## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AfDB</td>
<td>African Development Bank</td>
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<td>AIDI</td>
<td>Africa Infrastructure Development Index</td>
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<td>BIS</td>
<td>Bank for International Settlements</td>
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<td>BMZ</td>
<td>Federal Ministry of Economic Cooperation and Development</td>
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<tr>
<td>BVMAC</td>
<td>Bourse des Valeurs Mobilières de l’Afrique Centrale</td>
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<td>BVRM</td>
<td>Bourse Régionale des Valeurs Mobilières</td>
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<tr>
<td>CAHF</td>
<td>Centre for Affordable Housing Finance in Africa</td>
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<td>DFI</td>
<td>Development finance institutions</td>
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<td>DRC</td>
<td>Democratic Republic of the Congo</td>
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<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
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<td>FSD Africa</td>
<td>Financial Sector Deepening Africa</td>
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<tr>
<td>GDP</td>
<td>Gross domestic product</td>
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<tr>
<td>GIZ</td>
<td>Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH</td>
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<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
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<td>ICA</td>
<td>Infrastructure Consortium for Africa</td>
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<tr>
<td>ICT</td>
<td>Information and communications technology</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<tr>
<td>IPO</td>
<td>Initial public offering</td>
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<tr>
<td>LTF</td>
<td>Long-term finance</td>
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<tr>
<td>MFW4A</td>
<td>Making Finance Work for Africa</td>
</tr>
<tr>
<td>N/A</td>
<td>Not available</td>
</tr>
<tr>
<td>ODF</td>
<td>Official development finance</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>PCA</td>
<td>Principal component analysis</td>
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<tr>
<td>PE</td>
<td>Private equity</td>
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<td>PPI</td>
<td>Private participation in infrastructure</td>
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<td>PPP</td>
<td>Public-private partnership</td>
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<tr>
<td>SME</td>
<td>Small and medium-sized enterprise</td>
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<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>UNECA</td>
<td>United Nations Economic Commission for Africa</td>
</tr>
<tr>
<td>VC</td>
<td>Venture capital</td>
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Executive Summary

This report highlights the need for deepening domestic markets for long-term finance (LTF) in Africa by identifying the key long-term funding gaps in infrastructure, housing, and enterprise finance and providing recommendations for addressing those gaps. The analysis is based on the work developed through the LTF Initiative, described in section 1 of this report. The Initiative has taken a two-pronged approach: a database has been assembled (the LTF Scoreboard) 1; and country diagnostics have been conducted (so far in Côte d’Ivoire, Ghana and Ethiopia). All are available at https://altf.afdb.org/. The tables next page provide an overview of the key findings and recommendations.

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1 A report on the data collection process and current data gaps can be found on the LTF Initiative’s website (Africa LTF Data Report_o.pdf (afdb.org)).
# Funding gaps in Africa

<table>
<thead>
<tr>
<th>Current state</th>
<th>Recommendations</th>
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<tbody>
<tr>
<td><strong>Infrastructure finance</strong></td>
<td></td>
</tr>
<tr>
<td>- Governments supported by multilateral and bilateral donors are still the predominant providers of long-term funding for infrastructure, most often circumventing the domestic intermediation process.</td>
<td>- Increase public and private investment to close the infrastructure gap.</td>
</tr>
<tr>
<td>- The volume of private participation in infrastructure (PPI) is still quite low, as it places considerable demands on implementation capacity and the supporting legal and regulatory framework.</td>
<td>- Develop the domestic intermediation process. Gradually reduce reliance on government financing and increase private sector investment by strengthening the local legal, regulatory, and institutional environment.</td>
</tr>
<tr>
<td>- The availability of foreign borrowing is volatile and entails foreign exchange risks that cannot easily be passed on to local users of infrastructure services.</td>
<td>- Place greater reliance on capital markets as a funding source.</td>
</tr>
<tr>
<td>- Excessive recourse to government borrowing places severe constraints on the availability of LTF for the private sector.</td>
<td>- Strengthen the institutional independence and governance of infrastructure service providers.</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Housing finance</th>
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<tbody>
<tr>
<td>- Most of the investment still comes from the DFI sector or government-related investors.</td>
<td>- Use government owned land to stimulate the development of affordable housing.</td>
</tr>
<tr>
<td>- Lending to the housing sector represents a very small proportion of bank lending and is predominantly funded by bank deposits.</td>
<td>- Develop a properly functioning land title registry.</td>
</tr>
<tr>
<td>- The average percentage of adults with loans for home purchase across the continent is still very low.</td>
<td>- Ensure land tenure for all property owners.</td>
</tr>
<tr>
<td>- Mortgage interest rates are still prohibitive for most households and carry considerable spreads over deposit rates.</td>
<td>- Increase availability of domestic private sector funding by strengthening the local legal, regulatory, and institutional environment – for example, foreclosure practices in case of default – thus strengthening the value of real estate as collateral.</td>
</tr>
<tr>
<td>- Lack of funding for land management required to formalize property ownership is a major constraint to housing development</td>
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<tr>
<th>Enterprise finance</th>
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<tbody>
<tr>
<td>- Small and medium-sized enterprises face serious challenges in accessing adequate long-term financing in Africa.</td>
<td>- Develop a more diversified set of options for SME financing to support long-term investment.</td>
</tr>
<tr>
<td>- Traditional banking products are available to most formal enterprises, but often at a high cost.</td>
<td>- Generate finance through unlisted instruments and alternative sources of finance – for example, through private equity or subordinated debt for SMEs.</td>
</tr>
<tr>
<td>- Legal, financial, and business environment factors limit the depth and availability of other products and services.</td>
<td>- Strengthen the registration of movable and immovable property.</td>
</tr>
<tr>
<td>- Alternative sources of finance, including private equity, equity and corporate bond markets – even factoring and leasing – play only a marginal role on the continent.</td>
<td>- Improve the process for foreclosure on collateral in the case of default by the borrower.</td>
</tr>
<tr>
<td>- The vast majority of SMEs do not produce financial statements that yield credible financial information and that are reliable/audited.</td>
<td>- Establish an enabling environment for credit bureaus to provide access to reliable and comprehensive information about borrowers’ current and past repayment performance.</td>
</tr>
<tr>
<td>- Lack of credit histories and collateral often results in severe credit constraints for SMEs.</td>
<td>- Reduce information asymmetry and agency costs, crucial to moving up the funding escalators and enabling larger levels of capital to be intermediated on financial markets.</td>
</tr>
<tr>
<td>- Lenders encounter problems liquidating collateral when a loan cannot be repaid.</td>
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Deepening the domestic market for LTF

Domestic markets for LTF are underdeveloped in most African economies. Large portions of domestic resources are channelled towards government lending, either in the form of loans or (short-term) debt securities. The recommendations of this report focus on the need to deepen the non-banking domestic markets for LTF by strengthening the enabling environment and institutional infrastructure.

