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East Africa Banking Industry Trends  
Report 2021/22  
**Fortifying Resilience**

**MAKING AN  
IMPACT THAT  
MATTERS**  
*since 1845*

# What to expect

# Abbreviations and Acronyms

AI	Artificial Intelligence
API	Application programming interface
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CIR	Cost-to-income ratio
COVID-19	Corona Virus Disease 2019
DBS	Development Bank of Singapore
EIR	Effective interest rate
ERP	Enterprise Resource Planning
GDP	Gross Domestic Product
IoT	Internet of Things
KES	Kenyan Shilling
LIBOR	London InterBank Offered Rate
NPL	Non-performing loan
M&A	Mergers and acquisitions
SOFR	Secured Overnight Funding Rate
ROA	Return on Assets

ROE	Return on Equity
RPA	Robotic process automation
RWA	Robotic process automation
TRWA	Total Risk Weighted Assets
TZS	Tanzanian Shilling
UBA	United Bank of Africa
UGX	Ugandan Shilling
US	United States

# Introduction

The banking industry has seen better times. The emergence of the COVID-19 pandemic has posed significant threats and shocks to economies worldwide. In order to remain relevant, banks are being forced to rethink how they operate their businesses. Bankers who have been relying on traditional methods are under pressure to transform their business and operating models by adopting innovative digital ways.

Prior to COVID-19, the financial services industry was evolving at a steady pace, driven mainly by changing consumer expectations, heightened competition, evolving regulations and advancements in technology. Within a short time, COVID-19 has forced radical changes in customer behaviour, moving significant portions of the economy online and increasing customers' willingness to engage digitally. The urgency to get onboard with the digital transformation agenda is further stressed upon by the ongoing crisis, as digitally mature global banking institutions have displayed agility and resilience in the immediate aftermath of the crisis.

The future of banking involves innovating ways to make a consumer's daily life easier. Banks will have to create or select the right platforms that bring the most distinctive and personalised user experience.

From a workplace environment perspective, the exponential use of technology in the banking environment (combined with the dizzying impact of the pandemic) has had a dramatic impact on work, the workforce, and the workplace. Going into the future of work, these changes in work, workforce, and the workplace are fundamentally shifting how banking talent needs to be managed. Creating a much more dynamic view of work, the workforce, and the workplace will be key to surviving and thriving.

Finally, banks are increasingly considering a risk-based pricing approach for their loans, linking loan prices directly to the borrowers' risk profile and past credit behaviour. This allows banks to optimize revenues from lending, and reward deserving, financially disciplined customers. On the other hand, this could choke the supply of credit to certain segments of borrowers as relatively wealthy customers may have relatively easy access to low-cost loans while less well-off borrowers may not be able to bear the costs of borrowing. As for any new approach, risk-based pricing will come with challenges but the positive implications for both lenders and borrowers are too powerful to ignore. The institutions that prepare for the shift, by building data capabilities and pulling together systems to build a more holistic view of customers, will be well positioned to capitalize on the opportunities.





The time to start thinking strategically about how to pivot during these uncertain times is now, in a way that not only protects banks' balance sheets but also ensures survival.

Our Banking Industry Trends Report 2021/22 is based on the first-hand experience and insights of Deloitte's subject matter specialists, and we hope you find it thought provoking as you contemplate your strategic priorities and adjust your agenda for the year ahead. Please share your feedback or questions with us. We welcome the opportunity to discuss our report directly with you and your team.



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# Banking Industry's Key Trends

As the industry continues to grapple with high cost of doing business and a slowdown in the economy due to the global pandemic, we observe the following being the key trends in the banking industry



## Accelerating Digital Transformation

1

As the invasion of digital transformation is taking shape, incorporating it into banks' customer experience strategy has become integral for thriving in this era of digital disruption.



## Strengthening Operational Resilience

2

The banking industry is expected to maintain its focus on operational resilience while also reacting to increasing demand from regulators, investors, and other stakeholders for increased Environmental, Social, and Corporate Governance (ESG) reporting.



## Recovering Credit Losses

3

Rigorous credit loss assessments will assist banks in better risk assessment and pricing of their credit facilities. In so doing, banks will be better prepared to mitigate their expected losses.



### Mitigating Cyber Crimes

**4** The potential for cyber risk is on the rise, with greater interconnectedness in the banking ecosystem, rapid adoption of new technologies and continued reliance on legacy infrastructure designed for a different age.



### Adapting to the Evolving Regulatory Environment

**5** Regulators are expected to maintain vigilant enforcement programs and to demand more data from banks to test the operational integrity of complex institutions—especially when under stress.



### Emergence of Inorganic Growth

**6** Most banks will need to reinvent themselves in order to thrive, and Mergers & Acquisitions (M&A) activities are expected to have a strong influence in shaping the “next normal” environment.

# Accelerating Digital Transformation

## Overview

As the invasion of digital transformation is taking shape, incorporating it into banks' customer experience strategy has become integral for thriving in this era of digital disruption. Customers are demanding seamless, tailored products and service choices with user-friendly interfaces. Therefore, streamlining front-end operations could be an essential priority. Mobile and online banking emerged as the top IT priority for nearly half of the global corporate banking respondents in an Ovum ICT Enterprise survey. The banking industry received a big blow when governments encouraged the shift from the conventional cash transactions to electronic money, in order to curb the spread of the pandemic. This move saw customers relying heavily on big players in the mobile money market like M-Pesa in Kenya, MTN in Uganda, Tanzania, and Rwanda, and Tigo in Rwanda.

