central Bank of Nigeria and the Nigeria Inter-Bank Settlement System developed a data warehouse and dashboards allowing risk-based and timely financial supervision (di Castri et al., 2018).

**Scaling up supervisory coordination between regulatory authorities.** Delimiting mandates is necessary to avoid overlaps and inefficiencies in regulatory oversight. Within the Economic Community of Central African States, for instance, the regional banking sector regulator sets financial services regulation, while other regulations, such as those covering data protection and consumer protection, are set nationally, potentially resulting in overlaps or conflicts. To avoid such issues, the National Bank of Rwanda and the Rwanda Utilities Regulatory Authority signed a memorandum of understanding to delineate responsibilities for oversight of the financial market.

## Emerging regional regulatory cooperation

**Accelerating continental harmonisation of data protection and regulatory frameworks.** The African Union's *Digital transformation strategy for Africa (2020-2030)* (African Union, 2020b) recognises the need to create a harmonised regulatory environment conducive to developing digital financial services. It aims to fast-track the adoption of the Malabo Convention on Cyber Security and Personal Data Protection, which so far only 14 African Union Member States have signed, and eight have ratified. Additional efforts are needed to reach the 15 ratifications required for the convention to enter into force (African Union, 2020a). Other objectives of the African Union's strategy include reinforcing public-private dialogue around digital financial policy and regulation or ensuring the interoperability of digital financial service systems. While a pan-African framework does not yet

exist, some regions are moving ahead on cybersecurity and protection of personal data. For instance, the Southern African Development Community agreed on a model law for such emerging issues through the HIPSSA<sup>23</sup> initiative, supported by the European Union and the International Telecommunication Union (African Union Commission and OECD, 2021).

**Fostering international cooperation and enabling cross-border activities could strengthen regulatory oversight of digital financial services.** The upcoming e-commerce protocol of the African Continental Free Trade Area offers the opportunity to improve cooperation in harmonising digital payment regulations and ensuring the interoperability of systems at the continental level. This protocol includes the adoption of common regulations on anti-money laundering/combating the financing of terrorism, as well as know your customer requirements aligned with international standards such as ISO 2022. Another opportunity would be to establish a regional regulatory framework to facilitate cross-border interoperability and oversight of digital financial solutions. The European Union's regulatory framework, for instance, permits firms (such as money transmitters) to establish a presence or carry out activities in EU countries other than their main country of operation<sup>24</sup>.

## Challenges and the way forward

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**Digital financial service solutions and providers in Africa are attracting strong interest from investors, but the tightening of funding conditions risks slowing development.** FinTech is perceived as a major opportunity for venture capital investors, including in emerging and developing markets. According to the Emerging Markets Private Equity Association<sup>25</sup> (EMPEA, 2021), FinTech received the highest share of venture capital investment in 2020, with 32 deals representing 25% (\$120.4 million) of total investments on the continent, making the sector an investment “bright spot for the continent during the crisis year”<sup>26</sup>. Companies such as the payment firm Flutterwave, which partnered with Alipay in 2019, continue to secure large venture capital investments. Mauritius-based FinTech JUMO, a lender to small and medium businesses, received a \$55 million investment — one of Africa's largest deals. A number of notable exits were also achieved: for example, Nigeria's Interswitch and Paystack were acquired by other financial service firms (EMPEA, 2021; GSMA, 2020a). However, data on the private equity sector presented in Chapter 3 suggest that funding conditions are likely to tighten significantly in the coming years in the wake of the COVID-19 crisis. This could impact young FinTech firms in particular (African Private Equity and Venture Capital Association, 2021; EMPEA, 2021; CCAF et al., 2020). Against this backdrop, investors like the EIB are trying to promote FinTech investments through the provision of patient, longer-term capital and blended finance instruments.

**Investment in digital infrastructure and capacity building will also be needed for digitalisation of the financial sector to bring the expected benefits for inclusive growth.** Policy measures and investment will be needed to increase and broaden the uptake of digital financial solutions across the population, including among the poorest and most vulnerable groups to avoid a digital divide in the financial sector, which could exacerbate financial exclusion (Disse and Sommer, 2020). Digital literacy is essential to ensure inclusive access to digital financial services, and to protect users from fraud and scams (Benni, 2021; Disse and Sommer, 2020; Sahay et al., 2020). Adequate development of infrastructure and the provision of affordable connections is also essential. Current prices of data services would have to be halved to be affordable for 75% of the African population (African Union Commission and OECD, 2021). However, public investment is at risk during the COVID-19 recovery, as African states struggle with elevated debt burdens (see Chapter 1 of this report). International financial institutions such as the EIB should continue working with African partners to support the development of digital strategies, provide guidance for the provision of an enabling environment and ensure that essential investments in digital infrastructure and skills are not sacrificed.

**Finally, further development of regulation will be essential to support innovation, which can drive financial inclusion and growth while also safeguarding consumer protection and mitigating systemic risks.** As the EIB's

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<sup>23</sup> Support for harmonisation of the ICT policies in sub-Saharan Africa (International Telecommunication Union, n.d.).

<sup>24</sup> European Banking Authority, n.d.

<sup>25</sup> The EMPEA is now known as the Global Private Capital Association.

<sup>26</sup> Henderson, 2021.

survey demonstrated, cybersecurity is a key concern for banks — it undermines the trust which is essential for the adoption of digital financial services (He et al., 2017; IMF & World Bank, 2019; Sahay et al., 2020). African FinTech companies also recognise the need for appropriate regulatory support to mitigate risks in the sector (CCAF et al., 2020). Such support will need to not only balance risks and opportunities domestically but also work with increasingly globalised financial sectors. African regulators can use regional and international organisations to work with their international partners to avoid creating room for regulatory arbitrage<sup>27</sup>.

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<sup>27</sup> OECD, 2021.

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# Greening Africa's financial sector during crisis recovery

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<sup>2</sup> European Investment Bank.

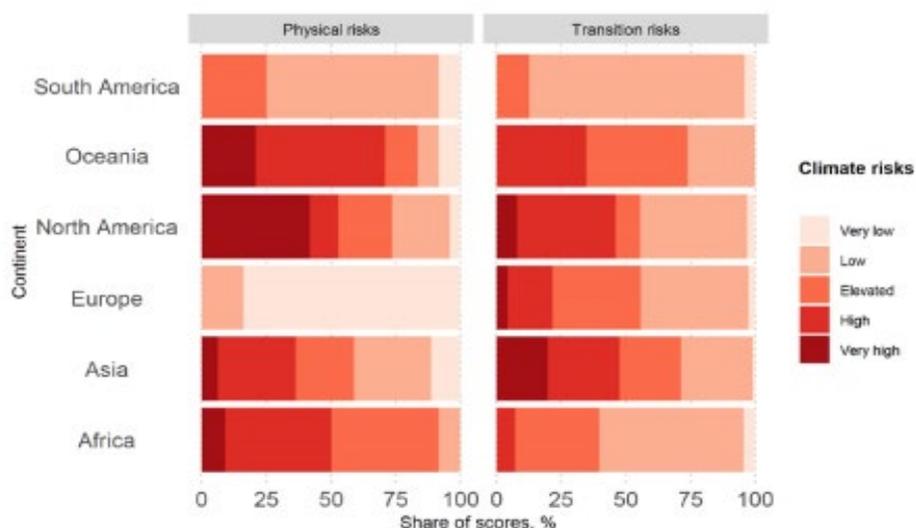
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The views expressed here are those of the authors and do not necessarily reflect those of the European Investment Bank. All remaining errors are the responsibility of the authors.

## Introduction

**Africa is highly exposed to risks associated with climate change.** The African Climate Policy Centre has calculated that an increase in global temperatures of 1 °C would lead to a 2% contraction of Africa’s gross domestic product (GDP). An increase of 4 °C would lead to as much as a 12% contraction of Africa’s GDP<sup>3</sup>. Recent analysis by the European Investment Bank (EIB) shows that almost all African countries face elevated, high or very high risk from climate change (Ferrazzi et al., 2021; see Figure 1). Exposure to physical risks associated with climate change is particularly high. For example, rising temperatures and more frequent droughts across the continent can reduce the productivity of agriculture, which is the mainstay of many African economies. Infrastructure will need to be upgraded to cope with higher temperatures, and coastal nations may need to adapt to rising sea levels. Evidence suggests that these risks are already materialising in Africa (World Meteorological Organization, 2019)<sup>4</sup>. African countries are less exposed to transition risk than other regions because they have lower levels of industrialisation. However, a number of African countries are significant producers of fossil fuels, and around one-third face high or elevated exposure to transition risk. Consequently, climate change poses the risk of halting or reversing progress on development and poverty reduction (United Nations Economic and Social Affairs, 2020; Niang et al., 2014). The impact of the COVID-19 pandemic is further jeopardising sustainable development achievements, including those on climate goals (World Bank, 2020).

Figure 1: Physical and transition risk index scores by continent



Source: EIB analysis, summarised in Ferrazzi et al., 2021.

**Climate change will affect African financial institutions.** Their physical assets could be damaged or destroyed, while the return on other assets could also be affected. One extreme potential outcome is banks being left with unprofitable “stranded assets”<sup>5</sup>. Disregarding the risks related to climate change could thus reduce the quality of assets (in other words, the probability that borrowers repay), and thus cut profitability. This means that it is in the interests of Africa’s financial institutions to consider climate risk and green financing opportunities.

<sup>3</sup> United Nations Climate Change, 2020.

<sup>4</sup> Physical climate change risks concern physical issues (e.g. droughts and extreme weather events such as storms) that can have a physical impact on an investment, for example by damaging infrastructure. Transition risks occur where changes in policy, liability or technology can have a negative impact on a project: for instance, environmental laws may be introduced that prohibit a type of production process or use of certain pollutants (International Finance Corporation (IFC), 2016b).

<sup>5</sup> The International Energy Agency (IEA) defines stranded assets as “investments which have already been made, though at a point in time prior to the end of their economic life are seen to no longer earn economic returns as a result of changes in the market and regulatory environment brought about by climate policy” (<https://carbontracker.org/iea-climate-energy-map-commentary/>).

**Greening the financial sector is crucial to mobilising additional capital in the fight against climate change.**

Globally, investors are showing increased interest in environmental sustainability, so green finance presents an opportunity for attracting further capital to Africa to finance the climate transition. Green finance aims to find the right balance between financial and environmental sustainability by supporting financially viable investments that help to protect the environment and reduce carbon emissions. To attract international investors, it is essential that green finance follows recognised standards with high levels of transparency.

**More can be done to ensure that the financial sector addresses climate risks and grasps the opportunities of climate finance. This has become particularly urgent in the context of the recovery from COVID-19.**

As this chapter's analysis will show, African financial institutions, governments, central banks and regulators are increasingly aware of the risks climate change poses and are taking up opportunities in green finance. However, according to estimates by the International Monetary Fund, 2020, \$30 billion to \$50 billion a year in incremental finance is needed for climate adaptation in sub-Saharan Africa alone. The United Nations Economic Commission for Africa, 2020 also highlights the importance of addressing climate change as part of the response to the COVID-19 crisis, and the need for significant additional finance to do so. According to Buchner et al., 2019, the average annual worldwide flow of adaptation finance in 2017 and 2018 amounted to only \$30 billion, of which less than 23% went to Africa. Almost all of this finance came from public bodies.

**The COVID-19 crisis now threatens finance for climate action in developing countries.**

Concerns about some developing countries' fiscal capacity, debt sustainability and ability to access international markets are likely to constrain African governments' ability to invest, as discussed in Chapter 1 of this report. Even prior to the crisis, the perception that climate change adaptation needs were competing with other demands was setting back investment in developing countries (Allan et al., 2019). In this context, it is essential that the African private sector, supported by a functioning financial sector, plays a bigger role in supporting climate action and environmentally sustainable investment. This chapter describes the current trends and developments in green financing and provides some insights into the additional efforts needed to close the green finance gap. Data gaps on climate and green financing on the continent also remain large, which limits analysis and understanding of the sector. International organisations can play an important role by working with financial institutions to finance the climate transition, and in helping to address gaps in knowledge and capacity to provide sustainable finance products.

**Box 1: What is green finance?**

**Green finance is structured finance that aims to support improved environmental outcomes.** The EU taxonomy for sustainable activities establishes a list of activities that can be considered green finance, including investments that promote climate change mitigation or adaptation, sustainable use of resources (water, marine, land), the circular economy (increased recycling, material efficiency, efficient waste disposal), pollution reduction, and protection of biodiversity and ecosystems (European Union, 2020).

**Green finance draws on both debt and equity instruments.** Equity finance is commonly employed at the early stages of a project or for relatively young companies. Junior equity positions (i.e. stocks with lower payment priority in a company liquidation) are frequently used in such cases, as they allow investors to absorb more risk. International financial institutions play a particularly important role in taking on junior equity, which can serve to signal financial viability (Krushelnyska, 2017). Green debt finance flows to sustainable investments mainly through loans from financial institutions (including commercial banks and development finance institutions) and through the bond market.

