Fintech as the driver for growth in Africa's banking sector

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Return to Africa Connected: Issue 2

According to the 2017 Global Findex Database,[1] about 1.7 billion adults remain unbanked, and nearly half of those live in just seven developing economies, of which Nigeria is one.[2] In 2014, it was reported that Sub-Saharan Africa, with about 350 million unbanked adults, accounts for 17% of the global unbanked population.[3]

Most people and small businesses in Africa are financially excluded, as they do no not fully participate in formal financial systems. Many transact exclusively in cash and do not have access to credit beyond their personal networks and informal lenders. Those with basic financial accounts often lack access to a broad range of financial products. As a result, there is a potential loss of deposits or savings for individuals and loss of investible funds for businesses. A heavy reliance on cash creates significant costs for financial institutions, and reduces the number of customers that they can effectively and profitably serve. It also makes it difficult for financial service providers to gather the necessary information required to assess the creditworthiness of potential borrowers, thereby creating room for fraud. Further, reliance on cash reduces government tax revenue and creates a leaky pipeline for expenditure.[4]

Access to financial services is a widely acknowledged tool for promoting credit creation and enhancing capital accumulation, and thereby increasing the levels of investment and economic activity. Fintech offers a transformational solution for Africa's banking sector. The unique environment for financial services in the continent presents a fertile ground for innovative fintech players to capitalize on the opportunities to disrupt or leapfrog established business models, in order to make financial services more affordable, accessible and profitable.

Fintech: Benefits and opportunities

Research[5] has shown that the shift from cash payments to digital payments will not only increase the number of people who own and use bank accounts, but also improve efficiency by increasing the speed of payments and reducing the cost of disbursing and receiving them. Fintech can be used to enhance the security of payments and increase transparency, and thus reduce associated crime and corruption. The Bank Verification Number was implemented by the Central Bank of Nigeria to increase security and protect bank customers from illegal transactions.

By providing access to a diverse range of financial products and services such as credit facilities for individuals and businesses, fintech can boost aggregate expenditure, thereby improving gross domestic product (GDP) levels. Provision of financial services through the use of technology also benefits the government by providing a platform to facilitate an increase in aggregate expenditure, which subsequently generates higher tax revenue from an increase in the volume of financial transactions.[6]

Additionally, financial innovation through technology can have long-term positive effects for banking performance. A recent study[7] examining the impact on bank performance of the adoption of SWIFT, a network-based technological infrastructure and set of standards for worldwide interbank telecommunication, showed that it has large effects on long-term profitability, and a significant improvement on banking performance.

Digital trends in Africa's banking sector

The widespread use of mobile phones and the internet have given rise to a new generation of financial services in Africa. The younger element of the population has rapidly adopted the use of mobile financial wallets, with partnerships between telecommunications companies and banks set to encourage and increase the use of mobile payments. Relatively simple, text-based mobile phones have powered the spread of mobile money accounts, and smartphone technology is increasingly being used to make transactions through financial institution accounts.

The Kenyan fintech sector has been dubbed one of the fastest growing on the continent, with technology increasingly defining the day-to-day running of businesses in the country. Kenya has adopted digital platform banking models whereby service providers create an ecosystem of diverse and multiple industry players in their core business, opening new growth paths. For instance, KCB Bank empowers its customers by connecting them to credible home investors and giving them the opportunity to own homes at a lesser cost.

Similarly, Equity Bank Kenya has launched Equitel, a user-friendly platform that lets customers manage their money and communicate with more freedom, choice and control. Equitel's Eazzy Loan allows users to acquire loans through their mobile phones, monitor their loan balance and make repayments through the same channel. The main advantage of this platform is that the loan is deposited directly to customers' mobile phones, and they are not required to visit the physical branch or subject themselves to any form of physical assessment.

Nigeria as a case study

Nigeria's banking ecosystem has moved to retail banking and the use of e-banking channels, which has led to improvements in financial inclusion. According to the 2017 annual report of the Central Bank of Nigeria (CBN),[8] the total value of electronic payment transactions recorded in 2017 rose by 32.5% to NGN83.1 trillion, from NGN62.7 trillion in 2016. Nigerian banks are starting to adopt more dynamic operating approaches, and introducing financial products that are in sync with the emerging digital trends. For instance, Zenith Bank launched Scan to Pay, an app that can be used by both customers and non-customers to make online and in-store payments in seconds through quick response (QR) code scanning on any internet-enabled phone. Banks and telecommunications companies have also introduced unstructured supplementary service data (USSD) codes, by which normal banking transactions can be carried out on mobile phones.

Nigeria Inter-Bank Settlement System (NIBSS) is jointly owned by all licensed banks in Nigeria, including the central bank. NIBSS operates as a shared service infrastructure for handling inter-bank payments, in order to remove potential bottlenecks. It also operates the Nigeria Automated Clearing System, which facilitates the electronic clearing of cheques and other paper-based instruments, electronic funds transfer, automated direct credits and automated direct debits. Further, NIBSS has launched the mCash payment system to facilitate low-value retail payments and grow e-payments by providing accessible electronic channels to a wider range of users, and extending e-payment benefits to payers and merchants at the bottom of the pyramid, where cash payments have been predominant.

