



Information asymmetry and financial development dynamics in Africa

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Abstract

We examine policy thresholds of information sharing for financial development in 53 African countries for the period 2004–2011. Public credit registries (PCRs) and private credit bureaus (PCBs) are used as proxies for reducing information asymmetry whereas financial development includes all financial dimensions identified by the financial development and structure database (FDSD) of the World Bank, namely: depth, efficiency, activity and size. The empirical evidence is based on interactive generalised methods of moments with forward orthogonal deviations. The following findings are established. First, PCRs and PCBs have negative effects on financial depth, with the magnitude of the former higher. Second, contrary to PCRs which have insignificant effects, PCBs have a negative impact on banking system efficiency. Third, PCRs and PCBs have negative impacts on financial activity, with the magnitude of the latter higher. Moreover, both of their marginal effects are negative. Fourth, PCRs and PCBs have positive effects on financial size, with the effect of the former higher. While marginal effects are positive, corresponding thresholds are not within range. Policy implications are discussed.

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1. Introduction

The World Bank publication of April 2015 on world development indicators has revealed that poverty has been decreasing in all continents of the world with the exception of Africa (Asongu & Kodila-Tedika, 2015). According to the report, many countries in the continent are failing to attain the millennium development goals (MDGs) extreme poverty target (Caulderwood, 2015; World Bank, 2015) despite over two decades of growth resurgence that began in the mid-1990s (Fosu, 2015, p. 44).

There is a wide consensus from recent literature that the quality of growth needed to reduce poverty is positively driven by financial development (Asongu, 2015; Asongu & De Moor,

2015). Unfortunately, access to finance in African financial institutions has been marred by substantial issues of surplus liquidity (Saxegaard, 2006; Fouda, 2009), despite the introduction of public credit registries (PCRs) and private credit bureaus (PCBs) to mitigate the information asymmetry associated with financial development (Triki & Gajigo, 2014). The underlying measures towards reducing information asymmetry have fundamentally been linked to the imperative of increasing information-sharing among banks in order to reduce adverse selection and moral hazard between lenders and borrowers. This is supported by a large number of literature documenting that basic financial access in Africa (like credit, payments, private and corporate insurance) has been substantially constrained by a plethora of factors that limit, inter alia: eligibility, physical access and affordability (Batuo & Kupukile, 2010; Allen et al., 2011).

There has been a considerable amount of theoretical studies supporting the position that information asymmetry hereafter IA between lenders and borrowers affects financial development by reducing the efficient allocation of capital (Jappelli &

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Pagano, 2002). In essence, lenders are most often confronted with issues of adverse selection owing to their lack of information on the characteristics of borrowers, especially when it comes to risks associated with the investment for which borrowers want to mobilise financial resources. In addition, the concern is even more worrisome when lenders are unable to control the actions of borrowers after credit has been granted. Accordingly, a borrower could decide to conceal the proceeds of the underlying investment in order to reduce responsibility in event of default or prevent repayment of the underlying debt. Such tendencies are not exclusively present in insolvent borrowers since solvent borrowers could also face the temptation of manoeuvring to avoid complying with reimbursing financial obligations associated with the loan. Ultimately, in order for lenders to caution against such risks, credits are often characterised with rationing activity and high interest rates which have substantial adverse consequences for financial development, growth and poverty alleviation. These downsides can be limited by the sharing of information on borrowers' solvency characteristics. PCBs and PCRs serve as brokers for this by providing the much needed information to banks. Consistent with Jappelli and Pagano (2002), by sharing information these brokers enable, among others: the efficient allocation of capital, relaxation of credit constraints and increase of credit market competition.