## Green finance in Africa

### Capital markets

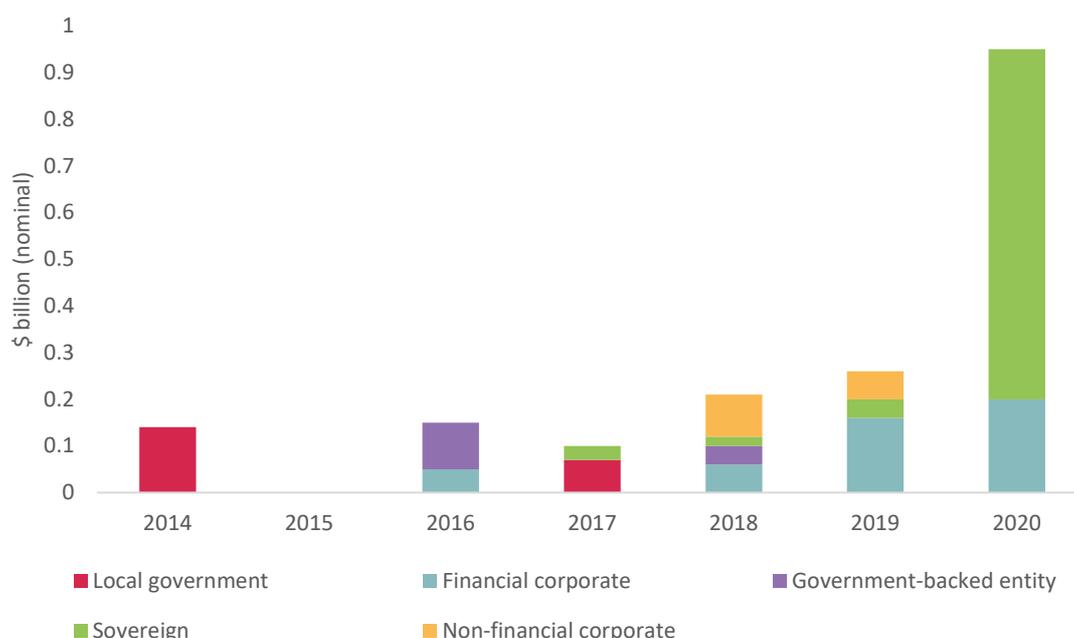
**Green bonds are a means of collecting financial resources to fund projects with positive environmental components.** They have been issued by various players including sovereign states, multilateral development banks, large corporations and commercial banks. The various categories of green bonds include "use of proceeds" bonds (proceeds from the bond sale are used to fund a green project), project bonds (debt backing is limited to the project assets and liabilities), green securities (bonds secured by some form of collateral), and

green “payment by results” bonds (private investors fund an intervention and are repaid, with profit, if an agreed result is achieved).

**The global green bond market has expanded rapidly since its creation in 2007**, when the EIB issued the world’s first green bond — €600 million in climate awareness bonds. The first World Bank Green Bonds were issued in 2008 (equivalent to \$346 million), followed by a \$1 billion green bond issuance by the International Finance Corporation (IFC) in 2013 (IFC, 2016a). The Climate Bonds Initiative (CBI) estimates that the green bond market was worth approximately \$1 trillion by 2020 (Climate Bonds Initiative, 2021a). This growth has been driven by the need for finance for green projects and by the emergence of a strong green investor base, comprising not only specialist funds but also generalist investors seeking to address climate risks in their portfolios.

**Africa’s green bond market has been developing, with the number and value of issuances increasing almost every year (Figure 2).** Nedbank of South Africa issued the continent’s first green bond in 2012, with an initial principal of ZAR 5 billion (\$577 million). The proceeds were dedicated to investments aiming to boost employment in the manufacturing, construction and infrastructure sectors of the green economy. In the years that followed, a number of green bonds were either issued by governments or benefited from sovereign guarantees. Bonds have also been issued by municipal authorities (seeking to raise money for urban infrastructure), private sector companies and financial institutions. Two African green bonds were issued during 2020 — an \$800 million issue by the Egyptian government and a \$200 million issue by Standard Bank in South Africa — accounting for 53% of total African issuances to date.

**Figure 2: Types of issuers of African green bonds by value (\$ billion, nominal), 2014-2020**



Source: Environmental Finance Bond Database, 2021.

**Table 1: Total green bond issuances by region, cumulative over 2014-2020**

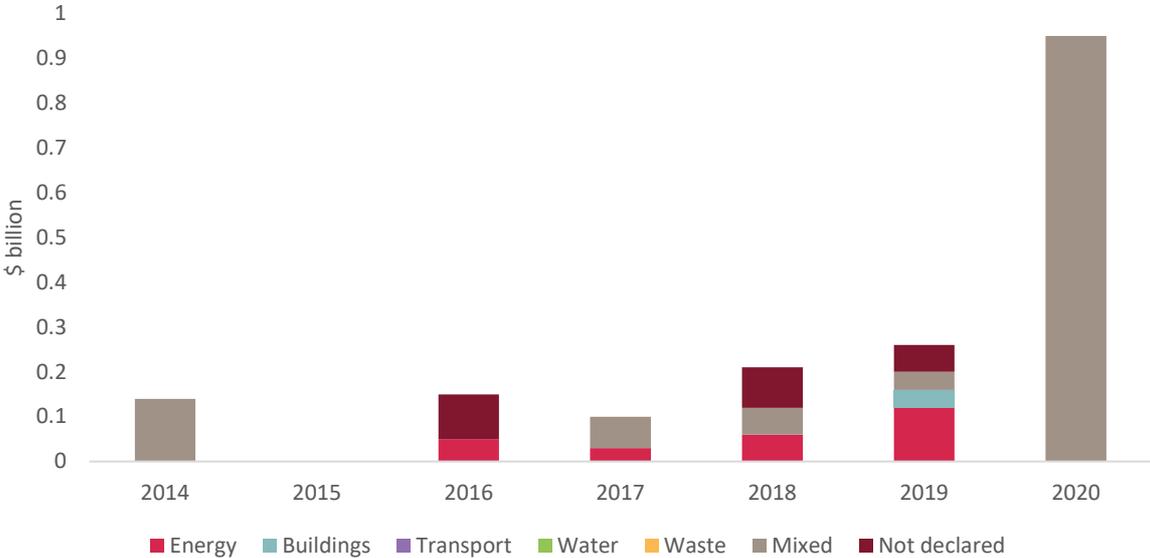
Region	Green bond markets	No. issuers	No. deals	Value (\$ billion)
Europe	25	687	1 385	456.9
North America	2	561	4 628	247.8
Asia-Pacific	18	619	844	217
Latin America	11	81	107	20.9
Africa	6	17	20	1.9
Total	62	1 965	6 984	944.5

Source: Climate Bonds Initiative, 2021a.

**Africa’s green bond market remains small relative to other regions.** Between 2014 and 2020, 20 green bonds worth around \$2 billion were issued in six African countries. Over the same period, green bond issuances reached \$1 trillion globally. With Africa representing approximately 0.2% of the world’s green bond market over that period but accounting for 2.8% of world GDP in 2020 (International Monetary Fund, 2021), the African green bond market has yet to achieve its full potential.

**Green bonds have targeted diverse sectors, in hard and local currencies.** By 2020, green bonds covered projects in the waste, energy, water, construction, transport and manufacturing sectors, among others. The US dollar is the most common issuing currency, representing 53% of total issuances, followed by the South African rand (23%) and Moroccan dirham (13%) (Climate Bonds Initiative, 2021a). Green bonds have also been issued in currencies including Kenyan shilling, Namibian dollar, Moroccan dirham and Nigerian naira. Issuances in domestic currencies allow institutions to finance green projects that earn revenues in local currency using local currency loans, thereby avoiding passing on currency risk to project promoters.

**Figure 3: Use of proceeds of African green bonds by value (\$ billion, nominal), 2014-2020**



Source: Environmental Finance Bond Database, 2021.

**A number of initiatives are providing common standards, cooperation platforms and supporting infrastructure to promote the development of the green bond and capital markets.** In 2012, the Johannesburg Stock Exchange (South Africa) and the Egyptian Exchange were among the founding members of the Sustainable Stock Exchanges (SSE) initiative<sup>6</sup>, whose goal is to create a global platform for stock exchanges to promote sustainable investments. Another 14 African countries<sup>7</sup> have now joined this initiative (Sustainable Stock Exchanges initiative, 2021). Stock exchanges are increasingly aware of the importance of sustainability and environmental, social and governance (ESG) reporting. For instance, the stock exchanges in Botswana, Egypt, Kenya, Nigeria and South Africa issue annual sustainability reports, while those in Botswana, Nigeria and South Africa also provide written guidelines on ESG reporting and ESG training opportunities. The Namibian, Nigerian, South African and Zimbabwean stock exchanges set ESG reporting as a prerequisite for listing, while the stock exchanges of South Africa, Kenya and Nigeria have implemented or are considering introducing specific green bond segments (Climate Bonds Initiative, 2021b). South Africa already has a green listing through the Johannesburg Stock Exchange.

<sup>6</sup> The Sustainable Stock Exchanges initiative is a United Nations Partnership Programme hosted by the United Nations Conference on Trade and Development, the United Nations Global Compact, the United Nations Environment Programme Finance Initiative and the Principles for Responsible Investment network. Other founding partners include the United States’ Nasdaq OMX, Brazil’s B3 stock exchange (Brasil, Bolsa, Balcão) and Turkey’s Borsa Istanbul.

<sup>7</sup> Zimbabwe, Tanzania, Uganda, Tunisia, Somalia, Seychelles, Rwanda, Nigeria, Namibia, Morocco, Mauritius, Kenya, Côte d’Ivoire and Botswana.

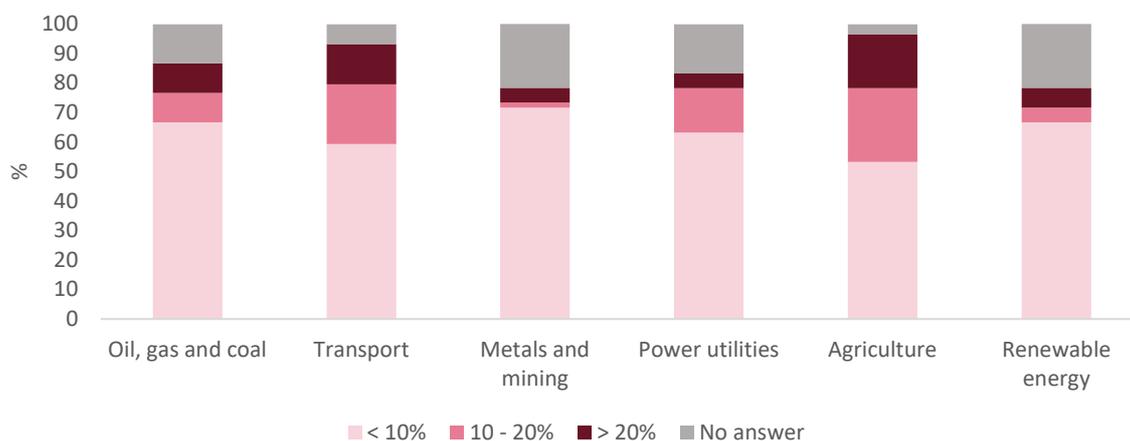
## Banks

**African banks could make an important contribution to supporting climate financing needs across the continent.** In South Africa, commercial banks are already providing significant volumes of green financing, accounting for approximately \$1.3 billion by 2018 (Cassim et al., 2021). However, this is small relative to total credit to the private sector — based on World Bank data, this would be equivalent to around 0.4% of domestic credit to the private sector, or 0.5% of bank finance for the private sector (estimated based on World Bank, 2021). As South Africa’s finance sector is among the more developed on the continent, the volume of climate finance from private banks is likely to be even lower in other African markets. There seems to be significant potential for banks in South Africa and other African countries to provide more support towards achieving nationally determined contributions under the Paris Agreement.

**The effects of climate change and energy transitions pose serious risks for African banks.** As the world transitions away from fossil fuels and climate-related events become more severe, many economic sectors will be affected. For example, 90% of Africa’s coal reserves are expected to become stranded resources, causing material losses for many countries (Bos and Gupta, 2019). According to the rating agency Moody’s, almost 30% of the total loan portfolio of African banks is invested in environmentally sensitive sectors<sup>8</sup>. More than 40% of the 78 banks interviewed in the *EIB Banking in Africa survey, 2021* reported having at least 10% of their portfolio in agriculture — a sector expected to be severely affected by climate change; almost half of these banks have over 20% invested in the sector (Figure 4)<sup>9</sup>. Furthermore, 20% of banks reported having at least 10% of their lending portfolio in the oil and gas sector. As such, climate risks can be expected to significantly affect the loan books and profitability of banks in Africa.

