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Risks and Rewards for Financial Services Companies Banking in Africa

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Africa's economic growth is exploding. But despite projections of substantial economic expansion, banking infrastructure on the continent remains limited and largely overlooked by the international banking community. This presents opportunities for future investment by international banks to avoid being left out of the next great growth market. Emerging markets also, of course, present uncertainty and risks, which must be weighed against the potential opportunity. In this article, we examine both the potential upsides and downsides for a foreign bank considering dipping a toe into the African banking markets.

Building Business and Infrastructure

Anticipated economic growth rates in sub-Saharan Africa will average 6 percent in 2014 based on strong macroeconomic policy, domestic demand, commodity export projections and foreign direct investment.[1] Six of the ten fastest growing global economies from 2000-2010 were in sub-Saharan Africa.[2] This growth expansion provides increased opportunities for energizing the international banking presence on the continent by accessing a rising middle class of consumers, utilizing new technologies for banking and money transmission and entering an expanding home and commercial property market.

These economic gains are tempered by a perception of instability. The majority of sub-Saharan African countries have stable governance without violent conflict, and in 2013 only seven of the 48 countries in the sub-Saharan region were considered to be in active conflict.[3] However, volatility concerns are not without merit. All the countries deemed the prior decade's fastest growing economies face some degree of challenges, and Nigeria in particular over the past six months has faced increasingly severe concerns with internal safety.

The international community is taking note of the economic opportunities available for pursuit in the region. In particular, the U.S. government is actively encouraging bilateral business development. President Obama invited 47 African leaders to a summit Aug. 4-6 in Washington to discuss ways to widen U.S. trade and investment with the continent, as well as development and security. During the summit, Michael Bloomberg will co-host a day-long business forum with the Secretary of Commerce, with the focus on efforts to ''strengthen trade and financial ties between the United States and Africa.''[4] Other sponsors and partners include Visa, Eurekahedge, the CFA Society of Washington D.C. and the Regulatory Compliance Association (RCA).

While the banking community has largely sat on the sidelines, foreign direct investment in African countries

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[1] *World Economic and Financial Surveys, Regional Economic Outlook, Sub-Saharan Africa; Keeping the Pace*, International Monetary Fund (Oct. 2013), http://www.imf.org/external/pubs/ft/reo/2013/afr/eng/sreo1013.pdf.

[2] These are Angola, Nigeria, Ethiopia, Chad, Mozambique, and Rwanda. *See Africa's Impressive Growth*, The Economist (Jan. 6, 2011), http://www.economist.com/blogs/dailychart/2011/01/daily_chart.

[3] *Major Episodes of Political Violence,* Center for Systemic Peace (March 27, 2014), http://www.systemicpeace.org/warlist.htm.

[4] *Bloomberg Philanthropies & U.S. Department of Commerce Host Inaugural ''U.S.-Africa Business Forum''*, Bloomberg Philanthropies (May 21, 2014), http://www.bloomberg.org/press/releases/bloomberg-philanthropies-u-s-department-commerce-host-inaugural-u-s-africa-business-forum/

exceeded $50 billion in 2012, primarily due to projects in the extractives industries.[5] These investments have driven economic growth by creating jobs, developing infrastructure, increasing real estate values and expanding the presence of expatriate professionals. For example, De Beers moved its rough stone sorting and trading division from London to Botswana, opening the doors to its new facility in 2013.[6] The relocation included professionals, equipment and technology transfer to the capital of Botswana, Gaborone. General Electric is currently building a $250 million manufacturing plant for power generation and oil production in Nigeria.[7] Wal-Mart recently acquired a majority stake in South Africa-based retailer Massmart, with operations in twelve African markets, because they were ''convinced that this is an important region with attractive growth characteristics.''[8] Barclays, Nestle, Coca Cola, Unilever and Ford are just a few of the other corporations that have operated on the continent for decades.

Long-awaited infrastructure developments are also increasing the continent's attractiveness for new investment. A limited and expensive electricity supply has historically hampered efforts to improve manufacturing and other industrial sectors in the region. As part of many efforts to address this structural limitation, the United States in 2013 revealed an initiative called Power Africa to double access to electricity in sub-Saharan Africa.[9] The pilot countries of Ethiopia, Ghana, Kenya, Liberia, Nigeria and Tanzania will receive U.S. government assistance and private sector development.

