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Does the expansion of regional cross-border banks affect competition in Africa? Indirect evidence

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ABSTRACT

This article investigates how bank competition has evolved in Africa following the recent penetration and expansion of regional cross-border banks over the past decade. We examine changes in competition in the banking industry of seven African countries highly affected by this recent phenomenon. The evolution of competition is evaluated through three different non-structural measures of competition (Lerner index, Panzar–Rosse model, and Boone indicator). With the exception of results from the Lerner index, our findings show an intensification of competition since the mid-2000s. This period corresponds to the rapid expansion of regional cross-border banks in the zone, indicating that this expansion has promoted competition in banking sectors in Africa.

1. Introduction

During recent years, cross-border banking has become an increasingly important feature of banking systems in developing countries and emerging economies. Africa's banking landscape has substantially changed with the expansion of regional banks over recent decades (Beck et al., 2014; Claessens and van Horen, 2014a,b). African economies have traditionally had a relatively high share of foreign banks on average. Over the past decade, however, with the expansion of regional cross-border banks, African banking systems have witnessed dramatic transformations. Cross-border banks from Africa[1] have not only increased their geographic footprints[2], but have also become economically significant beyond their home countries. A number of these banks hold a significant share of assets in host country banking systems and can be considered as major players in these markets.

The expansion of regional banks raises some questions about its effect on competition, financial deepening and inclusion and financial stability across the continent. The effect on competition is probably the most important change in the short-run because incumbent banks may anticipate future transformations and react by changing their behaviors.

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[1] In this paper, we employ indifferently the following terms: cross-border banks from Africa, regional banks or African banking groups. We define these banks as originating from an African country and operating in at least three African countries.

[2] For instance, Ecobank, a Togolese bank, tripled its affiliated network in Africa from 11 to 35 countries between 2000 and 2013. United Bank for Africa from Nigeria, increased its footprints from 1 to 19 countries. Other African banks, such as Standard Bank, Bank of Africa, BSIC, Attijariwafa, BMCE, BCP and Access Bank, have more than tripled their footprints in Africa over the past decade. Orientating from their respective home countries, these banks have generally expanded first to neighboring countries, then across the region and even across the continent.

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The competitive behavior of banks may play an important role in the development, outreach, efficiency and stability of financial systems in developing countries (Turk Ariss, 2010; Léon, 2015) and may influence economic growth in Africa.

The academic literature provides nuanced messages about the consequences of foreign and regional bank expansion on competition. It is often argued that the entry of foreign banks spurs competition. First, the entry of foreign banks increases the number of players when banks enter in the form of greenfield investment. Second, when entering new markets cross-border banks have a comparative advantage in terms of better access to capital, risk diversification, scale economies, skills and management expertise. Regional banks have an additional competitive advantage dealing with countries that share similar institutional, cultural and economic characteristics. Their lending technologies and financial products are thus more adapted to the local context than those offered by foreign banks from outside continents. Ultimately, competitive edge should increase competitive pressure on the other players in the banking markets. Several factors, however, may limit the ability of African cross-border banks to increase competition in host markets. First, the entry of new banks cannot exert any effect on competition in a non-saturated market in which only a fraction of the demand is served by incumbents. Second, the effect of the entry foreign banks on competition is conditional to market strategies and degrees of engagement in host countries. The entry decision is often driven by the need to follow a client abroad or by the pursuit of business opportunities (Beck et al., 2014). In any case, entries of foreign banks have a modest impact on the degree of competition in host countries. Most skeptics argue that the entry of foreign banks might exert a negative impact on competition in financial systems with a limited number of actors. A foreign bank may become a dominant player (especially when it enters by acquiring a major incumbent bank) and reduce contestability. In addition, the fact that cross-border banks interact in many markets may reduce their willingness to compete. Multi-market contacts may reinforce collusive behaviors instead of enhancing competition (Bernheim and Whinston, 1990).

The question is whether the expansion of regional banks in Africa has contributed to increasing competition. In this paper, we provide an indirect test by studying the evolution of competition in a sample of seven West African countries (Benin, Burkina-Faso, Côte d'Ivoire, Mali, Niger, Senegal, Togo) over the period of 2002–2009. Different measures of competition based on the New Empirical Industrial Organization (NEIO) approach are employed: the Lerner index, the Panzar–Rosse H-statistic and the Boone indicator. The countries under consideration, all members of the West African Economic and Monetary Union (WAEMU), have a major advantage for our purpose. Since the mid-2000s, the WAEMU banking landscape has been dramatically changed through the arrival and expansion of new banks from Africa. These African cross-border banks began their expansion into the WAEMU zone ten years ago, while this phenomenon has occurred much more recently elsewhere on the continent. This more recent expansion is explained by the presence of two major banking groups in the WAEMU (Ecobank and Bank of Africa) and by the proximity to the WAEMU of Nigeria and Morocco. In addition, these regional banks have become significant actors in these countries. The share of assets held by regional banking groups today exceeds 10% in the seven countries under consideration. Meanwhile, the Western foreign banks (mainly from France) have reduced their presence in the zone.

Our findings reveal that the penetration of regional banks goes hand-in-hand with increased competition among banks. Data exploration shows that concentration in the WAEMU's banking industry decreased over the second part of the 2000s. The econometric results, with the exception of those from the results from the Lerner index, show that the degree of competition has increased since the mid-2000s. This time period corresponds to the rapid expansion of regional banks in the zone. Put differently, the expansion of regional banks appears to spur competition in Africa.

This paper makes several contributions to the literature on the measures of bank competition in Africa. The NEIO approach has been widely applied in the literature to assess the degree of competition in the financial services sector of developed and emerging economies. However, due to the lack of reliable data, less attention has been paid to Africa and economists often focus on the degree of competition at a given period of time in spite of recent dramatic changes. In addition, there has been a bias towards the study of a handful of former English colonies to the exclusion of others and studies focusing on or including other African countries are rather limited (Saab and Vacher, 2007; Fosu, 2013). This essay is the first to employ the NEIO approach to assess the degree of competition in the WAEMU and to study the evolution of competition over time. Second, there are few studies, even if one includes those on industrialized countries, that compare the results from different non-structural measures of competition. There is no consensus in the literature regarding the best measure by which to gauge competition (Liu et al., 2013). Comparing different models offers a more complete picture of competition insofar as each measure proxies a specific aspect of competition.

This article also contributes to the literature on the effect of the presence of foreign banks on competition. Papers have documented the impact of the entry of foreign banks on bank competition in developing and emerging countries (Claessens and Laeven, 2004; Gelos and Roldos, 2004; Yeyati and Micco, 2007). However, to our knowledge, no paper has investigated this issue in Africa. In addition, little is known about the importance of the origin of foreign investors. van Horen (2007) documents that the origin of foreign banks matters in gauging their effect on host financial systems, especially in developing countries. Pohl (2011) provides indirect evidence of the competitive pressure induced by foreign banks from developing countries in Africa. Foreign bank entry has little effect on the net margins of domestic banks. When foreign banks are split out into two groups according to their home country, the results show that the entry of foreign banks from developing countries induces lower margins. These foreign banks force domestic banks to improve their efficiency, certainly by enhancing competition. In this paper, we provide more direct evidence of the positive effect of penetration of African cross-border banks on competition.