Artificial intelligence (AI) generates an enormous opportunity for the banking sector to understand the entire consumer footprint and accelerate their digital transformation journey. Creating a personalized experience with customers is impossible without automation and intelligence.

## Challenges Faced by Banks

There has been a decline in bank visits with customers opting to deposit cash via mobile money platforms and transfer bank deposits to their mobile money wallets.

This has posed a challenge to banks which have made significant investments in brick and mortar.

The high cost of investing in new technology and robust digital systems also poses a significant challenge to banks that have not considered significantly shifting to a digitized banking environment.

In addition, the promise of digital banking has not been fully realized, largely due to customer reluctance and/or a lack of attractive digital solutions by the banks. Banks have faced stiff competition from digital players such as M-Pesa, which has weakened their channel power.

## What Banks have done

Globally and locally, banks are investing in chatbots to improve their customers' experience. Chatbots are AI enabled conversational interfaces used to interact with customers instantly by replicating the patterns of human conversations. Banks using AI chatbots have been able to increase customer interaction and attract more customers compared to those who do not have the platform.

Several top tier banks in the region have developed credible and reliable systems that allow their clients to have a smooth transition into the new operating mode of a digitized banking environment. Some of these systems include Mobile money, Mobile banking applications and Online transaction systems.



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**Deloitte's Perspective**

Banks should consider leveraging innovations in technology such as cloud platforms, analytical capabilities, and augmented intelligence which can generate levels of customer engagement and operational efficiency that were unthinkable before. CBK's governor recently noted that cloud platforms present a great opportunity for financial institutions to upscale to cutting edge financial services platforms to meet the needs of today's discerning customers. Further to this, advancement in biometric technology including facial recognition is creating new opportunities for banks to streamline their customer experience. Currently, the facial recognition technology is operational in many smartphones and banks can capitalize on the already inbuilt and integrated software.

Exploitation of these digital platforms should enable banks to cross-sell services to customers more efficiently, potentially increasing banks' revenue streams. For instance, banks that pool data from different sources should enable sales personnel to leverage on this data via digital interface as they engage with clients. Digital tools with cross-business data could allow junior bankers to work directly with customers without relying on the relationships of senior bankers, while eliminating multiple roles in service delivery, all of which would reduce operating expenses and enhance customer centricity. By forming partnerships or linking with third party ecosystems, banks can provide a better customer

experience and can evaluate customers past the boundaries of their traditional interactions.

Banks should prioritize retaining first-time users of digital channels by using targeted offers and engagement strategies. At the same time, they should invest in digital, customer-facing technology to provide the seamless experience the industry has been seeking for a while. These enhancements may not only cover digital-only channels but also in-branch experiences, such as self-service digital kiosks/interfaces.

Banks should also focus on delivering hyper-personalized services that can factor in a customer's financial well-being holistically, by integrating their disparate data architecture across lines of business and functions and combine it with AI-driven analysis to create a 360-degree view of customers.

There should also be increased implementation of chatbots and conversational AI tools to assist Banks engage their customers more, given the impact of the pandemic which has accelerated the reduction in branch transactions. Finally, although digital interfaces are essential and desired, some customers tend to need person-to-person experiences to boost loyalty. Therefore, banks should be sure to maintain the human touch.

# Strengthening Operational Resilience

## Overview

Operational resilience is a foundational component of an organization's operational risk management framework. It enables organizations to proactively respond to (and recover from) operational disruptions to the business, industry, and customers. COVID-19 inflicted enormous stress on banks' operations, and there have been hiccups at some institutions, but many banks have handled the challenges well. Overall, the relatively smooth transition to a new virtual operating model is a testament to years of preparation and regulators' attention on operational resilience. The pandemic also highlighted the need for greater rigor in some banks' business continuity planning, crisis management, and recovery. Moreover, it has exposed vulnerabilities in their global footprint and dependence on external provider networks; in countries observing national lockdowns, many institutions experienced a disruption in offshore delivery centres.

The exponential use of technology in the banking environment combined with the dizzying impact of the pandemic had a dramatic impact on work, the workforce, and the workplace. Going into the future of work, changes in work, workforce, and the workplace have fundamentally shifted how banking talent needs to be managed to achieve an optimal organization structure. Creating a much more dynamic view of work, the workforce, and workplace will be key to surviving,

thriving and achieving an optimal organization structure.

Banks and other financial institutions are also facing increased demand from regulators, investors, and other stakeholders for enhanced Environmental, Social and Corporate Governance (ESG) reporting. ESG reporting is becoming more critical as sustainability becomes ever more important. Banks will need to increasingly consider the sustainability of their operations from an environmental and social impact perspective, as well as the operations of the institutions they lend to.

## Challenges Faced by Banks

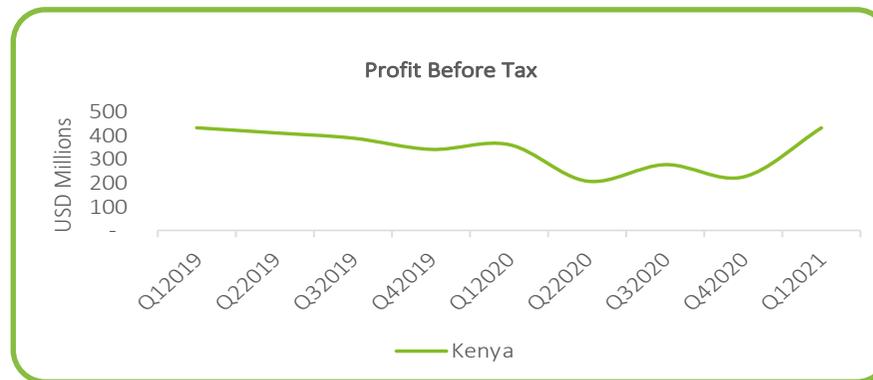
As banks grapple with lower top-line revenues, increased demand for digital offerings, need for revised Cyber security measures, adjustments to working in a post-pandemic era as well as traditional operational costs, banks now face a new challenge of revising their cost management strategies in a highly competitive, post-pandemic global economy.