Africa is also moving forward with the implementation of the 1991 Abuja Treaty to create a unified economic system.[10] The treaty's goal is to facilitate trade, financial transactions and banking systems by, among other things, reducing transaction costs. To implement the treaty, countries were to first join together to form regional economic communities (REC) and subsequently merge all RECs into one economic and monetary union forming an African economic community (AEC). There are now eight REC's, with the Economic Community of West African States (ECOWAS) functioning in the most robust capacity. ECOWAS includes the economic powerhouse nation of Nigeria. These cross-border regional communities expedite customs and other cross border movement through harmonizing tariffs, creating free trade zones, and developing REC passports and common visa schemes to accelerate movement of people and goods. The AEC's other goals, to harmonize monetary, financial and fiscal policies through streamlining payment and clearing house operations, will benefit a burgeoning international banking presence on the continent.

Growing Consumer Need for Secure Banking

Demographically, Africa boasts an increasingly robust urban, youthful and middle class population. The population of the continent is expected to double by 2050,[11] the bulk of whom will be young, providing a vast employment pool when many other global regions such as Europe will see their work force shrinking during this same period. Rapid urbanization has created new markets and entrepreneurship at unprecedented levels, increasing discretionary spending capacity for both individuals and governments. The demographic changes are driving domestic demand for the purchase of goods and services from cell phones to housing.

Africa is now the second-most connected global region by mobile subscriptions behind Asia, providing the primary source for internet access for the continent.[12] Half of the population of the continent is anticipated to have access to high speed LTE cellular networks within the next three years.[13] This provides a vast market for internet money transfers and banking, exposing an expanding, tech savvy, youthful and yet unbanked population, to new resources to manage their finances.

The rise of mobile banking leapfrogged the glacial pace of brick and mortar banking expansion on the continent to become the predominant mode of access to the banking community. Mobile banking benefited from rapidly increasing access to mobile phones, as well as the need to transfer remittances from diaspora populations to family members at home, along with an historical lack of faith in central banks. Mobile payments facilitated by local providers alone, though, cannot address the need of consumers to feel secure in the liquidity and value of money transferred through mobile systems.[14] Access to secure banking is also a concern for the large numbers of foreign expatriate employees on the continent looking to reliably deposit and transfer income to meet international and domestic financial obligations.

Although many countries in Africa have dependable financial and regulatory systems to govern their banking industries, access to convenient and reliable financial services for residents, expatriates and corporations

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[5] *Foreign Direct Investment to Africa Increases, Defying Global Trend for 2012*, UN Conference on Trade and Development (June 26, 2013), http://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=136

[6] James Rush, *Diamond Seller DeBeers Closes Its London Auction Rooms After Nearly 80 Years As the Company Heads to Africa*, Daily Mail (Oct. 3, 2013), http://www.dailymail.co.uk/news/article-2442403/Diamond-seller-De-Beers-closes-London-auction-rooms-nearly-80-years-company-heads-Africa.html

[7] Maram Mazen, *General Electric Plans $1 Billion Investment in NigerianPower*, Bloomberg (Jan. 31, 2013), http://www.bloomberg.com/news/2013-01-31/general-electric-plans-1-billion-investment-in-nigerian-power.html

[8] Robb M. Stewart, *Wal-Mart Sets African Offer*, The Wall Street Journal (Nov. 30, 2010),

[9] *Power Africa*, U.S.AID.com (last visited July 10, 2014), http://www.usaid.gov/powerafrica

[10] Treaty Establishing the African Economic Community, Annex III-3, June 3, 1991,

[11] Tom Gardner, *Africa's Population Set to Double to 2.4 Billion by 2050 Due to Better Medicine and Improved Health Care*, Daily Mail (Sept. 13, 2013), http://www.dailymail.co.uk/news/article-2419858/Africas-population-set-double-2-4billion-2050-better-medicine-improved-health-care.html

[12] Olusegun Abolaji Ogundeji, *African Mobile Subscriptions Make It World's Second Most Connected Region*, Computerworld (Sept. 11, 2011), http://news.idg.no/cw/art.cfm?id=65D347D9-978D-2EAA-1DB7D0F68AE51BF7

[13] *50% of the African Population to be Covered by LTE Networks by 2018*, ABIresearch (Feb. 5, 2014), https://www.abiresearch.com/press/50-of-the-african-population-to-be-covered-by-lte-

[14] Erik Heinrich, *Zimbabwe: Could it be Africa's First Cashless Economy?*, Fortune.com (Jan. 22, 2014), http://fortune.com/2014/01/22/zimbabwe-could-it-be-africas-first-cashless-economy/

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remains limited. The region is underbanked.[15] While access to credit in the private sector has increased dramatically in many African countries in the last decade, only small percentages of the adult population access this credit or open an account at a formal financial institution.[16] This provides robust opportunities and vast market potential for U.S. banks with brand recognition and solid reputations to serve this client base through brick and mortar operations, as facilitators of secure mobile banking transactions, or both. Expanding or entering the banking market in sub-Saharan Africa does come with substantial compliance issues that must be thoroughly explored and addressed prior to opening operations.