Another trend fast becoming a reality in Africa is the use of AI. To increase levels of customer acquisition and retention, AI can be used in delivering intelligence about customer behaviors and preferences that will help in the development of personalized responses, insights and product types. AI will affect the way banks conduct financial due diligence, especially with respect to fraud detection, risk management and credit allocation. The Union Bank of Nigeria announced, in 2018, the deployment of robotic process automation (RPA) technology in its operations. This uses software tools developed to simplify and improve the efficiency of business process delivery.

Regulatory developments in Nigeria

In a bid to promote mobile money payments in Nigeria, the CBN, in August 2011, granted licenses to 14 mobile money payment providers. The CBN has demonstrated an aggressive approach toward promoting fintech in Nigeria, and introduced several regulations and guidelines in this regard.[9]

The Nigerian Communication Commission (NCC) plays an important role in the promotion of fintech. Payment services involving telecommunications infrastructure are regulated under the NCC Licence Framework for Value Added Service (VAS). Under this framework, mobile payment service providers must obtain a five-year renewable license from the NCC under the category of VAS of a commercial nature. The NCC License Framework imposes certain requirements on VAS licensees, including:

- Advertising restrictions
- Prohibition of spam, unwanted messages and hidden charges
- Storage obligations
- Provision of flexibility to consumers for opting in and out of their services

Investment opportunities in Nigeria

As fintech startups continue to underpin consumers' daily transactions, they have attracted a high caliber of global and local investors. In 2018, it was estimated that investors pumped USD73.7 million into Nigerian startups, with fintechs receiving about 75% of these investments. Similarly, in 2017, an estimated USD800 million was injected into the African economy through investments in fintech companies.

The top areas for investors looking to participate in the sector include payment services/solutions, investment, savings and credit provision platforms, the first being the lead area for investors. Notable fintech service providers in Nigeria includes Flutterwave, PiggybankNG, Paystack, WalletNG, Cellulant, Crowdy Funds, and I-Invest. Traditional financial institutions also provide these services through their mobile banking apps.

Challenges and recommendations

Provision of fintech solutions comes with challenges. A major one is the lack of technological infrastructure in Africa – for example, unreliable mobile networks. Another is the lack of trust from stakeholders in both Africa's financial institutions and the products that they offer.

The McKinsey Global Institute[10] has identified three building blocks required for powering inclusive growth of fintech in emerging economies. These are a widespread digital infrastructure; a dynamic financial services market; and digital finance products that meet the needs of individuals and businesses in ways that are superior to the informal tools available to them currently.

Physical infrastructure (such as reliable electricity and mobile networks) and financial infrastructure (that includes both an adequate payments system and a physical network to deliver payments to all corners of an economy) is key to promoting fintech. Once the digital infrastructure is in place, it needs to be supported by an enabling business environment which requires putting in place consumer protection rules to safeguard fraud and abuse. Jurisdictions like Kenya and Nigeria have enacted consumer protection laws to protect consumer rights, but it is paramount that these laws are effectively implemented. The environment must also have a competitive market structure and financial markets that are open to foreign investments. Further, the digital financial products being offered must have a true advantage over the existing alternatives in terms of cost and utility.

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[1] World Bank Group, *The Global Findex Database 2017*, pages 35-36.
[2] Ibid., page 37: More than 60 million Nigerians are without bank accounts.
[3] Asli Demirguc-Kunt, Leora Klapper, Dorothe Singer and Peter Van Oudheusden, *The Global Findex Database 2014: Measuring Financial Inclusion Around the World*, World Bank, 2015.
[4] See Kenneth S. Rogoff, The Curse of Cash, Princeton University Press, 2016.
[5] Better Than Cash Alliance, *Responsible Digital Payments Guidelines*, 2016; Asli Demirguc-Kunt, Leora Klapper and Dorothe Singer , *Financial Inclusion and Inclusive Growth: A Review of Recent Empirical Evidence*, World Bank, 2017.

[6] J. Manyika, S. Lund, M. Singer, O. White, C. Berry, *Digital Finance For All: Powering Inclusive Growth in Emerging Economies*, McKinsey Global Institute, 2016.
[7] Susan V. Scott, John Van Reenen, Markos Zachariadis, “The long-term effect of digital innovation on bank performance: An empirical study of SWIFT adoption in financial services,” *Research Policy*, volume 46, issue 5, 2017, pages 984-1004
[8] Draft *Central Bank of Nigeria Annual Report 2017*
[9] *Regulation for Bill Payments in Nigeria 2018; Regulation for Direct Debit Scheme in Nigeria 2018 Guidelines on International Mobile Money Remittance Service in Nigeria 2015; Regulatory Framework for the Use of Unstructured Supplementary Service Data for Financial Services in Nigeria 2018*, covering the use of short codes for financial transactions, which has revolutionized payment methods in Nigeria; and *Guidelines on Operations of Electronic Payment Channels in Nigeria 2016*.
[10] J. Manyika et al (n 6), pages 12-14