Social distancing and long-term remote working have posed new business continuity difficulties that were previously unimaginable. Ensuring business continuity amidst the economic turmoil brought about by the pandemic has been a major challenge for banks.





Graph 1: Source - Central Bank of Kenya Reports



“Banks will need to increasingly consider the sustainability of their operations from an environmental and social impact perspective, as well as the operations of the institutions they lend to.”

From a regulatory front, the recent push into financial services operational resilience is the closest regulators have yet come to scrutinising how a firm designs its internal operations. Banks must learn to live with continuous and rising regulatory scrutiny of the resilience of their operations. Financial services operating models will have to adapt to this reality.

Banks have also found it challenging sustaining employees’ workload, accelerating digital efforts and balancing resources, often resulting in the constantly changing and increasingly complex work requirements not being prioritized and addressed accordingly.

Banks’ operating models also need to respond to new trends in the business environment as countries emerge from the COVID-19 pandemic. They cannot simply go back to the status quo ante operating models of early 2020.

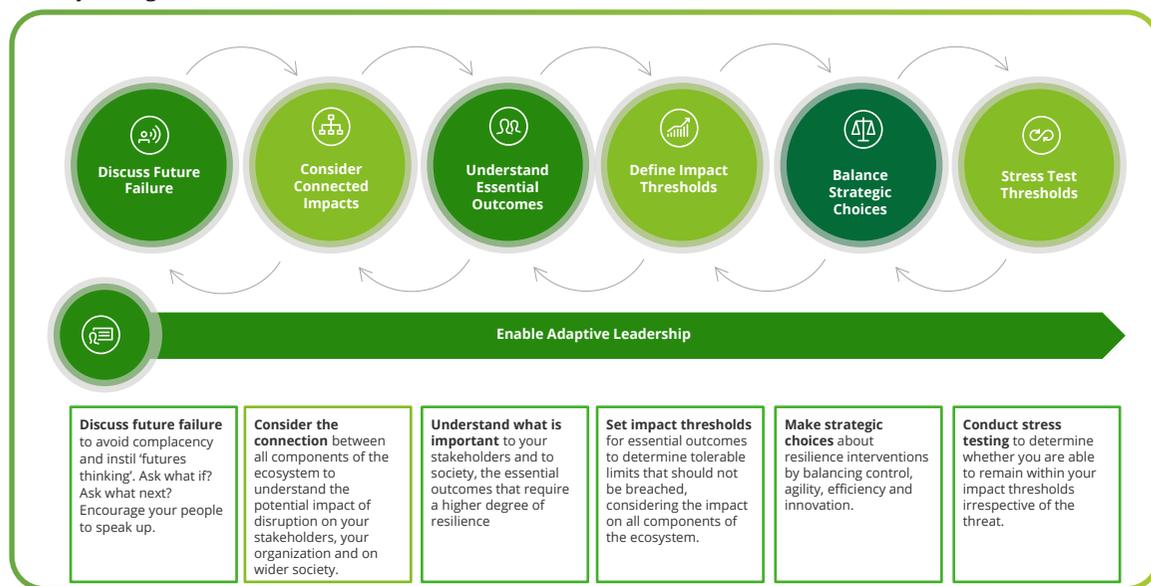
**What Banks have done**

Banks have ensured they have adequate liquidity, evidenced by the increase in the Kenyan Banking Industry average liquidity ratio from 49.7% in December 2019 to 54.5% in December 2020, whereas the Ugandan Banking Industry liquidity ratio increased from 48.6% in December 2019 to 50.7% in December 2020.

Banks have also suspended some of their expenditures as part of structural cost transformation initiatives to bolster operational efficiency.

Despite the enormous stress on banks’ profitability inflicted by the pandemic, there is a possible rebound in profit growth in 2021 as compared to the profit levels in 2020. As shown in graph 1, the Kenyan Banking Industry quarterly profit before tax increased between December 2020 and March 2021, owing to a lower decrease in income compared to decrease in expenses.

Figure 1: Source – Deloitte, Resilience Reimagined: A Practical Guide for Organizations



**Deloitte's Perspective**

Banks should make a shared corporate culture and understanding a top priority. They should also establish improved practices across the people, processes, governance and technology domains using a multidimensional operational resilience framework as a guide.

Undoubtedly, agility goes hand in hand with resilience. Banks should avoid perfection in favour of agile execution. Leaders should empower their front-line workforces with more decision-making authority by creating flatter team structures and revisiting responsibilities and accountability.

Banks should also pursue a structural cost

transformation initiative to bolster operational efficiency. They should invest significantly into their Enterprise Resource Planning (ERP) systems and other tools to achieve greater cost transparency and leverage insights from analytics reports to design better profitability strategies. They can also use branch and office space rationalization as one of the levers to lower fixed costs.

Banks should continue to explore how technologies such as cloud, machine learning, robotic process automation and distributed ledger technology can simultaneously contribute to significant cost savings while helping increase speed, improve accuracy, and provide scalability. Streamlining front-to-back data flows and

deploying data analytics will remain prerequisites to achieve the desired efficiencies. It is time for organizations to look at ways of shaping business culture to fully leverage digital technologies and to unlock new opportunities.