**Africa’s banks are making green investments, although these still represent a small share of their total portfolios.** East and Southern Africa are slightly ahead of other African regions in taking up these opportunities, with 12% of banks in East Africa and 7% in Southern Africa having more than 20% of their total portfolio in renewable energy, compared to 6% for the sample overall. However, the renewable energy sector still represents less than 10% of the total portfolio for two-thirds of banks, suggesting that green financing opportunities are yet to be grasped across the board.

Figure 4: Sectoral distribution of the total portfolio (% of surveyed African banks)



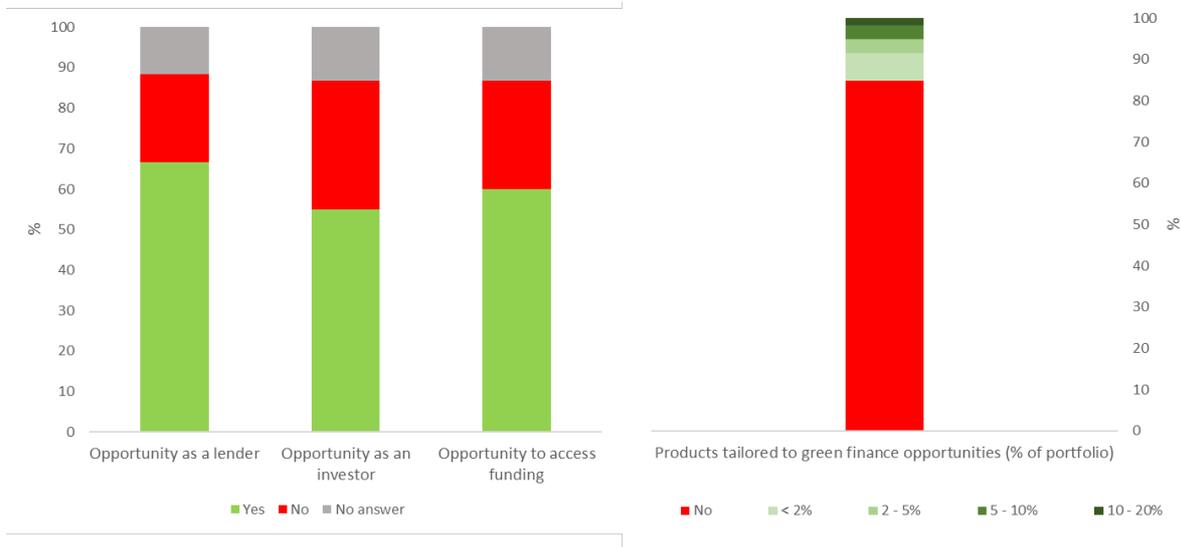
Source: *EIB Banking in Africa survey, 2021*.

<sup>8</sup> Bloomberg, 2021.

<sup>9</sup> The *Banking in Africa survey*, which is the basis for much of the analysis in this section, is described in more detail in Chapter 1 of this publication.

**Banks in sub-Saharan Africa are aware of the importance of adopting green financing principles, seeking to address risks and grasp new opportunities.** For commercial banks, a climate change strategy is an important tool to promote engagement in green finance investments and make those investments more effective (United Nations Environment Programme, 2014). Findings from the *EIB Banking in Africa survey, 2021* show that 54% of African banks apply green finance practices at various levels, ranging from the inclusion of climate within an existing ESG strategy to the formalisation of a standalone climate change strategy. The majority of banks (84%) recognised that a formal climate strategy can open new opportunities, for example in renewable energy. In addition, over three-quarters of banks are aware that having, and publicising, climate strategies and principles is critical to reducing reputational risks and the financial risks associated with climate change. Two-thirds of surveyed banks see green products, such as green mortgages and energy efficiency loans, as an opportunity to expand the range of products available to their client base. Over half recognise that investing in green portfolios, including green bonds, might represent a good opportunity to diversify their funding base. Finally, 60% of surveyed banks see green bond issuance and green credit lines from development finance institutions as future opportunities to expand their funding. However, only 17% of banks have so far introduced specific green financing products, and these are estimated to account for a small share of the portfolio — no more than 2% for 45% of these banks, and in the range of 2-20% for the remainder.

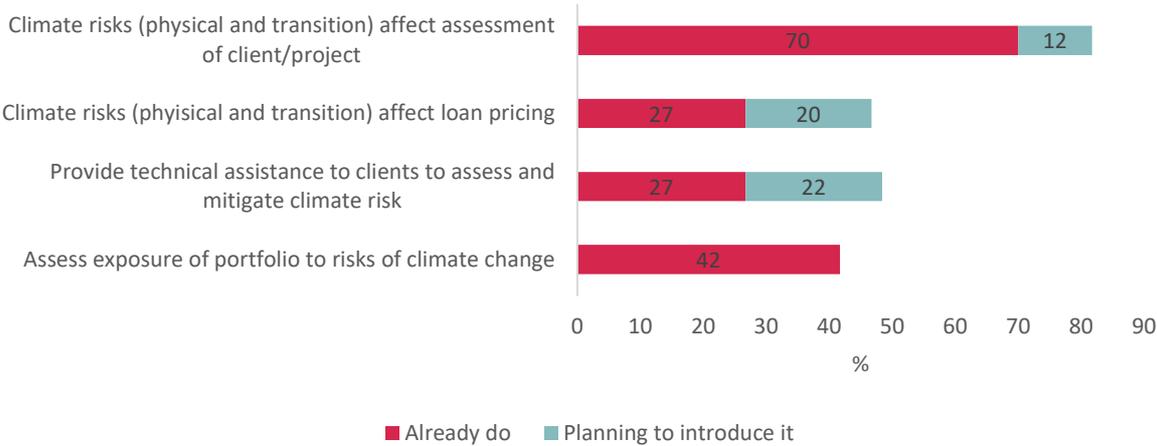
**Figure 5: Green finance opportunities and products (% of surveyed African banks)**



Source: *EIB Banking in Africa survey, 2021*.

**African banks are assessing how climate risks might affect individual loans or clients, but quantification of the risks at portfolio level is less common, and links to pricing are yet to become mainstream.** Banks need to assess climate risks because any unexpected deviations in financial results arising from such risks can significantly affect their earnings and expenses, thereby damaging financial sustainability (IFC, 2016b). Most surveyed banks (70%) reported that they do consider, during the appraisal of a loan, how physical and transition risks could affect their clients or investment projects, while 42% assess risk at portfolio level (Figure 6). However, the survey data do not reveal how systematic these assessments are, and only 27% of banks report pricing climate risk into their lending.

Figure 6: Climate risk approach (% of surveyed African banks)



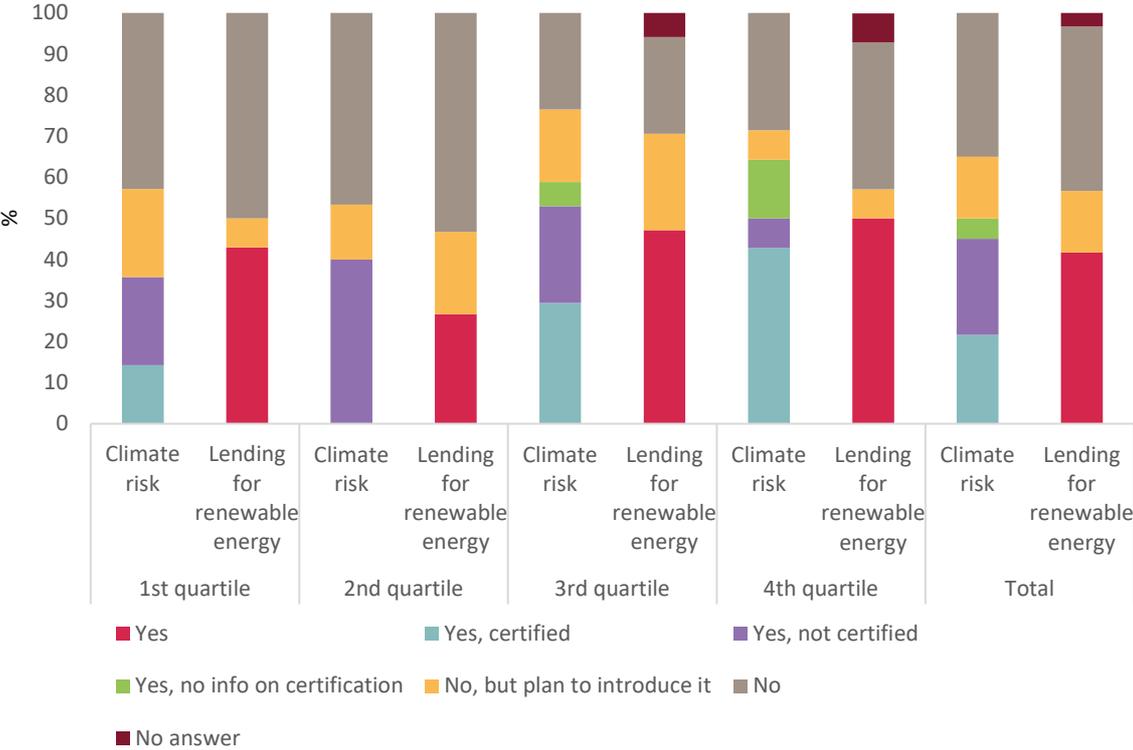
Source: EIB Banking in Africa survey, 2021.

**There appears to be potential to expand the provision of technical assistance for green finance and the development of green finance products (Figure 6).** Providing technical assistance to clients could help banks to improve their financial outcomes, as changes made to promote climate change mitigation and adaptation can often have a positive financial impact on firms (Ellis et al., 2013), generating greater financial returns and a higher likelihood of repayment. But in practice, only around 25% of surveyed banks provide such technical assistance, with an additional 22% considering implementing this service in the future. To provide such technical assistance, banks need to not only recognise the risks but also understand how clients can address them. This suggests that there may be a need for awareness raising and capacity building at the bank level as well, in order to enable them to extend this kind of support to clients. Technical assistance could also help banks to develop green finance products which, as noted above, remain uncommon.

**Banks are investing in dedicated staff to better grasp green finance opportunities.** Having personnel with climate change-related skills helps banks to properly engage in green finance (Task Force on Climate-Related Financial Disclosures, 2017). Half of banks surveyed in the *EIB Banking in Africa survey, 2021* had personnel specifically focused on climate risks, and a further 15% were considering hiring personnel to work on this area (Figure 7). Thirteen banks reported having hired or trained personnel with some form of climate risk assessment certification (e.g. the Environmental & Social Risk Analysis certification of the United Nations Environment Programme Finance Initiative). Larger institutions appear better placed to address climate change, as they are more likely to have specific personnel in place — only 36% of smaller banks have staff dedicated to climate finance, compared to 64% for larger banks<sup>10</sup>. Personnel dedicated to grasping opportunities in renewable energy and energy efficiency lending are currently employed by 42% of surveyed banks, with a further 15% considering hiring staff for this growing area.

<sup>10</sup> Banks were classified by the size of their total assets. Larger banks are in the fourth quartile, which identifies the highest 25% of observations with respect to total assets. Smaller banks are in the first quartile, meaning the lowest 25%.

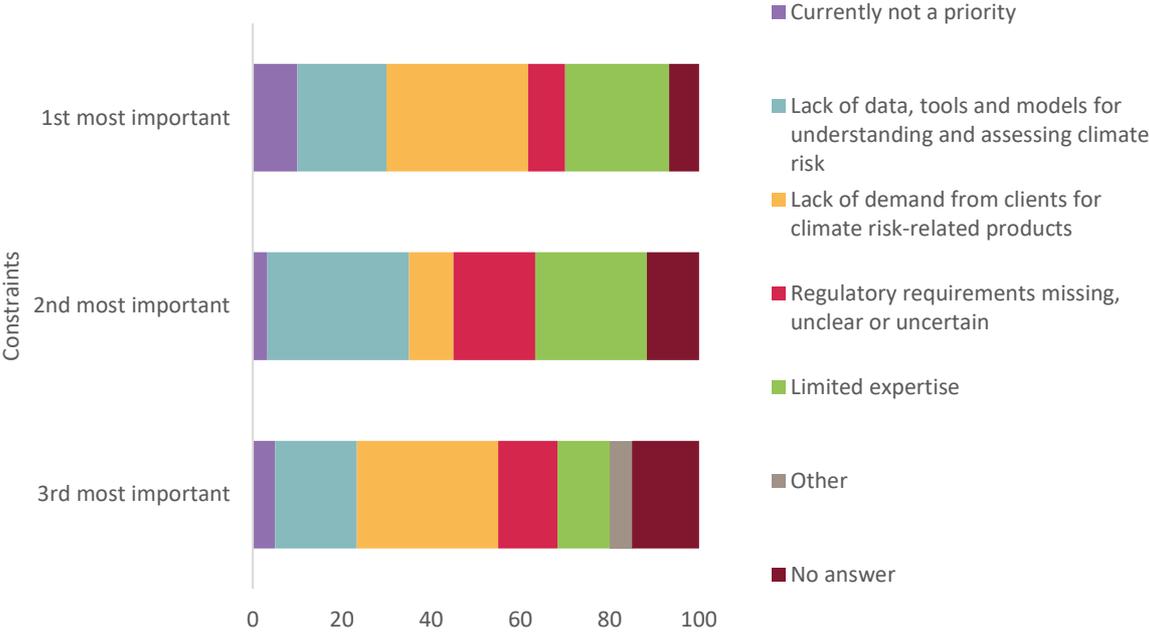
Figure 7: Climate change-specific personnel by bank total assets quartile (% of surveyed African banks)



Source: EIB Banking in Africa survey, 2021.