<table>
<thead>
<tr>
<th>Sources of LTF</th>
<th>Current state</th>
<th>Recommendations</th>
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<tbody>
<tr>
<td>Domestic saving rates are still quite moderate (ca 20% of GDP across the continent, compared to an average of 25% of GDP in lower-middle-income countries).</td>
<td>Enhance domestic savings to deploy scarce domestic resources more efficiently, and to reduce exposure to potential foreign exchange risks.</td>
<td>Deepen domestic markets by developing the enabling environment and institutional infrastructure.</td>
</tr>
<tr>
<td>Foreign borrowing entails foreign exchange risks, and its availability is volatile.</td>
<td>Address the pressures brought to bear on domestic savings by the need to fund the fiscal deficit through the banking system.</td>
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<thead>
<tr>
<th>Banking</th>
<th>Current state</th>
<th>Recommendations</th>
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</thead>
<tbody>
<tr>
<td>The assets of the financial sector in Africa are heavily concentrated in banking.</td>
<td>Establish liquid government benchmark issues that can provide guidance on pricing to potential private sector issuers.</td>
<td>Address the pressures brought to bear on domestic savings by the need to fund the fiscal deficit through the banking system.</td>
</tr>
<tr>
<td>Government borrowing is a threat to the deepening of domestic markets for LTF.</td>
<td></td>
<td>Improve the regulatory framework to increase recovery rates in insolvency and stimulate banks to finance long-term investments.</td>
</tr>
<tr>
<td>The mismatch between the maturities of deposits and credits highlights the reluctance of the banking sector to finance long-term investments.</td>
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<thead>
<tr>
<th>Bond markets</th>
<th>Current state</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reflective of governments’ reliance on borrowing, the deepest segment of most capital markets in Africa is the market for government securities (mostly short-term).</td>
<td>Increase regional collaboration to promote the development of (regional) capital markets.</td>
<td></td>
</tr>
<tr>
<td>The market for non-sovereign issues on most exchanges is quite small, with the emphasis being on private placements.</td>
<td>Reduce information asymmetry and agency costs: this is crucial to moving up the funding escalators and enabling larger levels of capital to be intermediated on financial markets. (for example: higher disclosure requirements, auditing standards).</td>
<td>Reduce listing costs.</td>
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<thead>
<tr>
<th>Capital markets</th>
<th>Equity markets</th>
<th>Current state</th>
<th>Recommendations</th>
</tr>
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<tbody>
<tr>
<td>In most African countries, stock exchanges are small and dominated by a small group of large companies, even when regional exchanges service several countries.</td>
<td>Increase regional collaboration to promote the development of (regional) capital markets.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Another challenge is the lack of liquidity in African stock markets.</td>
<td>Reduce information asymmetry and agency costs: this is crucial to moving up the funding escalators and enabling larger levels of capital to be intermediated on financial markets. (for example: higher disclosure requirements, auditing standards).</td>
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<tr>
<th>Private equity</th>
<th>Current state</th>
<th>Recommendations</th>
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<tr>
<td>As in most emerging markets, the focus of private equity investors in Africa is primarily on larger enterprises that are already relatively well serviced by the banking sector.</td>
<td>Introduce mechanisms to compensate general partners for the additional costs associated with investments in smaller enterprises. Consider placing more emphasis on subordinated debt rather than private equity.</td>
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<tr>
<th>Institutional investors</th>
<th>Current state</th>
<th>Recommendations</th>
</tr>
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<tbody>
<tr>
<td>Other than government securities and real estate, institutional investors hold a significant portion of their assets as term and savings deposits with banks.</td>
<td>Standardize disclosure and reporting on investments and returns and strengthen risk management practices.</td>
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</tr>
<tr>
<td>In some cases, pension funds allow retirees to withdraw their assets in the form of lump-sums when they retire, providing an incentive for elevated short-term consumption.</td>
<td>Strengthen the enabling environment so that insurance companies and pension funds are incentivized to invest directly in quoted equity, the corporate bond market or in project finance transactions.</td>
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In this report we proceed as follows: first, we introduce the LTF Initiative (section 1); we then explain what we mean by LTF and why it matters (section 2). In section 3 we provide an overview of the data collected (accessible through https://altf.afdb.org/) by presenting the LTF Radar. Section 4 highlights the funding gaps in Africa and section 5 provides the background for the need to deepen the domestic market for LTF.
This report was written in the context of the Africa Long-Term Finance Initiative, a joint initiative of the African Development Bank (AfDB), the Financial Sector Deepening Africa (FSD Africa), the German Federal Ministry of Economic Cooperation and Development (BMZ, implemented by GIZ), and the Making Finance Work for Africa (MFW4A) Partnership. Launched in 2017, the Initiative is hosted by the AfDB in Abidjan, Côte d’Ivoire.

While markets for short-term finance in Africa are far from fully developed, considerable progress has been made over the past decade, partly driven by financial innovation. Access to finance has been enhanced through traditional sources (predominantly banks) and the deepening of short-term (mostly government) securities markets, as well as through the increasing prevalence and adoption of intermediation models pioneered by microfinance institutions, savings and credit cooperatives, agent banking, and mobile financial services. Less progress has been made in developing LTF on the continent.

Against this backdrop, the Initiative’s overarching objective is to boost the intermediation of LTF in Africa to close the financing gap for firms. This applies particularly to small and medium-sized enterprises (SMEs), as larger enterprises already have better access to LTF – as well as for housing and infrastructure projects on the continent. This objective is to be accomplished through a two-pronged approach that aims to improve market intelligence and development across Africa and to provide impetus for effective reforms at the national level.

With a view to improving market intelligence, the LTF Initiative has developed a new LTF database and scoreboard to enhance transparency about LTF in Africa and to benchmark specific indicators to provide insight into the comparative level of development of markets for LTF across Africa. The purpose is to inform policy-makers, the private sector, and donors about the availability of LTF across Africa and existing bottlenecks, and to provide impetus for reform.

In strengthening the impetus for reform, the LTF Initiative has undertaken a series of in-country diagnostics. Going beyond comparative data, the in-country diagnostics provide in-depth analysis of LTF markets in individual jurisdictions. The diagnostics encompass enterprise finance with a focus on SMEs, housing finance, and infrastructure finance. The intention is to reveal strengths and weaknesses in the specific country context and to develop policy recommendations to improve the intermediation of LTF. The diagnostics follow a transaction-focused, bottom-up approach. The team works closely with private sector stakeholders to draw from their experience in servicing markets and leverages international good practice from other developing and emerging countries in advising on financing techniques relevant to the African context.
What do we mean by LTF and why does it matter?

LTF relates to funding to support medium-term and long-term investments by enterprises, households, and governments in a country’s real economy. LTF is typically defined according to a specific threshold maturity. In practice, however, the notion of LTF has different meanings for different markets. As an orientation, the minimum threshold for LTF as applied to the enterprise sector could be one year, whereas for investments in the housing and infrastructure sector the relevant thresholds could be fifteen years. However, even within sectors different types of assets require different loan tenors. Therefore, this report adopts a flexible definition of LTF based on the underlying asset: financing is considered long-term if funding tenors match the lifetime of the productive assets being financed. In any event, the aim is to lengthen maturities to achieve congruence between financing and asset life.

LTF matters because it funds economic growth. Whereas the emphasis of policy-makers in Africa and in the donor community over the past decades has predominantly been on enhancing financial inclusion, a growing realization is that inclusion is only one side of the coin. As much as inclusion is important in reaching the marginalized or informal economy and in providing short-term loans as working capital for firms, LTF is needed to support the growth of productive activities in key economic sectors. Longer-term investments support growth by reducing costs (such as for transport and communication), thus increasing productivity and competitiveness, and creating jobs.

