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Bank market power, ownership, regional presence and revenue diversification: Evidence from Africa

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ABSTRACT

We provide the first evidence that African banks with greater market power in lending and deposit markets earn more from non-traditional activities. This is consistent with dominant banks' ability to identify better non-traditional opportunities and utilize their greater bargaining capacity in contract creation. Non-African-owned banks are found to exploit non-traditional banking and earn higher non-interest income. In contrast, African banks in other African countries focus more on traditional financial intermediation. Our findings are important to other emerging markets because their banks are traditionally focused on financial intermediation and regulations and supervision in relation to non-traditional activities are relatively less developed.

1. Introduction

Africa, like other emerging and developing economic regions, has undergone significant regulatory and structural changes since the 1980s following a long period of underperformance (Apergis, 2015). Financial sector reforms aimed at improving bank performance and fostering competition have encouraged African banks to expand their banking models and diversify their range of financial services (Claessens and Van Horen, 2014; Léon, 2016). These reform packages include liberalizing interest rates, restructuring and privatizing state-owned banks, removing of credit ceilings and establishing stock exchanges in Botswana, Ghana, Kenya, Malawi, Mozambique, Nigeria, South Africa, Tanzania, Tunisia, Uganda and Zambia. The

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African Development Bank Group has also approved several Financial Sector Development Support Program aimed at increasing financial inclusion of households and small and medium-sized enterprises, strengthening governance of the financial sector (banking, insurance, capital market, private equity, etc.), aligning with international standards and deepening the capital markets to include new financial instruments (ADBG, 2014).

Consequently, the share of bank non-interest income to total revenue (*NITR* in Fig. 1) in Africa, on average, has increased from 34% in 1996 to 43% in 2014. Surprisingly, this is higher than in most developed countries as well as other emerging markets in Latin America, the Caribbean, East/South Asia and the Pacific.

Given this increasing focus on non-traditional income activities and intensified competition, prior African bank studies have investigated their market structures (Aboagye et al., 2008; Al-Muharrami et al., 2006; Demetriades and Fielding, 2012; Turk-Ariss, 2009), bank performance (Apergis, 2015), efficiency and bank net interest margin (Brown et al., 2009; Olson and Zoubi, 2011). Leon (2015) compliment these works by investigating the effect of bank market power on risk and return and net interest margins, using a sample drawn from 69 developing and emerging economies including selected African ones.

Our paper adds to this growing literature on African banking markets by providing the first evidence of the role market power plays in determining revenue diversification at the bank level. Motivated by the heightened competition and revenue diversification in African banking systems, we investigate whether bank market power affects banks' share of non-interest income earned through non-traditional activities. We further scrutinize whether this relation is influenced by banks' regional presence (African banks with subsidiaries in other emerging markets in Africa) and bank ownership.

We maintain that the investigation of the relation between market power and revenue diversification is essential because market power can impact on bank non-interest income in two opposing ways. Dominant banks with greater power and earning higher interest margins may be discouraged from diversifying into non-traditional banking activities, especially when the latter income is usually subject to greater volatility and higher financial risks (Hidayat et al., 2012). Alternatively, such banks may benefit from their capacity to identify better growth opportunities in non-traditional activities and so have greater bargaining strength with their customers than less dominant banks. They might also set lower interest margins or lending rates to increase their income from commission and fee activities (Nguyen et al., 2012a). Hence, we are motivated to ask our first question (RQ1): Does market power impact on African banks' non-interest income?

We also contend that for a given level of market power, banks characterized by different ownership forms may not diversify homogenously into non-traditional activities. Foreign banks, for example, have the capacity

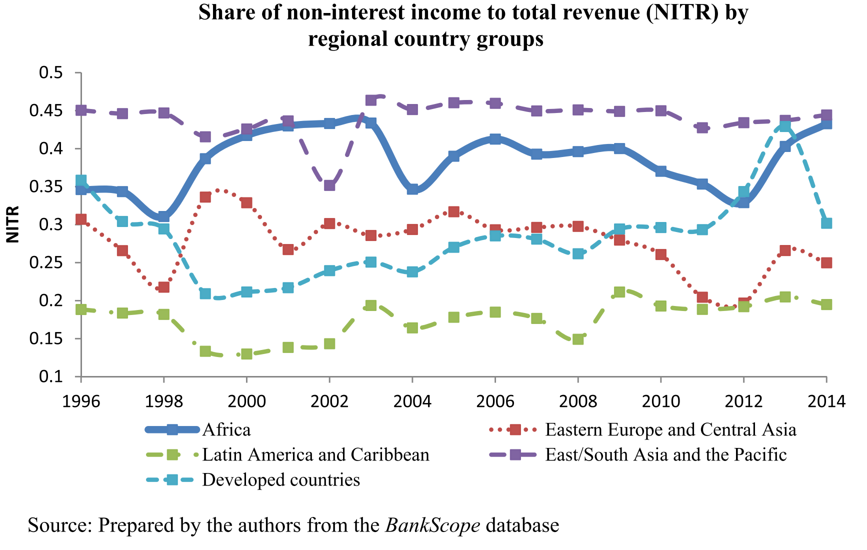

Fig. 1. Share of non-interest income to total revenue (NITR) by regional country groups.
Source: Prepared by the authors from the BankScope database.

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