**African banks see lack of demand for green finance and lack of technical capacity among their staff as the main constraints on investment in this sector.** Lack of demand for such products was cited by 32% of respondents as the most important constraint on doing more to identify, assess and address climate risks and opportunities. Moreover, 52% reported lack of data, tools and models to assess climate risk as either the most or second most important limiting factor. Lack of expertise in providing such products is seen as the biggest or second biggest constraint by 23% and 25% of banks, respectively. Nevertheless, demand might be expected to grow, as the Paris Agreement commitments could lead countries to legislate on new climate change mitigation and adaptation measures for the private sector. Raising awareness about green finance opportunities and green products and options could also potentially help address the lack of demand. Expertise can be reinforced by making training courses available to lower-income countries, such as the course on climate change and finance offered by the United Nations Environment Programme Finance Initiative (UNEP-FI); another means is through learning partnerships among banks, such as the IFC’s Alliance for Green Commercial Banks.

Figure 8: Main constraints on identifying, assessing and addressing climate risks and opportunities (% of surveyed African banks)



Source: EIB Banking in Africa survey, 2021.

Overall, the EIB survey data show that African banks are seriously considering the potential financial impact of climate change and the opportunities presented by green finance. They are proactively moving to address climate change in their operations, including by allocating staff resources to focus on the issue and, less commonly, by providing specialised technical assistance or products. This provides a robust potential foundation for further growth in green finance through African banks. However, the survey results also highlight the need for further progress in expanding the expertise base and in shifting portfolios towards sectors that mitigate or are more resilient to the impacts of climate change. Banks currently perceive a lack of demand for green finance. This suggests it may be necessary for banks to promote green finance products and raise awareness of climate risk and opportunities to generate more demand from their clients.

### Other financial institutions

#### Microfinance

Although microfinance institutions account for smaller volumes of green finance than banks, they fill an important gap in the market. These institutions help financially excluded and unbanked individuals, households and microenterprises invest in environmentally sustainable projects and adapt to/mitigate the impact of climate change. According to a 2019 survey by Consultative Group to Assist the Poor (CGAP), dedicated green investors provided almost 7% of the total \$10 billion in finance for microfinance institutions in the CGAP network that year; most of that green investment came from development finance institutions and bilateral donors. Also in 2019, \$2 billion was earmarked for microlending for agricultural and rural finance. These are key priorities for climate adaptation in Africa, so this lending also has a green dimension (Consultative Group to Assist the Poor (CGAP), 2019).

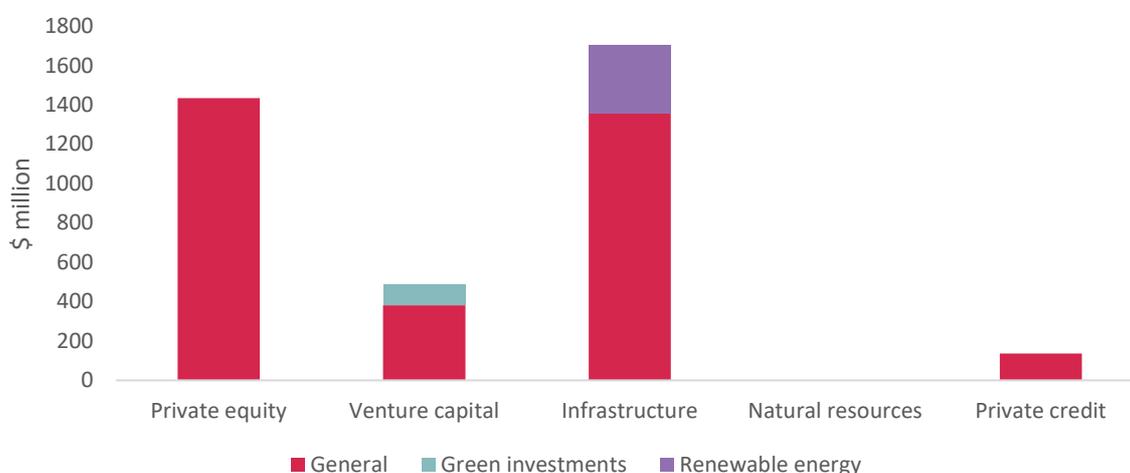
A number of initiatives use microfinance as a tool to strengthen the resilience and adaptation capabilities of farmers to climate shocks, for example by investing in irrigation systems or drought-resistant crops. However, results have been mixed. Different approaches have been taken to providing such green microfinance. For example, direct finance provided to Mozambique farmers for investment in climate-resilient irrigation had limited impact because of difficulty in maintaining equipment and financing inputs (Climate Investment Funds, 2020).

## Private capital

**Private capital can support investments ranging from large infrastructure projects to high-growth startups, although in practice infrastructure absorbs the largest volumes.** Between 2016 and 2020, \$2.2 billion of private capital was invested, through 115 deals, in renewable energy and CleanTech sectors in Africa, according to data from the Global Private Capital Association (GPCA)<sup>11</sup>. Green investments<sup>12</sup> in 2020 alone totalled at least \$450 million, representing 12% of total private capital invested in Africa. Infrastructure assets accounted for over half of these deals, with much smaller flows dedicated to financing startups. Private equity funds, which accounted for almost 40% of total private capital investment activity in 2020, invested less than 1% of their total invested capital into CleanTech companies.

**Venture capital funds focus on providing seed capital to finance the initial stages of a business, and can be particularly relevant for innovative ideas and uses of technology.** A few venture capital funds focus specifically on green finance opportunities in Africa. For example, the investment fund CI Ventures<sup>13</sup> provides capital to startup and growth-stage small and medium-sized enterprises that work within conservation areas, including firms in Kenya and South Africa. It targets conservation-focused firms that cannot raise traditional funding because of their risk profile, and provides short-term loans, growth capital or equity to enable the implementation of innovative conservation approaches. In 2020, venture capital investors allocated \$56 million (representing 5% of their total investments) to 18 startups and innovative companies operating in the CleanTech and renewable energy sector (Global Private Capital Association, 2021). One of these investors is the Ghanaian investment company Wangara Green Ventures, which focuses on high-growth, high-impact small and medium businesses engaged in renewable energy, energy efficiency, recycling and climate-smart agriculture. Another example is GreenTec Capital Partners, a fund which operates across 12 African countries and invests in green technology startups and small and medium firms providing, for example, eco-efficient stoves and environmentally sustainable agricultural goods and transport systems.

Figure 9: Investment in African companies by asset class, 2020



Source: Global Private Capital Association, 2021. Data as of 31 December 2020.

<sup>11</sup> Based on analysis of proprietary data shared by the Global Private Capital Association, available exclusively to member firms, described at <https://www.globalprivatecapital.org/gpc-analytics/> (retrieved May 2021).

<sup>12</sup> It is difficult to assess the actual market of green investments, as deals are typically classified by economic sector and investment type. For ease of reference we classify green investments as including any deals in the renewable energy and CleanTech sectors.

<sup>13</sup> Conservation International Ventures LLC.

## Insurance

**Green insurance can provide sovereign states or regions with cover against the impacts of climate change and climatic shocks.** For example, the African Risk Capacity (ARC) is an index-based weather risk insurance pool established by the African Union. This initiative provides African governments with insurance for natural disasters. The ARC uses early warning information in combination with an insurance mechanism that objectively and rapidly triggers payouts following a disaster. Schemes like the ARC can transfer the burden of weather risk away from governments, enabling them to build resilience and better plan, prepare and respond to extreme weather events. However, these schemes have been affected by a number of challenges, including limitations in government capacity, perceived high cost of the premiums compared with likely payouts, excessive concentration of risks in certain regions, and lack of coordination with national strategies in the agricultural sector (Oxford Policy Management, 2017; Clarke and Hill, 2013).

**Other insurance schemes help households cope with the risk of climate-related shocks.** Weather or crop microinsurance can be used to insure against losses from crop failures or prices falling due to weather events, offering significant potential benefits for smallholder farmers with high exposure to climate risks. For example, the African and Asian Resilience in Disaster Insurance Scheme provides climate insurance to rural families and smallholder farmers, aiming to provide recovery finance after any potential climate shock. It is backed by multiple development agencies and development finance institutions, such as the UK Foreign, Commonwealth & Development Office, the Dutch FMO, and the German KfW. Other smaller, privately led weather insurance schemes have been established. However, the effectiveness of such insurance has been limited by the low uptake by small-scale African farmers (Nshakira-Rukundo et al., 2021). There have also been issues with the construction of weather indices and other design and implementation problems (Roznik et al., 2019; Weber, 2019). This has led to greater focus on national-level weather insurance from providers such as the ARC regional sovereign risk pool (Syroka, 2015).

**Addressing gaps at higher levels in the insurance market can also facilitate green finance.** The EIB-supported Africa Energy Guarantee Facility targets a gap in the market for reinsurance, working with Munich Re and the African Trade Insurance Agency. The initiative aims to significantly boost private investment in sustainable energy projects by providing access to political and credit risk insurance for sustainable energy projects<sup>14</sup>. By addressing this gap, the initiative aims to catalyse over €1 billion in finance for Sustainable Energy for All projects.

## Policy initiatives

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### Domestic

**Governments play a key role in encouraging and facilitating the allocation of domestic financial resources to green investments, and in prohibiting or controlling investments in environmentally harmful activities.** This can be done using legal mandates, by providing positive or negative fiscal incentives, and through policy initiatives such as risk-sharing mechanisms. Several African countries are implementing initiatives to promote green finance. Central banks are generally the key makers and implementers of policy for the financial sector, including in the green finance sphere.

**Some countries have developed their own sustainable banking principles or joined international sustainable banking initiatives.** For example, South Africa's National Treasury published the Financing a Sustainable Economy<sup>15</sup> strategy in 2020. This strategy encourages voluntary green finance initiatives by the country's financial institutions and advocates creating a green finance taxonomy for the South African financial system. The Banking Association of South Africa has also launched the voluntary Principles for Managing Environmental and Social Risks (Sustainable Banking Network (SBN), 2019a). The Nigeria Sustainable Banking Principles, introduced by the Central Bank of Nigeria in 2012, include environmental and social risk management and governance, and cover the environmental footprints of financial service providers in the country (SBN, 2019c). The Kenya Bankers Association launched its Sustainable Finance Principles and Guidelines in 2015, and in 2019

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<sup>14</sup> <https://www.eib.org/en/projects/pipelines/all/20120168>.

<sup>15</sup> Republic of South Africa National Treasury, 2020.

added a (voluntary) reporting template to the toolkit (SBN, 2019e). The Bank of Ghana introduced sustainable banking principles in 2019, including environmental risk assessment guidelines (SBN, 2019d). In Morocco, the Bank Al-Maghrib is developing regulations to ensure that financial institutions disclose information on their environmental impact (SBN, 2019f). The Central Bank of Egypt is also in the process of adapting and applying the Principles for Responsible Banking established by UNEP-FI (SBN, 2019b).

**African countries are also using national development banks and other public financial institutions to raise and channel green finance.** The Development Bank of Southern Africa (DBSA) — the state-owned domestic and international development bank — became a green investment bank in 2021 by launching its first green bonds<sup>16</sup>. The proceeds are dedicated to projects which contribute to climate change mitigation or adaptation, support the transition to a low-carbon economy, or align with the UN Sustainable Development Goals; all projects must also meet a set of ESG criteria. The Rwandan government is currently developing the Rwanda Green Investment Facility, which will provide loans and credit lines to commercial banks for green finance projects (African Development Bank, 2021).

**Some African countries are addressing the impact of climate change on individuals and households, including through climate change and green growth considerations in National Financial Inclusion Strategies (NFIS)**<sup>17</sup>. The IFC's Sustainable Banking Network identifies three African countries whose strategies have particular relevance to green finance: Morocco, Tanzania and Rwanda. Morocco has a national roadmap with the strategic vision of promoting sustainable financial instruments and products as a driver of sustainable development. Morocco's NFIS also specifically points to insurance, microinsurance and agricultural insurance for vulnerable sections of the country as potential tools to address climate change. The Bank Al-Maghrib (Morocco's central bank) encourages domestic financial institutions to direct lending towards supporting the development of green technologies, in line with the country's NFIS goals (SBN, 2019f). Tanzania's NFIS aims to address climate change to tackle gender inequality, on the basis that women will be most vulnerable to climatic shocks. Finally, the National Bank of Rwanda specifically references climate change in its NFIS, particularly in terms of impacts on agriculture. Accordingly, it emphasises the importance of developing agricultural insurance products to minimise risks to farmers<sup>18</sup>.