Africa needs to accelerate investment to generate employment for the 12 million young African people joining the labour force every year.1

LTF also matters because it reduces risks and improves the affordability of investments. It is desirable that the maturity of financing approximates the economic life of the underlying asset. Where this is not the case, investors, firms, and projects are exposed to both liquidity and interest rate risks that may severely constrain investment. Providing LTF for investment projects is also essential to achieving affordability – whether in providing infrastructure services to consumers or in facilitating enterprise finance and mortgage finance. Long tenors reduce annual debt service and allow projects to have a development or “ramp up” period before debt repayment starts. Loans to finance hydroelectric projects or toll roads, for example, require fifteen years or longer so that the amortization of the loan to pay the capital cost of the project covers a long-enough period to result in an affordable tariff to end-consumers.

LTF is a key enabler to achieve the United Nations Sustainable Development Goals (SDGs). Through the channels outlined here, increasing the availability of LTF to the local economy directly and indirectly contributes to the attainment of the goals to end poverty and hunger (SDGs 1 and 2), improve access to quality education (SDG 4), obtain clean water and sanitation (SDG 6), and develop affordable and clean energy (SDG 7).

3 Data collection overview

The LTF Radar

The LTF Scoreboard (accessible through https://altf.afdb.org/) includes a radar graph that provides an overview of how the continent or a specific country ranks across different types of indicators gauging the 4 categories of data collected: 1) Sources of LTF, 2) Depth of LTF, 3) Uses of LTF, and 4) Enabling Environment. Countries can be compared to other African countries, sub-regions, or the African continent as a whole, allowing the reader to quickly identify “weaknesses” and “strengths”. For each of the 4 categories of data the “radar graph” includes 3 selected variables that summarize the available data. Figure 1 shows the LTF Radar for the African continent, based on the data collected for the 2013–19 period.

Figure 1. LTF Radar for Africa (2013–19)

The LTF Radar (accessible through https://altf.afdb.org/) summarizes data across 4 categories: 1) Sources of LTF (domestic savings, Foreign direct investment (FDI), Official development finance (ODF); 2) Depth of LTF (private credit, insurance penetration, government bond market capitalization); 3) Uses of LTF (investment, infrastructure, loans for home purchase); and 4) Enabling environment (enforcing contracts, protection of minority investors, getting credit). Each indicator is scaled to a fixed range (0–1) using a linear transformation based on the minimum and maximum value of each indicator across all countries.

Source: LTF Scoreboard
Figure 1 shows that the level of development of the enabling environment (business environment and regulatory framework) seems capable of supporting higher levels of sources, depth, and uses of LTF. In terms of sources of LTF, the channelling of domestic savings is the mainstay of LTF promotion. Financial markets are still quite underdeveloped. Consequently, investment in enterprises, infrastructure and housing is quite low across the continent.

Based on the average country data covering roughly the last decade and the twelve indicators used in the radar chart, a principal component analysis (PCA) was undertaken and the results obtained were linked to the general conceptual framework of the Scoreboard. The PCA has the merit of identifying the cases of relatively extreme countries, and above all, highlighting a possible typology of African countries in terms of LTF.

Figure 2. Principal component analysis (PCA) based on the LTF Radar indicators (2013-19)
The figure below depicts, for each African county, the 2 principal components (the first principal component in the horizontal axis, and the second principal component in the vertical axis) of the indicators included in the LTF Radar. The first principal component is correlated with the Depth of LTF indicators. The second component is correlated with the Sources of LTF and Uses of LTF indicators. The results of the principal component analysis show that 2 major components explain almost two-thirds of the variance in the data. The first component (horizontal axis) is positively correlated with the Depth of LTF indicators and, to a lesser degree, with indicators of the level of infrastructure and the business environment. This component reflects the degree of intermediation maturity. The second component (vertical axis), on the other hand, is linked to indicators on the sources and uses of LTF, and reflects the dynamics of savings and investment, as well as the attractiveness of external capital.

Source: LTF Team, based on data from the LTF Scoreboard
The graphic visualization of the countries based on the 2 factors described above thus allows the following reading:

- South Africa is (not surprisingly) an extreme case among African countries in terms of the depth of the financial system;

- A first group, made up of around ten countries (in green), is somewhat ahead of the others in terms of LTF mobilization. This is probably because of historical and political reasons, infrastructure endowment, and development trajectory. This group includes South Africa, North African countries, Mauritius, Nigeria, Ghana and East African countries;

- A second group of countries (in grey) is catching up in terms of maturity of LTF mobilization, and has a modest positioning in the second component of savings-investment and capital mobility. This group is mainly composed by countries in Western and Central Africa;

- A third group (in yellow) has a relatively high savings and investment rate (as well as FDI). In this group we find countries endowed with natural resources (Angola, Algeria, Gabon, and Equatorial Guinea) and countries which have posted strong economic performances during the last decade.
4 LTF funding gaps in Africa

This section assesses the current funding gaps in the areas of infrastructure, housing, and SME finance to quantify the challenge at hand. The assessment is based on data available under the Uses of LTF and Enabling Environment sections in the LTF Scoreboard.

4.1 Infrastructure finance

One of the main factors hindering economic growth in Africa is insufficient infrastructure in key sectors such as power, water, and transport services that would enable firms to thrive in industries with strong comparative advantages. The current lack or poor quality of infrastructure drives up the cost of doing business and poses a severe impediment to economic diversification and growth. According to the United Nations Economic Commission for Africa, the continent’s infrastructure deficit lowers Africa’s per capita economic growth by 2% a year and firm productivity by 40%.

The Africa Infrastructure Development Index (AIDI) is a statistical indicator computed annually by the Statistics Department of AfDB to help monitor the status and progress of infrastructure development across the continent. The index scores vary between 0–100 and are based on 4 major components: (i) Transport; (ii) Electricity, (iii) ICT, and (iv) Water & Sanitation. Figure 3 below shows, for the largest economies in Africa and Africa as a whole, the evolution of the AIDI between 2013 and 2019. Although the indicator increased for all African countries during this period, as a consequence of improvements in infrastructure across the whole continent, the average score is still low (29.6 in 2019), and there are large discrepancies between countries. Egypt, South Africa, and Morocco have the highest scores, although improvements are still necessary. The scores for Ethiopia and the Democratic Republic of Congo are below 10, underscoring the necessity for significant improvements in infrastructure.

**Figure 3. Africa infrastructure development (2013–19, Index 0–100)**

This figure depicts the Africa Infrastructure Development Index (AIDI) of the largest African economies, and the average for the African continent as a whole, in 2013 and 2019. The index scores vary between 0–100. The AIDI is based on 4 major components: (i) Transport; (ii) Electricity, (iii) ICT, and (iv) Water & Sanitation.