Issues to Consider Before Jumping In

U.S. banks considering entering Africa either independently or, more likely at the outset, in conjunction with correspondent partners, need to balance a number of concerns against the opportunity presented by the rapidly developing continent. Sub-Saharan Africa is an emerging market of consumers, products, resources and potential. Reaching for these rewards carries risks that must be weighed and assessed, including:

■ *Anti-money laundering (AML) and Foreign Corrupt Practices Act (FCPA) compliance issues*. Corruption remains an issue in the region, both in fact and in international perception. Regulators in the U.S. and elsewhere may apply a blanket presumption of heightened risk and skepticism to doing business in any part of the African continent. While several countries in the region are perceived globally to have less corruption risk than established market nations such as China,[17] entering any market in Africa will necessarily require establishing strong compliance systems with appropriate levels of transactional monitoring to ensure legal compliance. It is worth noting that many international banking regulations on money laundering and corruption issues are recognized within the region. South Africa, for example, is a member of the Basel Committee on Banking Supervision as well as the Financial Action Task Force (FATF), established to combat money laundering and terrorism financing. The African Development Bank, the Commonwealth Secretariat, and the Task Force on Money Laundering in Central Africa have observer status in FATF, and the Eastern and South African Anti-Money Laundering Group is a regional initiative constituted in line with FATF principles to combat issues in the region. Finally, 16 countries in Africa have established financial intelligence units, government entities that receive and investigate reports of suspicious financial activity, in compliance with The Egmont Group standards.

■ *Sanctions compliance, including screening for Office of Foreign Asset Control (OFAC) sanctions issues*. Currently, OFAC is administering sanctions regarding the following sub-Saharan African nations: Central African Republic, Cote d'Ivoire, Democratic Republic of the Congo, former Liberian Regime of Charles Taylor, Somalia, Sudan, South Sudan and Zimbabwe. Most of the listed countries are subject to only targeted sanctions, intended to isolate certain individuals and their property perceived by the U.S. government as fostering, furthering or profiting from violent conflict or the commission of human rights abuses

It is critical that U.S. companies maintain a vigilant awareness of OFAC sanctions and appropriately adhere to legal requirements regarding business operations with designated governments, persons or entities. However, even the presence of targeted sanctions does not entirely preclude business opportunities in these countries with appropriate diligence and guidance. This year, for example, Atlas Mara Co-Nvest, an acquisition company with a focus on the financial sector in Africa, completed a purchase of BancABC, a financial services company with operations in several countries including Zimbabwe.[18]

■ *Establishing procedures to monitor for Politically Exposed Persons (PEP)*. A properly structured compliance system will include research and analysis of persons considered a PEP to minimize exposure to FCPA, fraud, embezzlement and other risks triggered by business dealings with PEPs.

■ *Developing appropriate policies and procedures to ensure compliance with local regulatory regimes*. While most local African banking regulatory regimes are fairly well developed, consulting with local experts is advisable.

■ *Deciding the appropriate structure for entry*. Possible options might include opening a local branch, a subsidiary, a joint venture, or an International Banking Facility (IBF).

■ *Compliance with Basel Committee standards and best practices*.

■ *Adhering to the Patriot Act and Anti-Terrorism Act*.

Africa is riding a wave of population expansion, developing infrastructure, growing consumer markets, increasing manufacturing and rising foreign direct investment. The result is the creation of a large underbanked population in need of secure modes of saving and transferring their expanding incomes. An increasing number of corporations are banking on Africa. Financial services corporations should consider the risks and the rewards of doing the same.

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[15] "Africa is the world's most unbanked continent and it is estimated that only about 20 per cent of families have bank accounts." South Africa Groups Look to Underbanked. Financial Times. December 15, 2013. http://www.ft.com/intl/cms/s/0/10b21e82-5751-11e3-9624-00144feabdc0.html#axzz36onlapSN

[16] *See supra* n.1 at 42-43.

[17] *The 2013 Corruption Perceptions Index*, Transparency International (last visited July 10, 2014). http://cpi.transparency.org/cpi2013/. *See also* the TRACE 2013 Global Enforcement Report. *Global Enforcement Report (GER) 2013*, TRACE International Report, March 2014. http://www.traceinternational.org/Knowledge/TRACE_Publications.html

[18] Martin Arnold, *Bob Diamond Re-enters World of Banking*, Financial Times (Mar. 31, 2014), http://www.ft.com/intl/cms/s/0/9af3d958-b914-11e3-98c5-00144feabdc0.html#axzz376yoXOWJ.