## Regional and international

**African economies are joining international initiatives and establishing new regional ones.** Central banks and supervisory authorities of some African states (Morocco, Seychelles and South Africa, and the states of the West African Economic and Monetary Union) are members of the Network for Greening the Financial System, whose goal is to promote best practices in green finance, including risk management techniques and supervision<sup>19</sup>. Finding ways to mobilise green capital is also a priority of the African Adaptation Initiative, launched by African heads of state in 2015. Currently in its third phase, the initiative aims to address the adaptation financing gap on the continent by sharing knowledge and pooling financial resources. In its 2020-2030 work plan, the initiative expects to contribute to reaching the goal of \$1 billion of investments in climate information services and to support the launch of the first continental and thematic climate bond.

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<sup>16</sup> DBSA, 2021.

<sup>17</sup> World Bank, 2015.

<sup>18</sup> In 2020, of the 17% of Rwandan adults who had or used insurance products, only 1% had taken this up in order to insure against agricultural risk (Access to Finance Rwanda, 2020).

<sup>19</sup> <https://www.ngfs.net/en>.

### Box 2: EIB support for green finance in Africa

**As the EU climate bank, the EIB invests in many green finance initiatives, including in Africa.** The EIB is one of the largest multilateral providers of climate finance worldwide. All of the Bank's operations are fully aligned with the principles and objectives of the Paris Agreement. This focus on climate is reflected in the Bank's operations in Africa, many of which involve partnerships with financial sector institutions to channel finance to climate action. For example, in 2020, the EIB and African Export-Import Bank provided \$300 million for a COVID-19 recovery fund for sectors hit hardest by the pandemic in Africa, reserving 25% of the capital for green projects<sup>20</sup>. The EIB has also invested in the DBSA Climate Action Facility<sup>21</sup>, which provides a credit facility to the Development Bank of Southern Africa. In addition, it is an implementing partner in the City Climate Finance Gap Fund<sup>22</sup>, which provides cities with investment funding for low-carbon and climate-resilient investments. This fund has already confirmed grants for cities in Ethiopia, Morocco and the Democratic Republic of the Congo. The EIB also partnered with the Luxembourg government to create the Luxembourg-EIB Climate Finance Platform, which has already invested in a number of funds addressing climate change, including in Africa<sup>23</sup>. In 2021, the EIB announced a collaboration with the AfDB to grow a shared pipeline of investment projects, including those aimed at tackling climate change and environmental sustainability (AfDB and European Investment Bank, 2021).

**International organisations also play a crucial role in providing guidance on and definitions of green finance, and an increasing number of African financial institutions are signing up to relevant initiatives.** For example, in 2021 the African Development Bank (AfDB) and the Global Centre on Adaptation joined forces to develop the African Adaptation Acceleration Programme, which aims to mobilise \$25 billion to finance climate resilience activities, ranging from climate-smart digital technologies to climate-resilient infrastructure<sup>24</sup>. The AfDB also set up the African Financial Alliance for Climate Change, which links stock exchanges, sovereign wealth funds, central banks and other financial institutions in Africa, with the aim of mobilising capital and shifting their portfolios towards green investments<sup>25</sup>. Thirty-four African financial institutions from nine countries have joined UNEP-FI and take part in its various programmes. These include the Net-Zero Banking Alliance, whose member banks are committed to aligning their portfolios with net-zero emissions by 2050<sup>26</sup>. Kenya Commercial Bank (KCB) and Egypt's Commercial International Bank (CIB) have joined this alliance. Furthermore, 16 banks from six African countries have signed the Principles for Responsible Banking, while ten insurance companies from five African countries have signed the Principles for Sustainable Insurance. Finally, UNEP-FI has organised the Collective Commitment to Climate Action as part of its Principles for Responsible Banking. However, of the 38 signatory banks that have committed to align their portfolios with the Paris Agreement, Kenya Commercial Bank is currently the sole African representative (United Nations Environment Programme Finance Initiative, 2019).

**International institutions are partnering with commercial financial institutions to support green finance,** including through large investments in infrastructure projects and smaller investments in small and medium businesses. For example, in 2020 the IFC and the Dutch FMO provided a \$225 million loan to FirstRand Bank for financing climate-friendly infrastructure and manufacturing projects involving South African small and medium firms. The IFC has also backed green bond issues by African financial institutions, such as Standard Bank's \$200 million green bond — the first African offshore green bond listed on the London Stock Exchange. In 2015, the European Bank for Reconstruction and Development (EBRD) launched the SEmed Private Renewable Energy Framework, a \$250 million facility for financing green projects through local partner banks in North Africa (Morocco, Tunisia and Egypt) and Jordan<sup>27</sup>. In addition, the EBRD's Sustainable Energy Financing Facilities offer climate financing for North African partners. Under this initiative, the EBRD provided a €20 million credit line to Morocco's BMCE Bank to finance climate projects<sup>28</sup>. In 2020, the EBRD partnered with the European Union to support financial institutions in Egypt and in Morocco funding local business investments in green technologies<sup>29</sup>. The EBRD announced in 2021 that it would be scaling up its support for the Green Energy Financing Facilities,

<sup>20</sup> <https://www.eib.org/en/press/all/2020-218-eib-and-afreximbank-direct-eur-300m-of-support-to-african-covid-response>.

<sup>21</sup> <https://www.eib.org/en/projects/pipelines/all/20190296>.

<sup>22</sup> <https://www.eib.org/en/press/all/2020-245-city-climate-finance-gap-fund-launches-to-support-climate-smart-urban-development>.

<sup>23</sup> <https://www.eib.org/en/projects/pipelines/all/20170945>.

<sup>24</sup> <https://www.afdb.org/en/documents/eoi-multinational-african-adaptation-acceleration-fund-aaap>.

<sup>25</sup> <https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-financial-alliance-on-climate-change-afac>

<sup>26</sup> <https://www.unepfi.org/net-zero-banking/>

<sup>27</sup> <https://www.ebrd.com/work-with-us/projects/psd/semmed-private-renewable-energy-framework.html>

<sup>28</sup> <https://www.ebrd.com/news/2016/creating-green-financial-markets-in-africa.html>

<sup>29</sup> <https://www.ebrd.com/news/2020/ebird-and-eu-join-efforts-to-boost-green-finance.html>.

which back local financial institutions' funding of climate projects; member countries include Egypt, Morocco and Tunisia<sup>30</sup>.

**The Green Climate Fund (GCF), one of the largest global climate funds, is also active in Africa.** The GCF is mandated to invest 50% of its resources in mitigation and 50% in adaptation, of which at least half must be invested in the most climate vulnerable countries, including African states. Accordingly, the GCF has focused particularly on Africa. By March 2021, it had channelled approximately \$3.1 billion (37%) of its total portfolio to projects in African countries (Green Climate Fund, 2021). Globally, 34% of GCF funding is channelled through the private sector, including via financial institutions; 19 financial institutions active in Africa, including a number of domestic and pan-African banks, have been accredited for direct access to funding in support of GCF projects. Over 30 African countries have accessed GCF funding, including Egypt, Morocco, Rwanda, Kenya and South Africa.

**Bilateral development finance institutions are also supporting the greening of Africa's financial sector.** For example, in 2017 the Dutch FMO signed a memorandum of understanding with members of the Kenyan Bankers Association to develop Kenya's green finance sector<sup>31</sup>. FMO also collaborates with private investors and other development finance institutions, such as the German KfW and the Austrian OeEB, in supporting the eco.business Fund, which invests in sustainable businesses in sub-Saharan Africa (and Latin America) through either local financial institutions or direct investments<sup>32</sup>.

## Conclusion

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**An active greening of the financial sector is already underway in Africa.** Most banks and non-bank players are aware of the risks related to climate change and are exploring green finance opportunities, sometimes with support from bilateral or multilateral institutions. Central banks and regulators are playing a role in developing the green finance market. International partners are playing an important supportive role, not only by providing finance but also in setting definitions and standards.

**However, Africa's green finance sector is still relatively underdeveloped.** Support for bond market development would help catalyse larger volumes of funding. The adoption of recognised green finance principles and strong transparency standards could also help to boost investor demand for green finance products in Africa, enabling financial institutions to benefit from favourable financing rates. Even if sufficient finance is available, African financial institutions may need support to deepen their engagement with green finance opportunities, for example by developing specific products or providing training and awareness raising to clients. Many of the banks interviewed cited lack of demand for green finance as a constraint to increasing activity in this sector. Banks and their partners may be able to do more to raise awareness of climate risks and opportunities to generate more demand from their clients.

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<sup>30</sup> <https://www.ebrd.com/news/2021/ebfd-and-green-climate-fund-extend-cooperation-by-us-500-million-.html>.

<sup>31</sup> <https://www.fmo.nl/news-detail/5253f3e7-09f6-4edb-ad39-1af4ae119155/fmo-to-promote-green-finance-innovation-in-kenya>.

<sup>32</sup> <https://www.ecobusiness.fund/en/>.

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# Partnering with African financial sectors to support businesses during the COVID-19 crisis

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## The EIB's investment in Africa

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**The European Investment Bank (EIB) has a global reach, with operations in more than 140 countries beyond Europe and in almost all African countries, and decades of development experience.** In 2020, 71% of EIB operations beyond Europe were carried out in fragile or conflict-affected situations and least developed countries. EIB lending accounts for close to 30% of EU institutions' official development assistance<sup>2</sup>.

**The EIB has been investing in Africa since 1963, financing a wide range of projects that support sustainable economic development, including private sector initiatives to create and sustain jobs.** In Africa, the EIB finances operations using its own resources, both under the external lending mandate and under the ACP-EU Partnership Agreement (Cotonou)<sup>3</sup>. In addition, the EIB lends to the private sector, both directly and via partnerships with intermediaries, through an off-balance sheet revolving fund — the ACP Investment Facility. The Bank uses the dedicated Impact Financing Envelope, under this facility, for higher-risk, higher-impact projects. The geographical spread of operations in Africa in 2020 is shown in Figure 1.

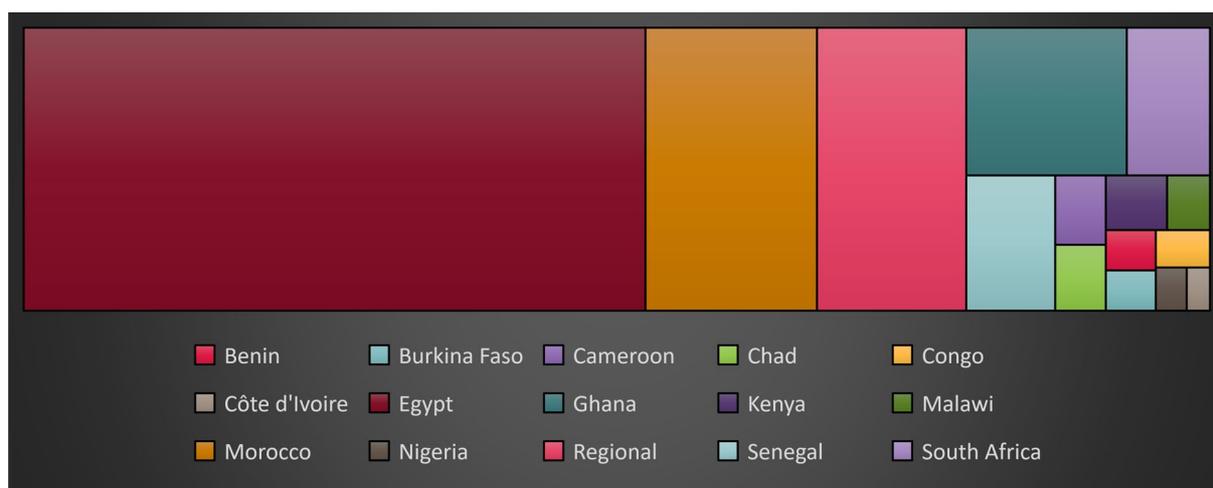
**The EIB's research provides a strong basis for its understanding of the markets where it operates.** Drawing on macro and micro data, we assess barriers and investment needs given country-specific macroeconomic and institutional contexts, focusing on strategically relevant thematic areas, such as access to finance, innovation, climate change, infrastructure and inclusion. For example, the *EIB Banking in Africa survey, 2021* provides insights into the latest trends in the banking sectors of sub-Saharan Africa. The findings from the survey carried out in early 2021 are presented in this volume and in a report by the SME Finance Forum, drafted in the context of the G20 Global Partnership for Financial Inclusion (SME Finance Forum, 2021, forthcoming). Jointly with peer international financial institutions, we foster knowledge sharing to deepen our understanding of countries' needs and investment opportunities. For example, in collaboration with the World Bank and the European Bank for Reconstruction and Development (EBRD), we have launched enterprise surveys within and beyond Europe, including in North Africa. The data collected inform evidence-based research and reveal constraints on and opportunities to promote development in targeted economies. Together with the EBRD, the World Bank Group (including the International Finance Corporation, or IFC), and the development agencies of the United Kingdom and Sweden, we established the Country Diagnostic Working Group to share perspectives and experiences of preparing country diagnostics and develop cross-institutional collaboration. The EIB is also partnering with the African Development Bank and EBRD to produce a country diagnostic for Morocco.