Source: AfDB (Statistics Department)

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2. This report bases its analysis on a selection of representative larger African economies so as to be able to illustrate the outcomes of the analysis undertaken. The LTF Scoreboard includes data for all countries, when available.
Estimates for the Africa-wide infrastructure gap have increased dramatically in recent years. According to AfDB estimates, the annual infrastructure investment needs in Africa are between USD 130 billion and USD 170 billion. At the rate of current spending, this translates into an annual funding gap of USD 68 billion to USD 108 billion. The gap is significantly larger than previous estimates of USD 93 billion in investment needs and a resulting annual funding gap of USD 31 billion. The Infrastructure Consortium for Africa reports a decline in infrastructure commitments from a peak of USD 83 billion in 2013 to USD 63 billion in 2016, dropping by 21% from 2015 to 2016 alone. Infrastructure commitments regained momentum in 2017, increasing to USD 100.8 billion in 2018 – mainly because of increased contributions by African governments rising from USD 26.3 billion in 2017 to USD 37.8 billion in 2018, and by China, rising from USD 6.4 billion to USD 25.7 billion. The share of private sector commitments also increased, from USD 2.3 billion to USD 11.8 billion.

Historically, the principal source of long-term debt for infrastructure projects has been funding provided by multilateral and bilateral development finance institutions. However, the availability of concessional donor funding is constrained. Moreover, foreign borrowing in general, whether undertaken by governments or the private sector, entails foreign exchange risks that cannot easily be passed on to local users of infrastructure services, and its availability is susceptible to change.

To make greater space for domestic financing of infrastructure projects, African governments have gradually shifted toward catalysing the deepening of domestic financial markets. Long-term funding for infrastructure in Africa is still predominantly provided by circumventing the domestic intermediation process. The dominant share of infrastructure investment continues to be financed by national governments (using tax and non-tax revenues, as well as domestic and international borrowing). Little reliance is placed on funds intermediated by local financial markets, whether in the form of bank finance, private placements, syndicated loans, or public issuance of securities. The participation of domestic financial institutions is restricted, because they are constrained in being able to offer long-term loans due to their limited access to long-term funding, and they lack experience and capacity in undertaking project finance transactions. Consequently, there is very little domestic capacity for lending to infrastructure projects, and excessive reliance by governments on debt issuance to fund their own needs places severe constraints on the availability of LTF for the private sector.

The development of the domestic intermediation process is fundamental both to enhancing domestic savings and the efficient deployment of scarce domestic resources, and to reducing exposure to potential foreign exchange risks. If properly structured, corporate debt issued to finance infrastructure investments can be attractive to local institutional investors, as it matches the structure of their longer-term liabilities and creates attractive risk diversification opportunities that are well-suited to their risk-return preferences.

The progression towards greater reliance on domestic markets in the financing of infrastructure is illustrated by the funding escalator in Figure 4, which illustrates how reliance on government financing gradually declines in line with domestic market development. Governments can support the development of local sources of LTF for infrastructure by strengthening the local legal, regulatory, and institutional environment. Governments and donors alike may also need to revisit their role in development finance to ensure that scarce public resources are used as effectively as possible in catalysing private funding rather than only being used to directly fill financing gaps. Prudence in using fiscal resources is also crucial in supporting government efforts to keep public debt levels manageable. Because of risk aversion, banks prefer to invest in “risk-free” government securities rather than lend to the private sector. Where governments’ domestic borrowing is excessive, it tends to crowd out bank lending to the private sector, thereby stalling the process of financial sector deepening and the creation of sustainable domestic solutions.

Eventually, in moving up the escalator, borrowers will be able to place greater reliance on capital markets as a funding source. However, in the short to medium term, recourse to capital markets will be associated with considerable challenges relating to: (a) high preparatory costs arising from the need to corporatize the issuing utility and prepare relevant disclosure documents to potential investors (such as audited financial statements); (b) regulatory reforms (sanctioning the adjustment of tariffs to ensure cost recovery); (c) the small size of the investor base; and (d) significant issuance.
costs (in terms of preparing a prospectus, paying fees to the exchange, arrangement fees charged by banks, and so on). In addition, the advantages of issuing on the quoted market may be compromised because of the absence of market liquidity, which is important both in pricing new issues and in enabling the trading of securities on the secondary market.

Figure 4. The infrastructure funding escalator

Private sources represented only about 10% of the total investment in infrastructure in Africa in 2018. This percentage is even lower (6%) when excluding the ICT sector. To close the infrastructure gap, both public and private investment are needed. An increase in private investment can be achieved both through direct investment or through public-private partnerships (PPPs). To manage the process of attracting private sector investment, an enabling environment with sector laws and strong institutions with responsibility for the regulation of the sector are needed. It is also important that authorities establish a competitive and transparent procurement process to create confidence and achieve value for money. As PPPs bundle together project preparation, construction and service delivery, they are challenging to implement, but offer rewards in terms of strengthening innovation and fostering long-term efficiencies.

Although PPP legislation exists in the majority of countries, the volume of private participation in infrastructure (PPI) is still quite low across the whole continent. Figure 5 shows the number of countries with existing PPP legislation and the 2019 volume of PPI as a percentage of GDP for Africa as a whole, and for a selection of countries with available data. Data availability concerning the use of private sources is still very limited. Available data show that PPI still represents a small percentage of GDP (below 0.5% in most countries and 0.16% across Africa).

Note: LT = long term.
Source: LTF Initiative

Figure 5. Existence of PPP legislation and PPI (2019, % GDP)
This figure depicts the number of African countries that answered “YES” (Existing), “NO” (Non-existing) or did not answer the LTF survey question (N/A) about whether PPP legislation exists in the country (left) and the average PPI in 2019, and PPI as a percentage of GDP for a selection of countries with available data (right). PPI includes PPP projects, but also other projects and contracts with private participation that are not officially regarded as PPPs.

Key challenges in making infrastructure investment attractive to the private sector are poor credit worthiness, and the perception of political and regulatory risk. Addressing these issues will be fundamental for increasing private investment. Private sector investors in infrastructure premise their commitment on partial risk guarantees that mitigate political risk provided by development finance institutions and multilateral development banks. The limited availability of such guarantees constrains the extent of the private sector’s involvement. Reducing reliance on such instruments depends on strengthening the institutional independence and governance of infrastructure service providers.

4.2 Housing finance

Given the megatrends of urbanization and rapid population growth, greater investment in housing is critical to improving living conditions, and could be a major driver of local employment. The lack of affordable housing can undermine economic growth and exacerbate poverty. Moreover, housing finance plays a crucial role for households: it allows them to smooth their income over time and benefit from higher returns on their savings. However, housing finance is only at a nascent stage in most African countries. Although investor interest has grown over the past decade, most of the investment is still coming from the development finance institution (DFI) sector or government-related investors.

Lending to the housing sector represents a very small proportion of bank lending and is predominantly funded by bank deposits. As is the case for other medium- to long-term lending activities, banks mostly rely on term transformation of deposits to fund mortgage lending. Mortgage penetration (the ratio of outstanding loans to GDP) is still below 5% for most African countries, as illustrated in Figure 6.
Another major constraint to housing development is the lack of funding for land management required to formalize property ownership. The reliability of land titles and their transfer remains a major issue in several countries. Figure 7 illustrates this point: theRegistering Property index (Doing Business Database) is still quite low across all countries. The average African country scores 50 of the possible 100 points, and little progress has been made over the past 5 years. Procedures for registering land titles are often both lengthy and costly, and the lack of reliable land records generates land disputes. Housing markets cannot thrive without properly functioning land title registries. Land tenure needs to be recognized and secure for all property owners, including those who hold titles on a customary basis. Government-owned land can be used to stimulate the development of affordable housing, because it is usually free of litigation and thus a sought-after resource by private sector developers.