Building resilience cannot be considered a one-time effort, and bank executives must strive to establish a dynamic resilience strategy and continually redesign, iterate, recreate, and develop resilience. According to a research conducted by Cranfield University in Partnership with Deloitte, seven future practices were identified which form a resilience methodology for organizations (figure 1). Banks may choose to focus their efforts on a specific practice or practices but should be mindful of the implications on an adjacent practice in the model.

Finally, Banks will need to integrate ESG factors in their operational, lending and risk management strategies. This will enhance their long-term value creation and open up opportunities for development of new sustainable banking and investment products.

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# Recovering Credit Losses

## Overview

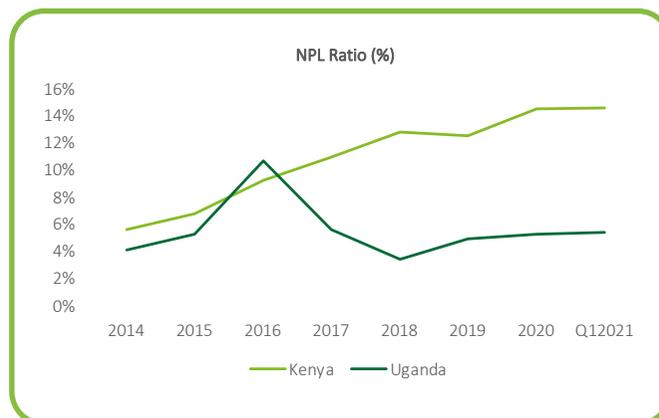
Banks in East Africa have experienced a reduction in client transactions and amounts in bank collection accounts (for example, collection accounts for rent) as businesses faced a downtime in operations. This directly translated to a reduction in the amount of funds available for banks to invest and lend. Hence most banks have diversified their income streams. Additional services offered in banks include bancassurance, letters of credit and guarantee, agency banking, and custodial and merchant services. Although all income streams have shown a significant decline in amounts of revenue collected in terms of commission, banks that offered these services were better cushioned against large losses compared to banks that did not provide for these services.

## Challenges Faced by Banks

One significant challenge faced by banks is the increase in the number of Non-Performing Loans (NPLs). Layoffs, salary cuts, low demand and low purchasing power means collaterals such as vehicles are not easy to dispose, and banks may ultimately be unable to cover their losses in the event of a default. As can be seen in graph 2 below, the NPL ratio for the Kenyan and Ugandan banking industry have been on a gradual increase between 2018 and the first quarter of 2021.

Another key dilemma banks face is whether to continue financing businesses that have experienced cash flow challenges to allow for their survival during

Graph 2: Source - Central Bank of Kenya, Bank of Uganda



this uncertain period, or stop financing based on the increased probability of default of these businesses. The latter option may lead to the eventual closure of these businesses and ultimately end up as bad debts in the bank's loan books.

## What Banks have done

The short-term environment is very uncertain. Industries such as hospitality, tourism and transport had immediate adverse effects that saw the closure of hotels, tours and travel companies and airlines. Consequently, banks have generally been sceptical of issuing any short-term loans secured by salary with a dark gloom over the economy, and preferred issuing long-term loan facilities that are more stable.

Clients affected by the pandemic, after negotiations



with their banks, were able to restructure their loans, allowing them to pay the amount they could afford. Most restructures included a change in the repayment amount, allowances for no principal payments, no interest payments, or no payments for both principal or interest for a duration of time.. The loan duration was also amended in line with the change in repayments. The impact was that the banks could retain their clients into their loan books, hence securing their income position. In addition, they were able to help their clients continue running their businesses despite their local economic strain.



### Deloitte's Perspective

The credit risk models used by many banks were not developed to accommodate the extreme economic conditions and the levels of government support measures being introduced. The inclusion of more extreme economic inputs may identify issues with the sensitivity and calibration of existing models. Thus, entities may find that additional model development is required for banks to accurately predict their expected credit losses and make subsequent allowances for them. These new assumptions and risk assessments should be more directly embedded into stress-testing exercises. This rigorous credit losses assessment will also assist banks in better risk assessment and pricing of their credit facilities. In so doing, banks will be better prepared to mitigate their expected losses.

In addition, regular monitoring of loan performance by clients is essential in determining the trend of clients' behaviour. This will allow banks to predict defaults early and set up mitigation procedures such as reduction of overdraft amounts or funding more where business require additional capital despite overall market performance.

Banks need to rethink old governance models and the way they are applied. They should prioritize a risk management approach that is holistic, all-encompassing, and embedded across the business to ensure a resilient foundation in the long term.

Finally, banks need to assess which sectors/clients are most at risk of defaulting and re-examine loan loss provisions under different economic scenarios. Banks also need to reach out to clients with communications and information requests to provide temporary help as appropriate.

“Most restructures included a change in the repayment amount, allowances for no principal payments, no interest payments, or no payments for both principal or interest for a duration of time.”

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# Mitigating the Rise of Cyber Crimes

## Overview

The potential for cyber risk has been increasing with greater interconnectedness in the banking ecosystem, rapid adoption of new technologies and continued reliance on legacy infrastructure designed for a different age. According to the global Deloitte 2021 Banking and Capital Markets Outlook, the financial services sector is more likely than other industries to be a victim of hackers, with many institutions increasingly naming cybersecurity as the most important risk type. This risk is now of top concern for financial services risk managers. Cyberattacks have indicated a need for many banks to understand their ecosystem and the inherent vulnerabilities that exist within their networks.