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<sup>2</sup> European investment Bank, 2021a.

<sup>3</sup> ACP: African, Caribbean and Pacific.

Figure 1: Geographical coverage of EIB operations in Africa, 2020



Note: The large volume of operations in Egypt reflects the fact that Egypt is the largest country in EU's immediate Southern neighbourhood, in terms of both its population and the size of its economy.

**EIB investments combine high development impact with financial sustainability (Figure 2).** The EIB invests in Africa to achieve EU policy priorities and support achievement of the Sustainable Development Goals. Projects signed in Africa in 2020<sup>4</sup> are expected to contribute towards 210 million people getting vaccinated against COVID-19, 595 400 households being supplied with newly generated energy, 778 000 people benefiting from improved water supply, and farmers benefiting from 26 500 hectares of newly irrigated land and 3 076 hectares of newly planted forest. As these projected outcomes demonstrate, the Bank is helping the European Union remain a frontrunner in implementing the 2030 Agenda and supporting Africa's Agenda 2063. As the EU bank, the EIB is fully dedicated to continuously improving the development impact of its operations.

Figure 2: Sustainable Development Goal highlights



**The EIB delivers all its investments through partnerships<sup>5</sup>.** We typically do not fund more than half of a project's total cost. The European Commission, European External Action Service and various African governments are key long-term partners for all operations in Africa. Other partners include European bilateral development finance institutions, other multilateral development banks, UN agencies, the African Union and philanthropic foundations. By working with our European, African and multilateral partners, we can maximise the positive impact of our financing to make a real difference for people across the continent.

<sup>4</sup> European Investment Bank, 2020a.

<sup>5</sup> European Investment Bank (2020a), p. 38.

**As part of Team Europe<sup>6</sup>, the EIB stepped up financing to record levels to help African partners respond to the COVID-19 health and economic crisis during 2020.** The EIB supported measures to help countries deal with the immediate health emergency and measures to address the economic fallout. Its crisis response boosted health and economic resilience, including through support for vital economic and social infrastructure. The response aimed to benefit excluded, vulnerable and disadvantaged groups, including women and young people, who have been disproportionately affected by the crisis. During the pandemic, the EIB continued to support local private sector firms, targeting micro, small and medium-sized enterprises in particular, with the support channelled through financial sector intermediaries. This has been crucial, as such companies have been hardest hit by lockdown measures and other economic impacts of COVID-19. As these small firms play key roles in African economies by helping to sustain jobs and livelihoods and, ultimately, reducing poverty, ongoing support for them from the EIB has helped to mitigate severe economic effects.

**The EIB works with African financial institutions to channel finance to firms that improve lives and create job opportunities, especially for women and young people.** Most of the Bank’s financial sector lending (87%) is implemented in partnership with commercial banks, aiming to benefit underserved private sector firms (Figure 3), particularly small and medium-sized enterprises (SMEs) and other underserved groups. The EIB also works with African public development banks, leveraging their capacity and local knowledge to contribute to achieving EU priorities such as mitigating and adapting to climate change. In 2020, for instance, the EIB partnered with the Development Bank of Ghana, providing much-needed long-term finance to strengthen the resilience of the Ghanaian economy via working capital and investment loans to micro firms, small and medium-sized enterprises and mid-caps active in the agribusiness, manufacturing, ICT and tourism sectors. North Africa benefited from the largest volumes of investment during 2020 (Figure 4), including credit lines to support private sector firms, investments in impact funds and support to microfinance institutions, all designed to benefit micro, small and medium businesses.

Figure 3: Public–private distribution of the EIB’s financial sector operations, 2020

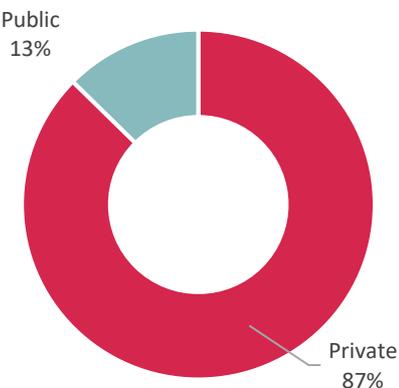
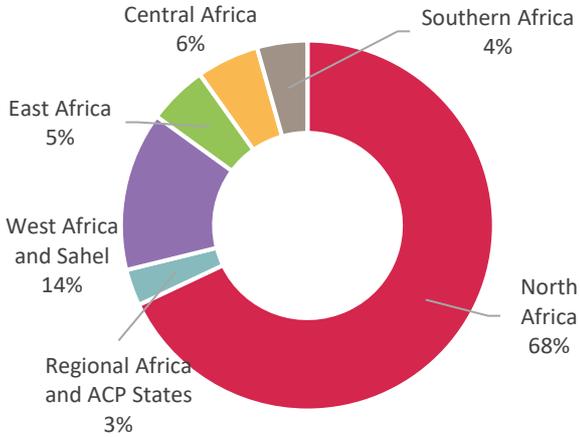


Figure 4: Regional subdivision of the EIB’s financial sector operations, 2020



**The EIB operates in line with EU policies, applying high environmental and social standards and aiming to make a positive contribution to climate action, environmental sustainability and social inclusion.** Under the EIB’s Climate Bank Roadmap for 2021–2025, the EIB has pledged that 50% of its financing will be dedicated to climate action and environmental sustainability, while the other 50% will not support operations that could harm the environment. All EIB lending is consistent with the principles and goals of the Paris Agreement. In 2020, 68% of the Bank’s financial sector operations had a climate component. The EIB has also contributed to establishing the framework for sustainable development finance at global level. For example, the EIB was the first institution to issue green bonds, and has contributed to developing the EU Taxonomy for sustainable green investments and

<sup>6</sup> Team Europe is a package launched by the European Union to support partner countries in the fight against the coronavirus pandemic and its consequences. It has now become an integral part of EU programming beyond Europe. Team Europe’s objective is to combine resources from the European Union, its Member States, and financial institutions, particularly the EIB and the EBRD. More information on the Team Europe approach is available at [https://eeas.europa.eu/headquarters/headquarters-homepage/76341/coronavirus-news-eu-action-team-europe-support-disinformation-repatriation-and-solidarity\\_en](https://eeas.europa.eu/headquarters/headquarters-homepage/76341/coronavirus-news-eu-action-team-europe-support-disinformation-repatriation-and-solidarity_en).

to implementing new regulations on non-financial disclosures that support the further development and upscaling of the climate finance sector<sup>7</sup>. This boosts the ability of financial institutions, including those in Africa, to grasp the opportunities of climate finance

**To improve the impact of its activities on women and girls, the EIB adopted a Strategy on Gender Equality and Women’s Economic Empowerment and a Gender Action Plan covering its lending, blending and advising work within and beyond the European Union.** SheInvest<sup>8</sup> is an initiative launched in 2019 that has so far mobilised over €1 billion of gender-responsive investments in Africa, boosting gender equality and female economic empowerment across the continent. Given the success of SheInvest, in 2021 the EIB committed to double to €2 billion its gender-responsive investments across Africa in cooperation with African partners<sup>9</sup>. The Bank’s increased focus on operations promoting digitalisation in Africa also creates business opportunities for young people, women and rural populations by connecting them to essential services, financing and customers.

## Partnering with financial institutions to support Africa’s private sector

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**The EIB tailors its investments and technical assistance programmes to help its clients deliver development impact.** As shown later in this section, each operation is designed to help EIB partner countries deliver on the Sustainable Development Goals, while also promoting other EU priorities such as climate action, digital transformation and gender equality. The EIB also aims to crowd in finance from other market players.

**Operations with financial sector partners are expected to deliver significant development results by reaching underserved private sector firms.** New credit lines provided in 2020 will enable local and regional banks to provide around 61 000 loans to African small and medium businesses and mid-caps. The average tenor of these loans is expected to be almost six years — significantly longer than the tenor of typical loans available in local markets. Beneficiary companies are expected to sustain around 700 000 jobs.

**The EIB can deploy a range of investment products to support its financial sector partners in achieving development impact.** These products include direct loans and equity investments, intermediated lending via banks and microfinance institutions, and investments in private equity and venture capital funds. The Bank also uses innovative risk-sharing products to catalyse private sector finance. A significant portion of the EIB’s lending, particularly in sub-Saharan Africa, is carried out in local currency. This allows our clients to reach final beneficiaries that do business mainly in local currency — often the smallest firms and those in sectors such as agriculture — without passing on the currency risk.

**The EIB can serve some larger firms directly but reaches out to smaller African private sector firms mainly through financial intermediaries.** The Bank’s intermediated investments allow the final beneficiaries to invest, innovate, create and sustain employment. As highlighted in earlier chapters of this report, private enterprises across Africa struggle to access finance for productive investment, particularly at longer tenors or in the form of equity. Financial market gaps often mean that smaller, younger firms and innovative companies are underserved, or lack access to finance altogether. The EIB works with intermediaries to reach these firms. In 2020, total signed deals for intermediated finance to micro, small and medium enterprises (including lending to banks, funds and microfinance institutions) reached €805 million in sub-Saharan Africa and the Republic of South Africa and €1.706 billion in North Africa, representing increases of 60% and 77% on the respective levels in 2019. These figures demonstrate the EIB’s commitment to supporting African private sector firms throughout the unprecedented health, economic and social crisis triggered by the pandemic.

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<sup>7</sup> To meet EU climate and energy targets for 2030 and achieve the European Green Deal objectives, investments must be directed towards sustainable projects and activities. The EU Taxonomy provides a common classification system for sustainable economic activities (European Investment Bank, 2020b).

<sup>8</sup> Gender responsiveness, according to the United Nations Development Programme’s definition, refers to outcomes that reflect an understanding of gender roles and inequalities and which make an effort to encourage equal participation and equal and fair distribution of benefits (UNDP, 2020).

<sup>9</sup> European Investment Bank, 2021c.

### Box 1: Assessing the impact of EIB projects

**We use three complementary approaches to measure our impact and our contribution to sustainable development.**

- Our results measurement framework tracks the outputs of our investments, the outcomes to which they contribute and their alignment with the Bank's strategic goals in targeted countries.
- We use macroeconomic modelling to investigate the broader economic impact of our lending.
- The EIB also invests in in-depth microeconomic research on the ground to understand the impact of our operations. Under a pilot programme in partnership with the Global Development Network, a set of talented researchers from Africa and the Caribbean carried out studies of private sector impact investment projects<sup>10</sup>. These rigorous impact studies used the most up-to-date methods and were supervised by renowned expert advisors, who provided technical advice. This approach contributed to building and supporting the local capacity of research communities in Africa and the Caribbean. The combined efforts of 30 researchers from Ethiopia, Rwanda, Senegal, Mali, Cameroon, Ghana, Nigeria, Kenya and The Gambia produced 16 impact studies. These deep dives assessed a variety of effects, including the provision of free internet in Kenyan schools, a small private health company delivering maternal and child health services in Senegal, and the contributions of microfinance to improving women's economic empowerment and economic well-being.

### Partnering with banks to reach smaller firms

**Example: The West and Central Africa COVID-19 Rapid Response Facility** dedicates €200million to addressing the adverse effects of the pandemic on the private sector, particularly small and medium businesses. The main objective is to support on-lending by financial intermediaries to private sector enterprises in West and Central Africa. This EIB facility allows intermediaries to borrow in local currency, thus eliminating the foreign exchange risk for partner banks and their clients, including small and medium firms. The facility also gives the intermediary banks access to funding at longer maturities than they can generally access on the market. This makes it possible for them to provide suitable long-term financing for capital investments by private enterprises. The short-term financing and liquidity solutions this facility offers are also very much needed to maintain business activities with the overriding objective of sustaining jobs and ensuring businesses survive the challenging economic environment.