**Figure 6. Mortgage penetration (average 2013–19, % GDP)**
This figure depicts the average mortgage penetration (the volume of mortgage loans as a percentage of GDP) for a selected countries for which data is available. 

**Figure 7. Registering property (2015–19, Index 0–100)**
This figure depicts the average Doing Business Database’s Registering Property index (0–100) for Africa and a selection of large African economies in 2015 and 2019. The score for registering property is the simple average of the scores for each of the component indicators: the procedures, time, cost to transfer property between 2 local companies, as well as the Quality of Land Administration index that evaluates the reliability of infrastructure, transparency of information, geographic coverage, land dispute resolution and equal access to property rights.

**Sources:** World Bank (Doing Business Database)

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*Figure 4 does not include an average for Africa, as data are only available for 23 countries.*
Mortgage interest rates are still prohibitive for most households and carry considerable spreads over deposit rates. Lenders typically face problems when liquidating collateral in the form of real estate if a loan cannot be repaid. High mortgage interest rates reflect the costly, lengthy and uncertain process involved when foreclosing on real estate in instances of delinquency on mortgage loans. Figure 8 shows trends in average mortgage spreads (difference between the average mortgage interest rate and the real interest rate) for a selected group of countries. Average mortgage interest rates carry a spread of 4-23%.

**Figure 8. Mortgage spreads (2014–19, %)**
This figure presents, for a selected group of countries, the evolution of the average mortgage spread (the difference between the average mortgage interest rate and the real interest rate) between 2014 and 2019.

![Figure 8](image)

**Source:** World Bank (Doing Business Database)

Furthermore, the perimeter of potential borrowers that mainstream banks would consider lending to is limited due to the dominance of informal employment across the continent. As a result of the factors outlined here – legal/regulatory issues, the high costs of mortgage finance, and the preponderance of informal employment – the average percentage of adults with loans for home purchase across the continent is still very low: around 6% in 2014 and decreasing further to 4.7% in 2017 (see Figure 9). In some of the selected countries, demographic trends (population growth over the past decade) have further contributed to a decline in this percentage between 2014 and 2017.

**Figure 9. Percentage of adults with loans for home purchase (2014–17)**
This figure depicts the average percentage of adults with loans for home purchase in Africa as a whole and in the largest African economies in 2014 and 2017.

![Figure 9](image)

**Source:** Global Findex
4.3 Enterprise finance

Small and medium-sized enterprises (SMEs) play a major role in most economies, both in developing and developed countries, representing approximately 90% of all businesses and generating more than half of the worldwide employment. Most SMEs are potentially important drivers of growth and employment, but in Africa their size remains small partly because they can only access short-term and often high-cost informal funding to finance their investment needs.

SMEs face serious challenges in accessing adequate long-term financing in Africa. Because the vast majority of African SMEs do not produce financial statements that are reliable/audited, asymmetric information is a serious problem for SMEs, much more so than for larger firms. Figure 10 shows that accounting standards (such as IAS or IFRS) are not used in at least 20% of African countries.

Figure 10. Usage of auditing and accounting standards in 2019
This figure depicts the number of countries that answered “YES” (Existing), “NO” (Non-existing) or did not answer the LTF survey question (N/A) about whether auditing and accounting standards (IAS / IFRS) are used.

Furthermore, the line of demarcation between the finances of the owner(s) and those of the business is often blurred in smaller firms. The ability of lenders to assess the business prospects of the activities undertaken by their borrowers is particularly acute in the case of SMEs. The lack of information about the borrowers also aggravates the principal/agent problem inherent in all financing operations. Against this backdrop, the lack of credit histories and collateral often results in severe credit funding constraints for SMEs. Due to difficulties associated with contract enforcement, collateral requirements often exceed the value of the loan, as illustrated below for countries with available data (see Figure 11).
Figure 11. Collateral to loan ratio (2013–17, % of loan amount)
For countries with available data, this figure shows the value of collateral needed for a loan (% of the loan amount) according to the World Bank Enterprise Surveys. (Each year the survey covers a different group of countries; the latest survey year for each country is indicated between brackets next to the country name.)

Source: World Bank Enterprise Surveys

When a loan cannot be repaid, the lender invariably encounters problems liquidating the collateral, which often involves lengthy dispute resolution. As Figure 12 shows, the average Recovery Rate in Insolvency index (0–100) in the Doing Business Database is around 33 across the continent, and below that number for several of the largest economies. As a consequence, access to finance is a challenge for a significant portion of SMEs. Figure 13 depicts the Access to Finance indicator from the Doing Business Survey for a selected group of countries. This indicator measures the percentage of firms that regard access to finance as a major constraint in their operations. In most countries, around one-third of the firms experience such constraints.

Figure 12. Recovery rate in insolvency (2013–19, Index 0–100)
This figure depicts the average Doing Business Database’s Recovery Rate in Insolvency index (0–100) for Africa and a selection of the largest African economies in 2013 and 2019. The score benchmarks economies with respect to the regulatory best practice on the indicator.

Source: World Bank (Doing Business Database)
**Figure 13. Access to finance (2013–17, % of firms)**
This figure depicts for countries with available data the percentage of firms identifying access to finance as a major constraint according to the World Bank Enterprise Surveys. (Each year the survey covers a different group of countries; the latest survey year for each country is indicated between brackets next to the country name.)

![Access to finance chart](image)

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<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>% of Firms</th>
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<tbody>
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<td>Angola</td>
<td>2013</td>
<td>0</td>
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<td>DRC</td>
<td>2013</td>
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<tr>
<td>Cote d’Ivoire</td>
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<td>Nigeria</td>
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<td>Sudan</td>
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<tr>
<td>Tanzania</td>
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**Source:** World Bank Enterprise Surveys

Traditional banking products are available to most formal enterprises, but often at a high cost. Legal, financial, and business environment factors limit the depth and availability of other products and services. Alternative sources of finance, including private equity and corporate bond markets – even factoring and leasing – play only a marginal role on the continent.

Analogous to the funding of infrastructure, a progression of the LTF market can be observed in enterprise finance. Rather than seeking funding on formal markets, SMEs may need to rely on funding provided by family and friends, although such funding is unlikely to be sufficient in size and maturity to satisfy their investment needs. Figure 14 shows that according to the World Bank Enterprise Surveys less than one-fifth of all firms use banks to finance their investments in those countries covered by the surveys.

**Figure 14. Firms using banks to finance investment (2013–17, % of firms)**
This figure depicts for those countries covered by the World Bank Enterprise Surveys the percentage of firms using banks to finance investment (each year the survey covers a different group of countries; the latest survey year for each country is indicated between brackets next to the country name).