## Challenges Faced by Banks

Cyber risk is only getting more complex, and in ways that are not fully understood and predictable. There is more to be done to make sure that cyber risk is incorporated into the bank's operations ahead of time, as opposed to after risk occurrence. This begins with building a robust culture of due care across the organization and ensuring that cyber security is a key consideration in the design of business processes, strategy, and innovation. Additionally the data protections regulations in Kenya and Uganda has increased the focus on cyber security controls to protect data held by Banks.

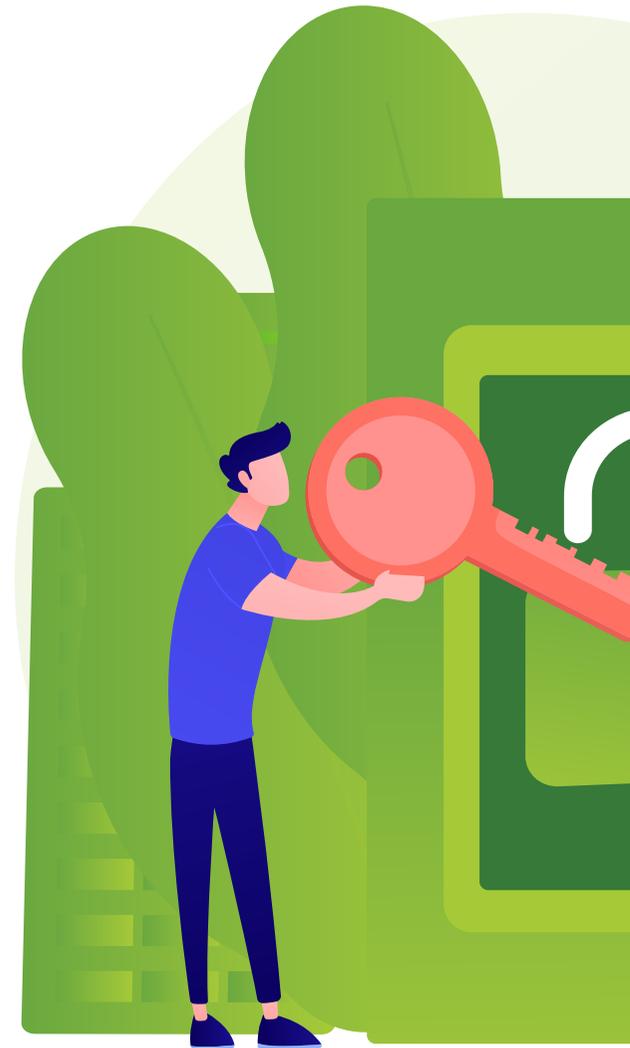
This focus on cyber risk as a critical element in almost every aspect of business increases the cyber awareness and helps them in timely identification of

risk elements. This will have numerous benefits such as the ability to improve speed to market and make organizations more resilient and responsive to market needs, which is the very definition of agility. The pandemic has tested the cyber resilience of banks, as the virtual/distributed work model became the norm. This has not only increased the perimeters of the Bank, but also enhanced the surface area for cyber attackers. There was an enormous increase in the number of attacks that Banks faced during this period. Insider risk is also increasing because of the psychological stress employees are likely to face as the pandemic continues.

Due to the complex nature of cyber risk, handling them requires specialized talent. Availability of trained and experienced professionals in the local market has been a significant challenge for organizations. As a result of this, some organizations are unable to correctly identify, manage and be resilient to cyber risk. Staying ahead of changing business needs and addressing threats from increasingly more sophisticated attacks are top challenges for executives.

Further, third-party relationships with external technology vendors, suppliers, or service providers could expose banks to information misuse and theft (insider risk), system failures and business disruptions (operational risk) and/or regulatory non-compliance.

Finally, technical debt, or the lack of legacy system modernization, remains a significant challenge in making the enterprise more secure.





### What Banks have done

Relatively few banks have recognized organized cyber-criminal networks, rather than hackers, as their greatest potential cyber security threat; even fewer are prepared to address this threat.

Banks tend to employ security-based “wall-and-fortress” approaches such as increasing funding geared towards enhancing their security systems and protocols and recruiting specialized talent into their cyber security units to address the threat of cyber-crime.

There is greater cooperation among banks, counterparties, and regulators, including sharing of information and best practices.

#### Deloitte’s Perspective

Bank leaders should rethink traditional cybersecurity measures that may still be in place considering these factors. Fully leveraging interbank alliances might help strengthen banks’ defence against these threats. Banks should adopt a “security by design” approach, where cybersecurity is strategically integrated into the entire business process and into standard code development.

They should also reassess how they deploy their cybersecurity budgets because higher spending does not always yield better outcomes. Some of the most mature programs in the industry attribute their success to improving governance by involving senior leadership in the journey, raising cybersecurity’s profile to an enterprise wide responsibility, putting cybersecurity at

the centre of digital transformation efforts, and aligning cybersecurity efforts with their strategy and daily operations.

In addition, banks should also use user behavior analytics and machine learning to further help detect potential anomalous behavior on the network and individual endpoints.

Banking institutions should also adopt more effective preventative controls as well as prepare for rapid recovery from adverse events caused by malware, ransomware, and other pernicious attacks. Banks should also develop robust Cyber Incident and Response Plans that takes into consideration various risk they are exposed to and the security technologies they have implemented. These plans should be tested frequently to make sure that it is able to handle cyber incidents.