**Example: The East Africa SME-focused Regional Facility** provides €150 million for financial intermediaries to on-lend primarily to small and medium enterprises in East Africa. The finance has been fully allocated through partnerships with banks in Kenya, Uganda and Rwanda, and the funds are expected to be fully utilised within three years. The targeted countries are low-income (with the exception of Kenya, which is lower-middle income), low human development economies, heavily dependent on agriculture. These countries have a relatively high rate of population growth, exerting pressures on youth unemployment. The private sector has great potential to support economic development and job creation but access to finance is one of the biggest impediments. To meet the on-lending needs of final beneficiaries (primarily small and medium businesses), the facility will provide loans in local currency and with longer-term maturities. Within this facility, the EIB is introducing, for the first time in sub-Saharan Africa, a specific focus on gender equality in its partnerships with banks<sup>11</sup>. Both the Ugandan Development Bank and the Development Finance Company of Uganda (DFCU) are committed to allocating at least 30% of an EIB-supported credit line or investment fund to women-owned or women-led businesses, or to businesses that create quality jobs for women or address a known gender gap through their projects and services. Support from the EIB will also help DFCU to scale up its gender strategy as part of the ShelInvest initiative. Moreover, the partnership with DFCU will support Ugandan small and medium firms. Overall, this facility is part

<sup>10</sup> The EIB-GDN Programme in Applied Development Finance. Available at <https://www.eib.org/en/publications-research/economics/impact/eib-gdn/index.htm>.

<sup>11</sup> "A financial cushion for the pillow-maker in Uganda." Available at <https://www.eib.org/en/stories/africa-gender-equality>.

of the EIB's accelerated response to help companies impacted by the economic consequences of COVID-19 and strengthen long-term resilience.



**Example: The Kenya Agriculture Value Chain Facility** combines a €50 million loan with a €10 million EU grant, aiming to integrate smallholder farmers into the agriculture value chain. Kenya's agriculture sector lacks access to financing on appropriate terms and conditions, particularly in local currency. The grant from the European Commission will provide local currency funding (without foreign exchange risk) to borrowing banks, thereby allowing the final beneficiaries in the agricultural sector to make investments at feasible rates. The EIB is working with TCX, a currency hedging fund, to make the facility available in Kenyan shillings. Given the importance of agriculture for the employment and livelihood of Kenyan women<sup>12</sup>, the operation is expected to indirectly contribute towards gender equality and empowerment of women and girls, as well as to addressing poverty and ending hunger.



**Example: The Kulima Access to Finance operation** will provide €25 million to be on-lent to private sector projects that aim to integrate smallholder farmers into commercial agriculture value chains in Malawi. This will be complemented by a €10 million risk-sharing facility, which is a loss-sharing agreement between the EIB and the Africa Investment Platform. Through this facility, the risk exposure of the portfolio of loans benefiting from the operation will be reduced. This operation aims to address market failures in the agriculture sector by providing and enhancing access to finance for underserved smallholders. Financing will be complemented by training and technical support for the participating financial intermediaries and final beneficiaries, thereby strengthening their capacity to operate within commercial value chains with higher value-added activities. This will allow them to boost their incomes and become more economically resilient.



**Example: EIB support for the Development Bank of Southern Africa Climate Finance Facility** will make up to €22 million available for on-lending to eligible projects undertaken by private businesses. This will enhance access to suitable finance for climate action projects under the Development Bank of Southern Africa's Climate Finance Facility, which is funded by the Green Climate Fund and focuses on private sector climate investments. Most of the funding is expected to benefit renewable energy, energy efficiency and water management in Southern African countries. The Bank's operation will support projects in South Africa, which is the largest market and the financial intermediary's home country.



<sup>12</sup> Agriculture, including forestry and fishing, currently accounts for about 30% of gross domestic product (GDP) and 60% of employment in Kenya. <https://www.usaid.gov/kenya/agriculture-and-food-security>; <https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS?locations=KE>; <http://www.fao.org/kenya/fao-in-kenya/kenya-at-a-glance/en/>.

**Example: The EIB supports small and medium enterprises in Egypt through a partnership with Banque du Caire, channelling \$90 million to private sector firms in product and service sectors to finance investment projects, including working capital needs.** Banque du Caire is especially well placed to serve the needs of small and medium businesses in less prosperous areas of Egypt, such as Upper Egypt, the Nile Delta and the Suez Canal Zone, which are often underserved. Half of its 222 branches are located in these areas and it is Egypt’s leading bank in the direct provision of microfinance loans, which often have the highest development impact in less well-off areas.



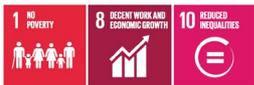
**Example: The EIB partners with Crédit Agricole du Maroc, a specialised financial sector institution, to support the agriculture and bioeconomy sector in Morocco.** The Bank’s €200 million loan will enable Crédit Agricole du Maroc to offer longer-term finance to its clients, mainly smallholder farmers. Support for micro, small and medium businesses in the bioeconomy sector, which includes primary agriculture, processing and logistics, is expected to have a strong positive impact on income generation and employment. This sector accounts for up to 20% of GDP and 40% of employment in Morocco, but bioeconomy firms often struggle to access long-term finance. As a majority state-owned bank, Crédit Agricole du Maroc is particularly well placed to reach these firms. It is Morocco’s fourth largest bank and its leading bank in the agrifood sector, with a vast presence in rural areas. The operation is accompanied by technical assistance to support the bank’s digitalisation strategy and strengthen its climate finance capabilities.



**Example: To help Egyptian small and medium enterprises and mid-caps withstand the COVID-19 crisis,** the EIB is working with the National Bank of Egypt and Banque Misr as part of Team Europe. The two facilities, amounting to €800 million and €750 million, respectively, will address the investment and working capital needs of private sector companies and are specially adapted to meet the needs of small and medium firms during the pandemic. The National Bank of Egypt and Banque Misr are the country’s two leading banks and operate extensive branch networks across all governorates, including the most underserved regions. Thus, they have key roles in the Egyptian government’s strategy to enhance access to finance for small and medium businesses. The operations build on the EIB’s successful longstanding partnerships with the two banks, which have already benefited many private sector firms. Specifically, between 2014 and 2020, the seven facilities signed with the National Bank of Egypt and Banque Misr totalling €3.9 billion provided EIB funding to over 3 700 small and medium companies and mid-caps in Egypt.



**Example: The Morocco SME Public Support COVID-19 Response** entails a €150 million loan to the Kingdom of Morocco to support the public guarantee scheme promoted by Caisse Centrale de Garantie (CCG). The project will help expand the product offer — through new COVID-19 response guarantee products — and increase the annual volume of guarantees that can be issued by the CCG. Over the period 2020-21, the CCG expects the annual volumes of guarantees issued to be more than twice the volume guaranteed in 2019. These guarantees will help commercial banks expand their lending to MSMEs by lowering the risks, thus improving access to finance.



## Lending to microfinance institutions

**By lending to microfinance institutions, the EIB is able to also reach the smallest firms.** Microfinance lending in Africa in 2020 is expected to support over 169 000 microentrepreneurs, including 75 570 women.

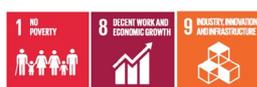
**Example: In 2020, the EIB supported the InsuResilience Investment Fund debt sub-fund** via a \$10 million debt investment. The fund lends to financial institutions and aggregators (mainly microfinance institutions) in return for participation in the development and distribution of climate risk insurance. This investment follows the Bank's \$10 million equity investment in the equity sub-fund in 2019. The fund's innovative strategy addresses one of the most pressing topics: the effects of extreme weather events and natural catastrophes. The debt sub-fund specifically aims to improve the resilience of poor and vulnerable households and micro, small and medium businesses to extreme weather events. Support is given to financial institutions based or operating in lower-income countries (those eligible to receive official development assistance) that offer their clients a loan in combination with agricultural insurance or insurance covering weather events and natural disasters.



## Private equity and venture capital

**Investments in private equity and venture capital funds** enable the EIB to reach out to early-stage companies or those moving into innovative industries or new markets — namely companies that are generally perceived as highly risky. Through the financing they received in 2020, investee companies of the EIB-supported private equity funds in Africa and neighbouring Mediterranean countries are expected to create 6 000 jobs.

**Example: The Janngo Capital Startup Fund**, which targets African technology startups and higher-risk early-stage companies, entails an equity participation of up to €15 million. It will be among the first venture capital funds to focus on West Africa. One novel feature of the fund is that it will target investee companies that strengthen market infrastructure through technology. This makes it easier for local small and medium firms to do business by helping them export (through logistics improvements), make/receive payments, sell online and access counterparts. The fund is intended to generate financial returns and produce a significant development impact, including for youth and women; it is led by and employs a significant number of women. Beyond the provision of capital, Janngo will take a hands-on approach in the portfolio companies, providing advice and technical support. The fund will also contribute to improving local ecosystems for entrepreneurs.



## Combining lending with technical assistance and advisory services to help intermediaries reach the underserved

**This report, together with the survey of African banks on which it draws, aims to enrich the evidence-base supporting our operations.** It gives an overview of the opportunities and challenges affecting banks and other financial institutions across the continent. In most sub-Saharan African countries, weak financial sector capacity is a major constraint on development. This is why we entered the €3 million Capacity Development Partnership with the International Monetary Fund (IMF) in 2017, aiming to promote macroeconomic stability, financial development and access to finance in sub-Saharan Africa. A key pillar of the partnership is a new online training course on financial development and inclusion<sup>13</sup>. Jointly developed by the EIB and IMF, this training combines IMF expertise in macroeconomic and financial sector policies with the EIB's focus on instruments. The course allows government officials and financial intermediaries to gain a deeper knowledge of financial access and inclusion topics, financial products and services designed to meet the needs of private sector enterprises, and standard risk management methodologies for lending to small and medium businesses. Since the course was launched in 2019, almost 1 000 participants invited by the EIB have enrolled, representing over 33 developing

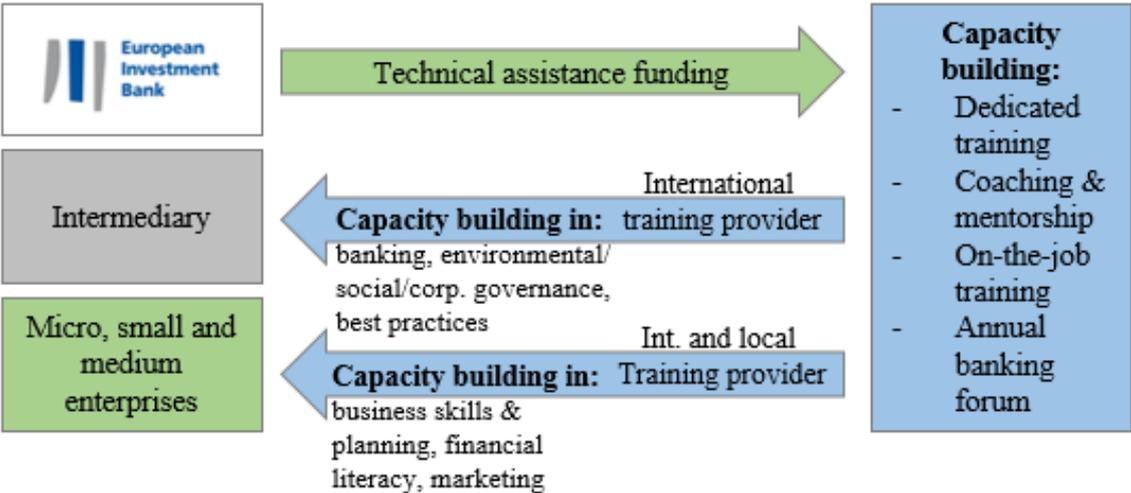
<sup>13</sup> <https://www.eib.org/en/publications-research/open-learning/financial-development-inclusion.htm>.

and developed countries (including the Dominican Republic and Somalia) across five continents. The course is offered on a continuous basis, and will be accessible until at least December 2022.

**Many EIB clients receive technical assistance alongside finance, enabling the Bank to promote the development of the financial sector to sustainably improve financial access and inclusion.** The EIB’s technical assistance offering is described in more detail in Figure 5. It helps to strengthen both the firms receiving funding and the local and regional financial sectors. Combining loans or equity finance with technical assistance enables the EIB to bring its expertise to projects and provide guidance on how to finance them. At the local level, the EIB’s technical assistance programmes can help develop the capacity and skills of local partner banks, which can then work directly with small businesses or microenterprises. Technical assistance helps financial intermediaries partnering with the EIB to improve working practices. It can also target the firms borrowing from these financial intermediaries, boosting their capacity to cope with sustainability, financial and risk management, and other issues. This support is often delivered through local training providers, including universities and banking institutes. The EIB works with local providers and focuses where possible on providing “training of trainer” programmes, aiming to ensure that training and capacity-building services can be provided locally after the EIB’s technical assistance programmes conclude. For example, the EIB, via its technical assistance programme, supports an SME Banking and Microfinance Virtual Academy for local financial institutions and small firms in Central and West Africa<sup>14</sup>.

**In 2020, the EIB signed five financial sector technical assistance operations, totalling €10.1 million.** These operations supported financial intermediaries benefiting from the Bank’s intermediated lending and equity products, as well as micro, small and medium enterprises as the final beneficiaries (Figure 5). Including operations signed in previous years, a total of 23 technical assistance operations financed by the EIB were actively supporting African financial intermediaries in 2020, including five targeting the microfinance sector. The bulk of these operations were dedicated regional programmes for the financial sectors in Southern Africa, East Africa and, more recently, West and Central Africa.