![Firms using banks chart](image)

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<td>Tanzania</td>
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**Source:** World Bank Enterprise Surveys
Nonetheless, among policy-makers the tendency has been to focus on the establishment of formal financial markets. When it comes to capital markets, policy implementation has often been focused on formal markets, and officials have not actively sought to promote the provision of a continuum of informal and formal, private, and public financing vehicles. A comprehensive review of the World Bank’s approach to capital market development in 2016 found that equity market interventions, particularly when targeted at listing local SMEs on the stock exchange, had only limited success.12

A more diversified set of options for SME financing is required to support long-term investment. Due to their complexity, the costs of issuance, and lack of liquidity, particularly when it comes to smaller issue-sizes, making a dent in filling the gap in long-term financing is unlikely to take place on listed, public markets. Rather, financing is likely to be generated through unlisted instruments and alternative sources of finance— for example, through private equity or subordinated debt for SMEs. Another example is SME funds. Such funds specializing in SME investment, such as COFINA in Côte d’Ivoire, are able to attract capital by listing on the stock exchange. Experience elsewhere with this approach suggests that such funds are more likely to succeed than encouraging SMEs to list directly on a stock exchange. Figure 15 illustrates how different sources of finance progressively become more available at various stages of market development. The evolution ranges from funds provided by family and friends, angel investors, and venture capital at one end of the spectrum, to private equity and listed instruments at the other end.

Figure 15. The enterprise funding escalator

![Image](image_url)

Note: VC = venture capital; IPO = initial public offering.
Source: LTF Initiative

Government interventions in the market for SME finance are different from in the infrastructure sectors. Experience suggests that providing direct funding to SMEs is unlikely to be a sustainable approach, mostly because public institutions have difficulty assessing credit risks and implementing commercially sustainable lending practices. In recent years, governments have used more catalytic approaches designed to support private banks in developing their capacity to lend to SMEs, such as credit lines and partial credit guarantees.13 Rather than lending directly to SMEs, Nigeria and Ghana recently established development banks to adopt a wholesale model. In this arrangement, funding is provided to private banks with the advantage that responsibility for credit risk management remains with the private sector. Their governance structures with professionally qualified boards and the requirement that they be financially sustainable distinguishes these banks from previous generations of similar institutions. While it is part of the mandate of these banks to expand the provision of partial credit guarantees, as yet the existence of guarantee schemes targeted at LTF is very limited. Figure 16 shows that only about 20 countries have indicated in the LTF Survey that guarantee schemes targeted at LTF (either for enterprise or infrastructure finance) existed in 2019.

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12 Independent Evaluation Group, World Bank Group, “The World Bank Group’s Support to Capital Market Development” (Washington, DC: World Bank, 2016), 120. The report finds that the “costs of the traditional model of being a ‘public, listed company’ are inherently too high for most small businesses.”

13 Partial credit guarantee schemes can play an important catalytic role only if they are financially sustainable. The success of partial credit guarantees is highly dependent on their design, including factors such as: guarantee coverage, adequacy of fees charged, reliability and speed of payout in case of borrower default, and utilization, in particular banks’ capacity to deploy the guarantee.
In addition, the authorities have a major role to play in improving the legal and regulatory environment for SME lending. This is principally in strengthening the registration of movable and immovable property, improving the process for foreclosure on collateral in the case of default by the borrower, and establishing the enabling environment for credit bureaus to provide access to reliable and comprehensive information – particularly about small borrowers’ current and past repayment performance.

Moving up each step on the funding escalator is predicated on a reduction in information asymmetry and in agency costs. As formality in the provision of capital rises, financial markets can intermediate larger amounts of capital. Thus, there is a correlation between the steps on the escalator and the progression from market opacity to greater transparency.

For the purposes of the assessment provided in this report, there are 2 crucial takeaways:

First, public capital markets are at the highest level on the escalators. At early stages of market development, capital markets with publicly listed companies represent only a small fraction of the LTF being intermediated in the economy. Such markets may well be able to function without the remaining components being active, but it is unlikely that they will be able to flourish, as financiers (whether they are governments or private sponsors) will gradually work their way up the escalators in generating “deal-flow”. Leapfrogging is likely to be the exception rather than the rule.

Second, reducing information asymmetry and agency costs is crucial to moving up the funding escalators and enabling larger levels of capital to be intermediated on financial markets. There is a logical relationship between moving up the steps on the escalator and progression from market opacity to greater transparency. At earlier stages of development with little private sector involvement in infrastructure finance – when enterprises largely rely on informal sources of finance (family or friends) and banks and homeowners predominantly rely on building their homes incrementally from current savings – little information is available to those agents who might arrange for third-party funding. Overcoming information asymmetries and reducing the agency costs are challenges that cut to the core of the effort to develop markets that can better serve the long-term funding needs of developing African economies.
Deepening the domestic market

5.1 Sources of LTF

The focus of this report is primarily on deepening the domestic market for LTF. Although deepening domestic markets is a medium- to long-term endeavour, it is fundamental both to enhancing domestic savings, the efficient deployment of scarce domestic resources, and to reducing exposure to potential foreign exchange risks. This section analyses the current state of domestic sources of finance (domestic savings) and foreign sources of finance (remittances, foreign direct investment, official development finance and cross-border lending). This assessment is based on data available under the section Sources of LTF in the LTF Scoreboard. As shown in Figure 17, official development finance (ODF) represents less than 10% of GDP in the selected larger African economies, and in general ODF decreases as economies develop.

Figure 17. Sources of finance (2019, % GDP)
The sources of finance depicted in this figure are gross domestic savings, remittances inflow, foreign direct investment, official development finance, and cross-border lending, scaled by GDP. The figure depicts, for each source of finance, the average across the continent in 2019, and the percentage for each country in the same year.

Domestic savings in African countries constitute ca. 20% of GDP (see Figure 18 for a comparison among a selected group of countries between 2013 and 2019). In several countries, the general trend in savings has been declining for over two decades, partly due to the increasing demands placed by the funding needs of governments. These demands restrict the private sector’s access to capital, which reduces productivity, employment and savings. Even though developing economies will likely continue to rely on foreign capital resources as an important source of investment financing for the foreseeable future, foreign borrowing entails foreign exchange risks.
that cannot easily be passed on to local users of financial services. Also, its availability – whether in the form of foreign direct investment, portfolio investment, or recourse to foreign borrowing – is volatile. Strengthening the domestic financial system, particularly the enabling environment and institutional infrastructure, will be important in gradually increasing both the depth of local markets and reliance on domestic funding sources.

**Figure 18. Gross domestic savings (2013–19, % GDP)**
This figure depicts the average gross domestic savings (as a percentage of GDP) in Africa as a whole and in the largest African economies in 2013 and 2019.

\[ \text{Source: AfDB (Statistics Department)} \]

Similarly, strengthening the domestic financial system will be key to attracting foreign sources of capital, such as foreign direct investment and portfolio investments, which are very susceptible to swings in investor confidence. Figure 19 shows that the levels of foreign direct investment are quite modest across Africa, accounting for 2–3% of GDP in the largest African economies. Cross-border lending, on the other hand, is more substantial in countries with more advanced capital markets, such as South Africa and Morocco, accounting on average for around 10% of GDP. But in the majority of countries such portfolio investments are concentrated in government securities.