Finally, banks should enhance data security and privacy management programs that considers governance, technology and people capabilities across the organization.

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# Adapting to the Evolving Regulatory Environment

## Overview

After a decade of intense scrutiny by regulators globally and regionally, banks seem to be sensing some stabilization. Higher capital and liquidity requirements, stress testing, and recovery and resolution planning will likely remain intact. Compliance expectations and executive accountability are expected to stay elevated. Regulators are also expected to maintain vigilant enforcement programs and to demand more data from banks to test the operational integrity of complex institutions—especially when under stress.

In Kenya, after the repeal of the interest rate cap via the banking regulations, institutions are continuously transforming their credit pricing methodologies to consider specific borrowers' risks. Risk based credit pricing forms the second pillar of the vision laid out in the Kenya Banking Sector Charter. As such, lenders are continually adopting this pricing approach.

Regionally and globally, regulatory authorities have continued to issue stricter monitoring and reporting requirements aimed at combating the ever-increasing money laundering risks. Anti-Money Laundering (AML) regulations require banks to implement effective compliance and detection systems. This places a strain on getting skilled resources and in many cases, manage multiple multi-jurisdictional AML

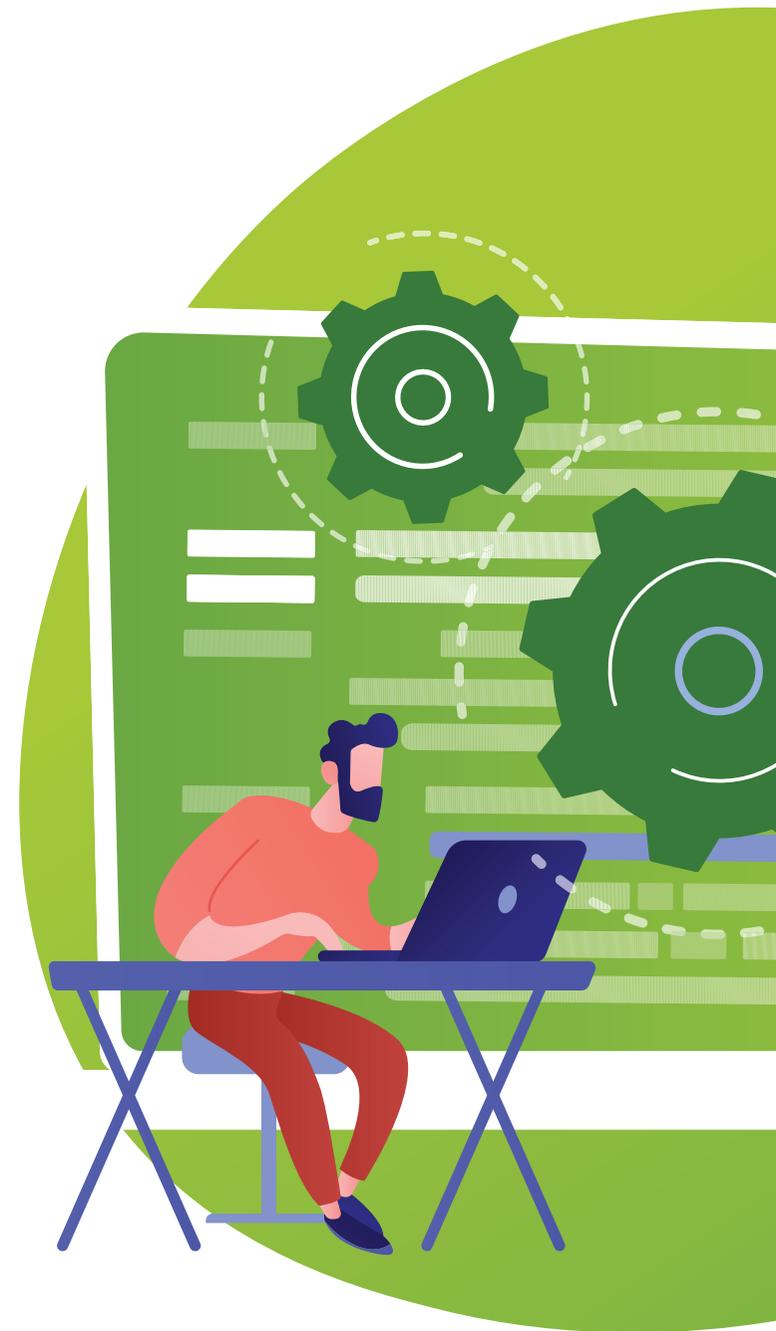
requirements.

Regulators globally have signaled clearly that firms should transition away from the London Interbank Offered Rate (LIBOR). The pressure is on, as the 2021 deadline for the global LIBOR transition approaches. After some initial uncertainty, regulators around the world have worked fervently to find replacement rates and build out working groups that will support the transition program. LIBOR underpins contracts affecting banks, asset managers, insurers and corporates to the extent to which market participants rely on LIBOR and demonstrates that a sudden and disorderly discontinuation of the rate could give rise to a systemic risk.

## Challenges Faced by Banks

Opponents say that risk-based pricing complicates their existing credit programs and may also result in disgruntled customers. Issues may arise when a credit analyst denies a customer a lower rate and there is difficulty in explaining the reasons behind the credit decision.

Others oppose risk-based pricing due to the potential legal implications that it poses around discrimination in issuance to the different customers. Further, lack of sufficient customers' data to assist in more accurate



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pricing is a challenge being faced by many industry players.