In the light of the above, there has been a substantial body of the literature devoted to assessing (i) the role of IA among creditors and (ii) the effect of stronger rights to information by creditors. The former (i) has examined how the sharing of information improves credit availability (Djankov et al., 2007; Brown et al., 2009; Triki & Gajigo, 2014), reduces credit costs (Brown et al., 2009), decreases rates of default (Jappelli & Pagano, 2002), affects corruption-related lending (Barth et al., 2009), influences antitrust intervention (Coccorese, 2012) and affects syndicated bank loans (Ivashina, 2009; Tanjung et al., 2010). The latter (ii) has assessed the role of stronger creditor rights in, among others: capital structure, risk-taking by banks (Houston et al., 2010; Acharya et al., 2011) and bankruptcy (Claessens & Klapper, 2005; Djankov et al., 2007; Brockman & Unlu, 2009).

What is quite apparent in the above literature is the overwhelming focus on regions where concerns about financial access are relatively less severe. In essence, whereas the great bulk of the literature has been devoted to developed countries and the emerging economies of Asia and Latin America, very little scholarly focus have been oriented towards Africa, a continent with the lowest level of financial development (Galindo and Miller, 2001; Love and Mylenko, 2003; Barth et al., 2009; Triki & Gajigo, 2014).

Galindo and Miller (2001) have provided macroeconomic evidence to establish that countries with more advanced development in credit registries are rewarded with less financial restrictions relative to those with credit bureaus that are less developed. Particularly, credit registries that are performing well, account for substantial decreases in a firm's sensitivity in investment decisions to 'cash flows availability', a typical proxy in the literature for financial constraints. As for Latin American countries, the authors conclude that there has been a reduction

in the performance of credit registries by about 50 percent of how investment decisions are sensitive to internal funds. Love and Mylenko (2003) have combined firm-level data from the World Bank Business Environment Survey (WBES) with data on public and private credit registries to assess if: (i) from the perception of managers and (ii) higher sharing of financing from the bank, the existence of credit registries is negatively associated with credit financing constraints. Findings reveal that the presence of private registries are linked to higher shares of bank financing and lower financing constraints, whereas the presence of public registries do not appear to exert any significant impact on underlying financing constraints. Barth et al. (2009) investigate the impact of lender and borrower competition as well as the sharing of information through credit registries/bureaus on corruption in lending by banks using the WBES covering 4000 firms across 56 countries and private credit in 129 countries. Two main findings are established. First, both information sharing and banking competition mitigate 'lending corruption' and the sharing of information plays a positive role in influencing competition to curtail corruption in lending. Second, it is also found that the legal environment, firm competition and ownership structure of banks and firms, have significant effects on lending corruption. Triki and Gajigo (2014) have examined: (i) the impact of private and public credit registries on access to finance by firms and (ii) the effect of PCR's design on the seriousness of financing constraints, in 42 African countries. Their findings show that (i) access to finance is on average higher in countries with PCBs, relative to those with PCRs or neither institution and (ii) there is substantial heterogeneity in financial access and design of information-sharing institutions among countries with PCRs.

The above studies leave room for improvement in three main areas: sampling, data and methodology. First, very few lines of inquiry have been positioned on Africa, in spite of the continent having the most acute financial access problems. Consistent with this idea, Love and Mylenko (2003) and Barth et al. (2009) have positioned their inquiries on four and nine African countries respectively. Whereas Galindo and Miller (2001) involve no African country, Triki and Gajigo (2014) which is closest to the present study have based their analysis on 42 African countries for the period 2006–2009. We fill underlying gaps by working on 53 African countries for the period 2004–2011.

Second, the discussed literature above, as well as recent information sharing (Houston et al., 2010) and IA (Ivashina, 2009; Tanjung et al., 2010) literature has been limited to bank specific measurement of constraints to financial access. We steer clear of this literature by using all financial dimensions identified by the financial development and structure database (FDSD) of the World Bank. These scopes include financial dynamics of depth (overall economic depth and financial system depth), efficiency (at banking and financial systems levels), financial activity (from banking and financial system perspectives) and size. The plethora of dimensions has been documented to provide more complete policy implications (Asongu, 2014). In essence, the fundamental objective of increasing (reducing) information sharing (information asymmetry) is to improve financial intermediation efficiency and the sharing of information to boost

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