**Figure 19. Foreign direct investment and cross-border lending (2013–19, % GDP)**
This figure depicts the average foreign direct investment (left) and cross-border lending (right) as a percentage of GDP in Africa as a whole, and in the largest African economies in 2013 and 2019.

\[ \text{Source: UNCTAD (left-hand figure) and BIS (right-hand figure)} \]
5.2  Depth of LTF

This section reviews the contribution of different segments of the financial system to providing the economy with long-term financing for the purpose of infrastructure, housing and enterprise finance. The main sources of finance considered by the LTF framework are bank finance, capital market finance, and institutional investors. The assessment in this section is based on data available on Depth of LTF and Enabling Environment in the LTF Scoreboard.

As this section illustrates, most African countries find themselves still largely reliant on funding from banks. Local public capital markets play an insignificant role in most countries. Figure 20 shows, for the largest economies in Africa, the relative sizes of the banking system (commercial banks’ assets), capital markets (bond and stock market capitalization) and the institutional investor base (insurance companies and pension funds’ assets). The size of each sector is presented as a percentage of GDP. With a small number of exceptions (most notably South Africa and Morocco), the banking sector still represents the largest source of funding in most African countries.

Figure 20. Depth of the financial system (2016\(^4\), % of GDP)

The depth of the financial system depicted in this figure is gauged by commercial banks’ assets, government bond market capitalization, corporate bond market capitalization, and stock market capitalization. The figure shows, for each indicator, the average across the continent in 2016 and the percentage for each country in the same year, scaled by GDP.

Sources: World Bank (World Development Indicators) and BIS, supplemented by the LTF Survey

\(^4\) Data on government and corporate bonds are only available until 2016.
5.2.1 Banking

The assets of the financial sector in Africa are heavily concentrated in banking. While the banking system plays a dominant role, the willingness of banks to provide long-term lending (maturity > 5 years) is highly constrained. This situation is partly an outcome of risk aversion on the part of banks, but it also reflects regulatory limitations on the maturity transformation that banks are allowed to undertake according to regulations.

Recent tightening of banking regulations provides impetus for moving up the funding escalator. Banking oversight and regulations have been strengthened with the purpose of increasing the banking system’s resilience to shocks and strengthen its soundness and capacity to service the economy’s future financing needs. However, in countries that are dependent on banking as the main provider of finance, such regulations can make banks less willing to lend to projects beyond a duration that is much shorter than the expected productive life of the investments being financed. Other regulatory changes could serve to encourage the development of non-bank financing channels – that is, moving up the funding escalator by increasing the contribution of the domestic capital markets as a source of investment finance. This could be done, for example, by unifying sovereign financing instruments and issuance practices, so as to increase market depth and to establish a liquid benchmark for pricing longer-term financing risk, and adopting a standard so-called global master repurchase agreement on the money market. This would address concerns about counterparty risks and enhance liquidity on the secondary market for government securities.

**Government borrowing is a threat to the deepening of domestic markets for LTF in Africa.** Government financing needs on domestic security markets inevitably put upward pressure on the yield on government securities. Unless governments address the pressures brought to bear on domestic savings by the need to fund their fiscal deficits, private sector resources will not be available to deepen the domestic provision of LTF to the private sector. Figure 21 shows that, except for countries such as South Africa and Morocco, foreign (external) debt still represents a small proportion of credit in most African countries. Moreover, most of the foreign credit is directed towards the public sector. Less than 25% of foreign debt is provided to the private sector. The percentage is lower in most countries and has declined over the past decade.

**Figure 21. Domestic private credit (2019, % GDP) and private external debt (2013–19, % of total debt)**

For Africa as a whole and the largest African economies, this figure shows average domestic private credit and external debt (external debt stock of the public sector and the private sector) as a percentage of GDP (left) in 2019, and private external debt as a percentage of total external debt (right) in 2013 and 2019.

Source: World Bank (International Debt Statistics)
As a consequence, most enterprises face difficulties in getting credit. Although access to credit improved between 2013 and 2019, the Doing Business Database’s Getting Credit index shows that less than half of the largest African economies score more than 50 out of the possible maximum score of 100. Across the continent, the percentage of borrowers accessing credit from commercial banks is lower than 5%, as illustrated in Figure 22 and Figure 23.

**Figure 22. Getting credit (2013–19, Index 0–100)**
This figure depicts the average Doing Business Database’s Getting Credit index (0–100) for Africa and the largest African economies in 2013 and 2019. The score measures the ease with which enterprises are able to access credit, reflecting the legal rights of borrowers and lenders with respect to secured transactions and the reporting of credit information.

![Getting credit index](image)

**Source:** World Bank (Doing Business Database)

**Figure 23. Borrowers from commercial banks (2013–16, per 1000 adults)**
This figure depicts the average number of borrowers from commercial banks per 1000 adults in Africa as a whole, and for a selected number of countries with available data in 2013 and 2019. Borrowers from commercial banks are the reported number of resident customers that are non-financial corporations (public and private) and households that obtained loans from banks.

![Borrowers from commercial banks](image)

**Source:** World Bank (World Development Indicators)
The mismatch between the maturities of deposits and credits highlights the reluctance of the banking sector to finance long-term investments. As Figure 24 shows (for a selected group of countries for which data are available), long-term deposits (maturity > 5 years) represent a larger portion of GDP than long-term credits in all countries except South Africa. This means that in many countries banks are unwilling to expose themselves to longer-term risk, even where they have the capacity to do so, seen from the perspective of matching the maturity risks on their assets and liabilities.

**Figure 24. Long-term deposits and credits (2013-19, % GDP)**
This figure depicts, for a number of countries with data available, the volume of long-term deposits (top) and long-term credits (bottom) (maturity > 5 years) as a percentage of GDP in 2013 and 2019.

5.2.2 Capital markets

5.2.2.1 Bond markets

A well-functioning market for government securities is essential to financing the government’s debt, but also to building the foundations for longer-term domestic financial intermediation. Reflective of governments’ reliance on borrowing, the deepest segment of most capital markets in Africa is the market for government securities. However, government debt is financed predominantly with short-term securities. Governments can strengthen the liquidity of markets for government debt and reduce their refinancing risks by extending the maturity of government debt issuances.
The market for non-sovereign issues on most exchanges is quite small, with the emphasis being on private placements. Gaining sufficient investor interest in private placements is difficult when the cost of borrowing is high due to the pressures brought to bear by the simultaneous issuance of sovereign debt (crowding out) and the fact that investors have credit risk concerns because of the insufficiently high credit ratings achieved by borrowers. Creating local credit rating agencies could make it easier for prospective local issuers to access credit assessment services and for investors to assess risk in a systematic way.

Sources: Bank for International Settlements (BIS), supplemented by the LTF Survey

Figure 25. Government bond issuance and volume of outstanding government bonds (2013–19, % GDP)
This figure depicts the average government bond issuance (left) and volume of outstanding government bonds (right) as a percentage of GDP in Africa as a whole, and in the largest African economies with available data in 2013 and 2019.

Sources: Bank for International Settlements (BIS), supplemented by the LTF Survey

Figure 26. Corporate bond market capitalization (2013–17, % GDP)
This figure depicts the outstanding value of corporate bonds issued as a percentage of GDP in countries with available data in 2013 and 2017.