Trying to adapt to clients ever changing needs at the same time ensuring compliance with regulatory requirements has proved to be quite challenging in the banking sector.

From a LIBOR transition perspective, without sufficient transaction data, LIBOR submissions rely on expert judgment, which heightens the risk of benchmark rate manipulation

**What Banks have done**

Banks are transforming credit pricing methodologies to consider specific client risks by the adoption of Risk Based Pricing. Banks considering this approach view it as a tool that enables lenders to reach small businesses and other underserved markets, thereby creating a wider reach.

Banks are also seeking alternative rates to replace LIBOR. Secured Overnight Funding Rate (SOFR), the proposed rate in the US, has been increasingly accepted as a viable alternative. For instance, debt issuances as well as trading volumes of exchange-traded futures and swaps tied to SOFR continue to increase. SOFR floating-rate notes have been issued by major entities such as the World Bank, MetLife, and Fannie Mae. In the United Kingdom, floating-rate notes totaling over US\$30 billion tied to the Sterling Overnight Index Average were issued in 2019. In Europe, the Euro Short-Term Rate started being published in October 2019.

**Deloitte's Perspective**

Banks should prepare for the shift to Risk based pricing by building their data capabilities and pulling together systems to build a more holistic view of customers so that they position themselves well to capitalize on this opportunity. Investments in robust AML detection and reporting frameworks will continue to be a key consideration. Banks need to invest in adequate resources and systems to assist in multi-channel detection of suspicious transactions, easily identify beneficial ownership and comply with the stringent AML reporting requirements. LIBOR transition is a complex undertaking and its success will depend on active collaboration between a range of market participants. Banks should prepare for the transition by mobilizing a cross-business unit and geography transition programme, setting out a transition road map and identifying the risks and implementing the mitigants early enough.

Frequent stress-testing is a key financial management tool for Banking institutions. It enables decisions about implementing liquidity contingency plans or seeking new capital injections.

# Emergence of Inorganic Growth

## Overview

Regionally and globally, banks need to counter the strong headwinds to achieve profitability, given compressed net interest margins from lower rates and lower demand for loans due to the pandemic. To bolster revenues, many banks may try to leverage fee income as the primary driver of growth, but such prospects may be limited, given the sombre macroeconomic climate and surge in industry competition. Banks will likely need economies of scale to survive, rationalize costs, and thrive.

A post-pandemic world may unleash structural and systemic changes across multiple industries, and it is widely expected that recovery will be highly asymmetric across regions and sectors. Most industries, including banking, will need to reinvent themselves in order to thrive and Mergers & Acquisitions (M&A) activities are expected to have a strong influence in shaping the “next normal” environment.

The case for consolidation in the banking industry has possibly never been stronger, as the M&A playbook gets rewritten for a digital economy. The need for scale, the desire to bolster digital capabilities, and lower cost structures to enable change, will likely be the primary motivations for banks seeking M&A.

## Challenges Faced by Banks

The drivers that were once favourable for continued M&A activity in the banking and capital markets sector — regulatory landscape, enhanced earnings as a result of tax reform, desire for scale efficiency, and the search for digital capabilities — have been overshadowed by the recent market turmoil and uncertainty caused by COVID-19.

## What Banks have done

As in any crisis, there will be organizations that are prepared and positioned to act on strategic opportunities that may arise, and there will be organizations that are not. For instance, in February 2021, Equity Bank Congo (EBC), a subsidiary of the Nairobi-based Equity Group, successfully merged with Banque Commerciale du Congo (BCDC) to form Equity Banque Commercial du Congo (Equity BCDC). Similarly, in May 2021, shareholders of the Nairobi-based KCB Group approved a proposal to acquire Banque Populaire Du Rwanda (BPR) and African Banking Corporation Tanzania Limited (BancABC).

Banks are modernizing the digital core and closing the gap in legacy infrastructure as they reposition themselves for the post pandemic world.

Banks are considering sales of businesses to support earnings and rationalize their business models.





### Deloitte’s Perspective

Bank boards and executives will need to stress-test and assess the impact of COVID-19 on their books with a focus on industries significantly affected and exposed to the situation (such as hospitality, travel, and energy) and the related impact to capital.

Once bank executives believe the “house is in order” then they should look at strategic acquisitions to identify the high-priority targets that may need a strategic partner to navigate concerns around liquidity, capital, or credit exposure to industries disproportionately affected by COVID-19. These potential targets could be other banks, financial technology companies, specialty lenders, and other shadow-banking types of businesses. The current market turmoil could disproportionately reduce the availability of liquidity for specialty lenders, and these lenders will need to keep volume up to remain profitable.

Banks may need a new set of tools, expertise, and processes to create a new M&A playbook that will withstand the post pandemic realities. The drive to enhance digital capabilities due to social distancing and the need to digitally develop banks’ small and medium-sized enterprise client channel acts as a catalyst in banks’ digital

transformation, and the situation could provide an opportunity not only to add scale, but also to transform legacy banks into agile digital-first banks of the future. In the long run, investors typically place a premium on digital-forward banks, driving up multiples for banks with efficient ecosystems of digital capabilities.

Organization leaders should carefully align their corporate and M&A strategies, remain alert to potential opportunities, and have the tools, teams, and processes in place should M&A planning move to action. Banks that develop and refine these competencies in the short-term should be better positioned to execute the right deal opportunities.

Caution should be exercised, and due diligence efforts may need to be modified to account for COVID-19’s unique impact on asset quality and industry competition.