Figure 5: Delivery model of the EIB’s financial sector technical assistance for intermediated lending



**These technical assistance operations generate significant impact, which is tracked through a set of concrete indicators.** For example, under the East Africa Financial Sector Technical Assistance Programme (2014–2020), over 500 training courses were organised which benefited 11 000 bank and microfinance institution employees. Of these, 243 staff were internal trainers who will be able to continue delivering specialised training to bank staff in the future as well<sup>15</sup>. Over 25 000 micro, small and medium enterprises have benefited from business and leadership training over the six years of this programme, including 1 500 smallholder farmers trained in

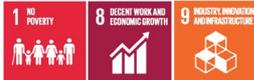
<sup>14</sup> <https://www.msmeфинanceta.eu/>.  
<sup>15</sup> European Investment Bank, 2020c.

agriculture value chain finance and over 1 700 refugees in Uganda who completed financial literacy training<sup>16</sup>. The technical assistance programmes for lending in West and Central Africa and in Southern Africa (totalling €4.2 million) focus partly on improving the financial literacy of the micro, small and medium businesses financed and on providing training at local universities, thereby fostering entrepreneurship and the sustainability of supported investments. Most technical assistance operations are expected to have a significant gender focus and contribute to increasing resilience to climate change.

**Example: The African Women Rising Initiative technical assistance programme** was launched in 2020. It aims to facilitate women entrepreneurs’ access to financial services in Côte d’Ivoire, Senegal, Uganda and Rwanda through capacity building, mentoring, and networking activities. The EIB will also support existing or potential financial intermediary clients in designing, establishing and actively promoting financial services tailored to women entrepreneurs. This three-year programme has a budget of €2 million and will seek to bridge the gap between capacity building for women entrepreneurs and improving the supply of financial and non-financial services meeting their needs. It will also have wider positive effects on economic growth, job creation and poverty reduction. Achievement of the overall objective will, in turn, contribute to realising the Sustainable Development Goals and the aims of the EIB Group Strategy on Gender Equality and Women’s Economic Empowerment.



**Example: Boost Africa** is a thematic facility of €30 million expected to mobilise over €180 million. It aims to support the earliest and riskiest stages of the entrepreneurial value chain by investing equity into early- and growth-stage venture capital funds. This joint initiative with the African Development Bank benefits from European Commission support, allowing the funding partners to invest in these relatively risky funds. The operation’s technical assistance component aims to provide support and technical/business training to investee companies and fund managers and to create investor networks. The target groups are sub-Saharan startup companies that operate in sectors where innovation can improve quality of life, particularly for poorer households, by providing access to affordable products and services.



**Example: The EIB is providing technical assistance to support the African Export-Import Bank (Afreximbank).** The Bank’s €300 million loan to Afreximbank is aimed at financing private sector trade-related infrastructure investments in sub-Saharan Africa, including at least 25% for climate action projects. These investments will be directly financed by Afreximbank or, for loans targeting small and medium enterprises, through local commercial banks. This financing will provide businesses across the continent with access to funding with tenors of up to 15 years for projects supporting climate action, and working capital to sustain jobs and maintain vital imports. A technical assistance component linked to the loan aims to support Afreximbank with project development, including expert guidance and advice on financial feasibility, technical design, environmental and social scoping (including gender issues), and legal matters.



<sup>16</sup> European Investment Bank, 2020c.

## The way forward

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**From 2021 onwards, operations will be carried out under the new EU/Africa-Caribbean-Pacific Partnership Agreement and under the EIB's own risk lending.** Financing will be provided, up to 2027, by the new Neighbourhood, Development and International Cooperation Instrument (NDICI) – Global Europe<sup>17</sup>. The EIB will also support private sector investments in Africa through the successor of the ACP Investment Facility, aiming to finance high-risk, high-impact projects, including in local currency. These investments will help African countries to continue maximising opportunities for sustainable and inclusive economic growth, which is closely aligned with EU objectives.

**Although Africa's economies are expected to begin recovering in 2021, lingering effects of the unprecedented economic shock experienced during the pandemic will make the recovery extremely challenging.** GDP contracted by an average of 2.3% across Africa during 2020 (International Monetary Fund, 2021), with the vast majority of countries experiencing a contraction. African states stepped up to support their populations and private sectors, but revenues contracted dramatically as growth plummeted, and the resulting increase in debt aggravated the already high indebtedness of many countries. These circumstances limit the capacity of African governments to support the recovery<sup>18</sup>. Although private external finance flows are recovering after a sharp fall in 2020<sup>19</sup>, and the international community is providing debt relief and other financial support, this will not be enough to cover all needs. As this publication has shown, Africa's domestic financial sectors have remained relatively resilient but are likely to have limited capacity to support the recovery, most notably due to asset quality issues.

**The impact of COVID-19 could also jeopardise the ability of public and private sectors to finance climate action and digitalisation.** To respond to the effects of the pandemic beyond Europe, the EIB Group has further increased its healthcare financing. Specifically, it has committed to provide up to €6.54 billion (as of March 2021) for urgent healthcare investment and private sector support as part of the Team Europe response deployed by the European Commission<sup>20</sup>. A recent EIB publication<sup>21</sup> on the adverse effects of the pandemic reports that smarter, more cost-effective investments are needed to improve technologies and digital solutions to respond to COVID-19. In another publication concerning the SME Access to Finance Initiative<sup>22</sup>, the EIB showcases how medium to long-term funding solutions and risk sharing can support hundreds of small and medium businesses and sustain thousands of jobs, including in Africa.

**As the bank of the European Union, fully owned by the EU Member States, the EIB implements EU policy only.** As mentioned by President Hoyer during the European Development Day 2021<sup>23</sup>, the European Union must play a stronger role in addressing the global challenges of our time. Development finance is a crucial component of strengthening EU visibility worldwide, and one key pillar is that financial institutions and development banks must invest in this transformation as Africa's partners, seeking impact in terms of job creation, tackling climate change and combating COVID-19 — truly global problems that must be confronted together. The *EIB development report 2021*<sup>24</sup> overviews the tailored support the EIB is providing to different regions, from the pre-accession countries of the Balkans to Europe's Eastern and Southern Neighbourhoods, Latin America and Asia. The report titled *A partnership with Africa*<sup>25</sup> explores the strategic and policy ideas at play in greater depth. In particular, it illustrates our enthusiastic participation in the European Commission's Team Europe initiative.

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<sup>17</sup> Proposed by the European Commission, the NDICI is a new financing instrument that aims to combine funding for programmes in different fields of EU external action into one single instrument. The budgetary framework for programmes in the fields of development, international cooperation and neighbourhood policies will be driven by a policy-based, inclusive approach under this instrument. (Immenkamp, 2021).

<sup>18</sup> The average fiscal deficit across sub-Saharan Africa rose from 4.1% of GDP in 2019 to 6.9% in 2020, while debt-to-GDP rose by 6 percentage points during 2020 (IMF, 2021).

<sup>19</sup> Private external finance for developing countries collapsed by \$700 billion in 2020, with remittances down an estimated 20%, foreign direct investment down 35% and net portfolio investment inflows down 80% (Organisation for Economic Co-operation and Development, 2020).

<sup>20</sup> European Investment Bank, 2021a.

<sup>21</sup> European Investment Bank, 2020d.

<sup>22</sup> European Investment Bank, 2020e.

<sup>23</sup> <https://www.eib.org/en/press/speeches/president-hoyer-speech-at-edds>.

<sup>24</sup> European investment Bank, 2021d.

<sup>25</sup> European Investment Bank, 2021b.

**The EIB is reorganizing its activities beyond the European Union to improve the way we deliver our development financing, in close cooperation with the European Commission and the European External Action Service.** On 15<sup>th</sup> September 2021, the EIB's Board of Directors endorsed a proposal to create a branch of the EIB focused on development finance<sup>26</sup>. The aim is to strengthen the Bank's development engagement outside the European Union. A key objective of this branch is to intensify the Bank's local presence in EU delegations, placing more bankers and engineers at the disposal of Team Europe on the ground. This will increase the EIB's development impact, responding to the growing need for stronger bonds between Europe and Africa, enhancing economic and trade ties between the two continents, and putting the European Union's climate action and development goals into operation on the ground. This reorganisation will also enhance our role in fulfilling the ambitious aspirations expressed in the strategies of our African partners.

**The EIB will continue to develop knowledge and understanding of African markets.** This publication will be updated in 2022 to include thematic analyses of the constraints on African private sector firms accessing the finance they need to flourish and to create and sustain jobs. It will also provide information about ongoing studies and results from surveys and data gathering.

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<sup>26</sup> <https://www.eib.org/en/press/all/2021-304-eib-strengthens-global-development-focus-and-backs-eur-4-8-billion-new-financing-for-energy-transport-covid-vaccines-and-business-investment>.

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## Addendum: data updates and recent developments

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Recent developments outlined in the IMF's [World Economic Outlook](#), Regional Economic Outlooks ([sub-Saharan Africa](#) and for the [Middle East and Central Asia](#)), and [Global Financial Stability Report](#), as well as discussions at this year's IMF/World Bank annual meetings in [Washington DC](#) and the COP26 in [Glasgow, reinforce the conclusions and urgency of the policy recommendations in this report](#). In particular:

**The recovery paths of developing and advanced economies are diverging.** Average incomes per person (GDP per capita) in sub-Saharan Africa are not expected to recover to their 2019 levels until 2023 and African economies will struggle to make up for lost growth. In 2024, per capita incomes in sub-Saharan Africa are expected to be almost 6% below the level that had been projected in 2019. Advanced economies, by contrast, are expected to quickly make up for the income losses they incurred during the pandemic. By 2023, incomes in advanced economies are expected to be higher than projected in 2019. As noted in the report, there are a number of reasons for this divergence. Firstly, African governments lack fiscal space and have been unable provide the same kind of fiscal stimulus that many advanced economies have. Secondly, access to vaccines remains highly unequal. By October 2021, advanced economies had fully vaccinated around 60% of their populations, while in sub-Saharan Africa the vaccination rate stood at around 2.5%. Morocco and Tunisia have achieved higher vaccination rates, but only around 11% of the Egyptian and Algerian populations have been vaccinated. The slow rollout of vaccines will make it particularly difficult for Africa's tourism sector to recover and leaves the continent vulnerable to further economic disruptions, if a new round of lockdowns has to be imposed. It also renders the continent and the whole world vulnerable to the emergence of new variants of the SARS-CoV-2 virus.

**Concerns about inflation have come to the fore.** Inflation projections for sub-Saharan Africa have been raised by around 2 percentage points, for 2021 and 2022. Inflation in Africa is being driven mainly by rising food prices. In a context where per capita incomes have shrunk, this could endanger food security and fuel social unrest. On the other hand, if the authorities respond to the uptick in inflation by tightening monetary policy, this could make the prospects for lending to the private sector, particularly to small and medium-sized enterprises, even more challenging than anticipated at the time this report was written.

**African governments are dealing with increased debt burdens, whilst external financing conditions are tightening.** As noted in the report, the COVID-19 crisis has reversed a projected fall in Africa's debt burden. During the crisis, a suspension of debt service by the G20 countries and grant-based support from the IMF helped many African countries to manage their debts. From early 2022, however, African countries will need to resume interest payments and settle arrears on suspended payments, unless they seek inclusion under the common debt treatment framework agreed by the G20. This could affect their access to market finance. So far, only three African countries have asked to participate. Africa will face these upcoming repayment deadlines in a more difficult global financial context, as advanced economies begin tapering their monetary stimulus.

**Financial stability risks have largely been contained, but concerns about asset quality in Africa's financial sectors are starting to crystallise.** The most recent [Global Financial Stability Report](#) made only slight adjustments to financial soundness and stability indicators for banks in Africa. Capital adequacy levels remain strong on average. Banks in half of the African countries that reported data actually continued to increase their average capitalisation levels during the crisis, as lending slowed. Asset quality, on the other hand, was already weak in many African countries before the crisis, with high levels of non-performing loans. Non-performing loan ratios have risen further during the crisis in half of the reporting countries. Preliminary data for 2021 suggest that the situation could get worse as policy support measures are withdrawn. As explored in the report, weaker asset quality will reduce banks' ability to finance the private sector by encouraging them to maintain and rebuild capital buffers.

**Success in digitalising, addressing climate change risks and managing the transition to net zero will determine Africa's long-term prospects.** The IMF's 2021 [Global Financial Stability Report](#) focused on "COVID, climate and crypto" demonstrating that digitalisation and climate change are seen as the critical issues for financial sector stability and soundness today. The most recent report of the [Intergovernmental Panel on Climate Change](#) underlined the urgency of the climate crisis, noting that 2020 was the second hottest year on record. The

discussions in Glasgow at COP26 have underlined the vulnerability of [developing countries](#) to the impacts of climate change and their important roles in climate action. Africa's financial institutions will need to seize the opportunities that the financing pledges made at COP26 could offer while at the same time dealing with the risk that assets could be physically damaged or become obsolete.





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