Sources: Bank for International Settlements (BIS), supplemented by the LTF Survey
5.2.2.2 Equity markets

In most African countries, when existing, stock exchanges are small, even in the case of regional exchanges that benefit from economies of scale in servicing several countries (BRVM and BVMAC*). Corporations find issuance of equity and bonds on the exchange to be less attractive because of: (a) competitive interest rates offered by banks to those companies that reach the critical size to be able to access the bonds market; (b) the disclosure and governance requirements imposed; (c) the high issuance costs associated with preparation of prospectuses and other issuance materials, in addition to brokerage fees and other costs; (d) the lapse of time in gaining authorization to make an issue; and (e) the relatively cumbersome process of arranging listings using a syndicate of intermediaries.

Altogether these factors make issuance of securities relatively unattractive compared to bank financing. Figure 27 shows the number of listed firms in the largest African stock exchanges, and the share of the top ten listed firms in the total market capitalization of those exchanges. With the exceptions of South Africa, Nigeria, and Egypt, stock exchanges in Africa are quite shallow, and dominated by a small group of large companies. Eventually, issuance on the capital market could prove to be attractive to enterprises as a means of diversifying the source of funding and providing competition to interest rates offered by banks. However, there seems to be little evidence that this is the case on most markets today.

Figure 27. Number of listed firms (2013–2019) and share of top ten firms in market capitalization (average 2013–19, %)

This figure presents the number of listed firms in 2013 and 2019 (left) and the average market capitalization of the top ten companies as a percentage of total market capitalization between 2013 and 2019 (right) for a selected number of countries with available data.

Sources: World Bank (World Development Indicators), supplemented by the LTF Survey

Another challenge is the lack of liquidity in African stock markets. Figure 28 shows that the average turnover of the stock markets in the largest African economies is around 6%. This is far below the world average, which has hovered around 100% over the past 2 decades. Liquidity did not improve between 2013 and 2019, except in the most liquid of these markets – Egypt and South Africa – where turnovers reached 25% and 33%, respectively, in 2019. Given the relatively small size of other parts of the capital markets, much depends on resolving the challenges associated with establishing liquid government benchmark issues that can provide guidance on pricing to potential private sector issuers.

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*Fifteen countries in Africa do not have a stock exchange, most notably Ethiopia, Angola, and the Democratic Republic of the Congo.
*Bourse Régionale des Valeurs Mobilières (the regional securities exchange for West Africa), and Bourse des Valeurs Mobilières de l’Afrique Centrale (the regional securities exchange for Central Africa).
Another important factor for the deepening of financial markets is the regulatory framework surrounding those markets. One of the aspects of the regulatory environment is the protection of minority investors. Figure 29 shows that the average index of investor protection (Doing Business Database) across the continent is, on average, below 60/100.

**Sources:** World Bank (Doing Business Database)
5.2.2.3 Private equity

As in most emerging markets, the focus of private equity investors in Africa is primarily on larger enterprises that are already relatively well serviced by the banking sector. In contrast, small enterprises are less attractive to private equity managers because of the additional resources required, both in assessing the viability of a larger number of small prospective investee enterprises and in mentoring and monitoring many small investee enterprises. Also seen from the perspective of SME owners, PE is often not that attractive, because it requires them to cede/dilute control and income upside on their own equity. Even those PE funds that do initially target SMEs tend, over time, to graduate towards investment in larger enterprises. This is because the costs associated with evaluating, preparing, and monitoring many small investments incentivizes PE fund managers to migrate to fund larger enterprises.

If the objective of supporting finance of smaller enterprises is to be achieved, it becomes important to find a mechanism to compensate general partners for the additional costs associated with investments in smaller enterprises. Finally, exit from PE at the close of the PE’s funds investment period is problematic, as local capital markets are underdeveloped. In this context, subordinated debt funds may be an attractive alternative funding method. In addition to resolving the issue of exit and resolving the issue of diluting the equity of SME owners, debt funds provide a risk profile which is more attractive to pension fund trustees. Figure 30 shows the relatively limited extent to which African countries benefit from PE.
Figure 30. Number of private equity deals and amount raised (2013–17, % GDP)
This figure presents the number of private equity deals (left) and the amount raised as a percentage of GDP (right) in 2013 and 2019 for a selected number of countries with available data.

Source: EMPEA/AVCA
5.2.3 Institutional investors

Institutional investors, such as pension funds, insurance companies and sovereign wealth funds, have longer-term investment horizons and provide a natural source of longer-term investment resources. Institutional investors manage approximately USD 80 trillion in assets worldwide. In Africa, institutional investors’ participation in financial markets is sizeable (ca USD 800 billion), and there is still large potential for growth. The growth of pension funds is hampered by the fact that the dominant share of the population works informally. However, where formal employees contribute to pension fund savings, the favourable demographic situation – with a low percentage of the contributing population currently nearing or above the age of 65 – will allow pension funds to accumulate considerable surpluses for a number of years.

Figure 31. Insurance companies and pension funds’ assets (2019, % GDP)
The figure depicts the average insurance companies and pension funds’ assets as a percentage of GDP across the continent and in the largest African economies in 2019.

Source: LTF Survey
Instead of investing long-term savings in long-term investments, institutional investors hold a significant portion of their assets as term and savings deposits with banks. This contributes to reverse maturity transformation, from long-term to short-term. Due to the risk-aversion of fund trustees, institutional investors prefer to invest in government securities and real estate rather than to take on project risks with which they are unfamiliar. Figure 32 shows that institutional investors’ long-term assets (maturity > 5 years) represent less than 10% of GDP in most countries. One way of addressing this situation would be to encourage banks to issue corporate bonds, in which institutional investors could invest. This would also allow banks greater leeway to lengthen the maturity of their lending.

Figure 32. Insurance companies and pension funds’ long-term assets (2019, % GDP)
For those countries with data available the figure shows insurance companies’ (left) and pension funds’ (right) long-term assets as a percentage of GDP in 2019.

Source: LTF Survey

Insurance companies and pension funds could promote the development of capital markets by investing directly in quoted equity, the corporate bond market, or in project finance transactions. Institutional investors could play an important role in “taking out” banks that have acted as lenders but are unable to provide longer-term finance because of the implied maturity mismatch between their short-term liabilities and the long-term commitments required of infrastructure and housing investments. To strengthen the protection of investors, disclosure and reporting on investments and returns should be standardized and risk management practices should be strengthened, so that institutional investors are able to determine the risk profile of the fund in which they wish to invest.

In many instances pension funds allow retirees to withdraw their assets in the form of lump-sums when they retire, providing an incentive for elevated short-term consumption. This does not provide pensioners with any longer-term income security. Tax incentives that discourage lump-sum withdrawals and exempt income from annuities, and housing investments from tax, could work towards encouraging the development of annuity markets and keeping a larger proportion of the invested funds in the pension system for a longer period. At the same time, despite the large domestic investment needs, it would be advisable to raise limits on pension funds’ foreign investments to facilitate pension funds in diversifying the risk on their investments.
Figure 33. Regulatory restrictions on institutional investors’ long-term investments in 2019
This figure depicts the number of countries that answered “YES”, “NO”, or did not answer (“N/A”) the LTF Survey question about whether there were regulatory restrictions on insurance companies’ (left) and pension funds’ (right) long-term investments in 2019.

Source: LTF Survey