### Let’s Talk

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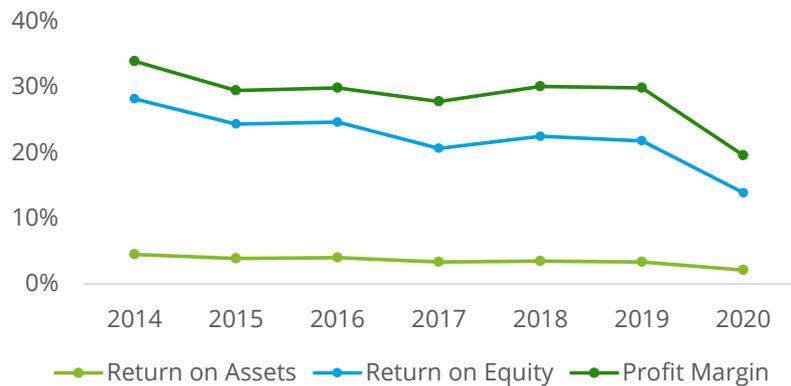
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# Banking Industry Performance

# Kenyan Banking Industry Performance

**Profitability**



## Profitability

The Kenyan banking industry experienced a decline in profits between the years 2018 and 2020, compared to the growth experienced between years 2017 and 2018. This decline is partly attributable to rising impaired credit quality that is matched by higher provisions, and the marginal increment in the cost-to-income ratio (CIR). As seen in the graph, the Kenyan banking industry experienced a gradual downward trend in profitability until the upturn witnessed during the year 2018, and a subsequent decline between 2019 and 2020. The decline in the 2020 profitability is mainly driven by the adverse effects COVID-19 had on the economy.

**Gross Loans & Advances and Customer Deposits**

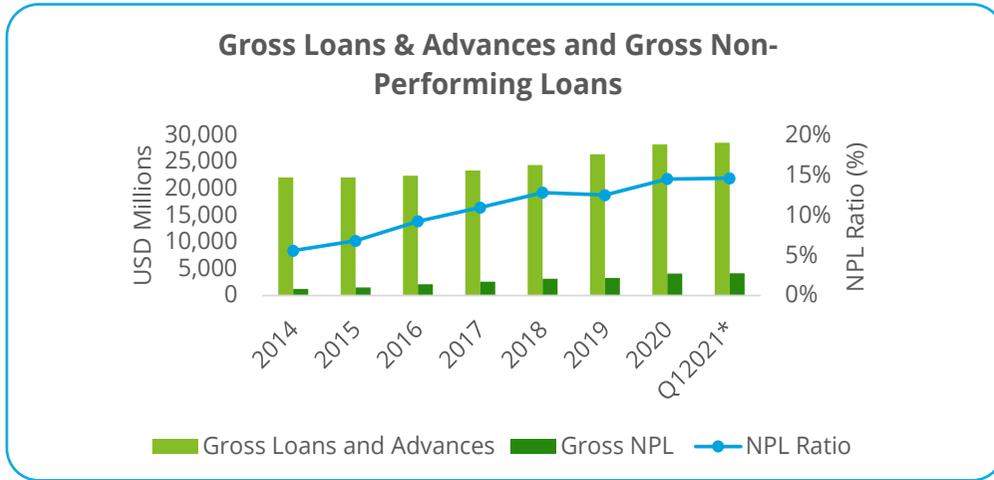


## Assets and Liabilities

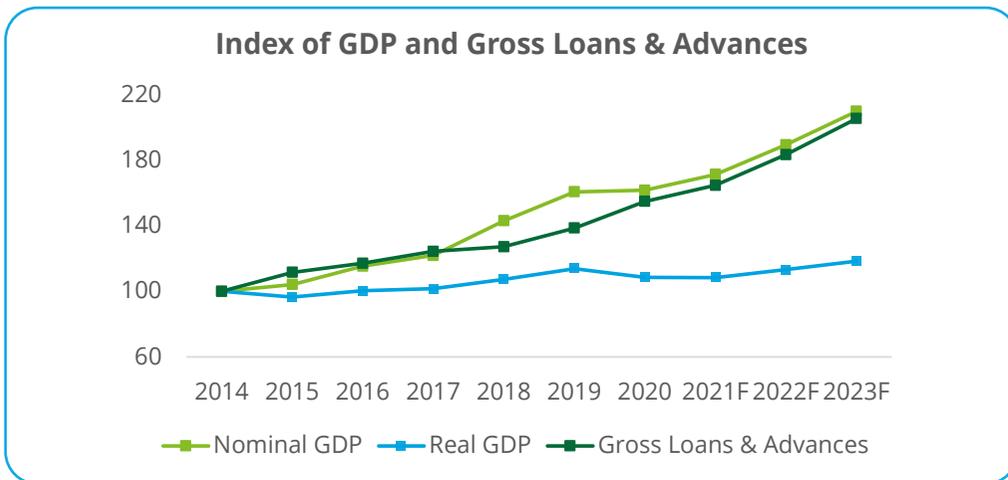
Customer deposits in the Kenyan banking industry continued to rise, witnessing an 8.9% growth from USD 34.3 billion in 2019 to USD 37.3 billion in 2020, with the first quarter of 2021 registering a further increase to USD 38.8 billion. The growth in gross loans and advances remained low compared to the growth in customer deposits. It is expected that given the stable macro-economic environment and the increasing customer deposits; banks will increase lending in the future.



Graph 5: Source - CBK Banking Industry Reports 2014 to March 2021 (Q12021\*)



Graph 6: Source - CBK Banking Industry Reports 2014 to 2020, Fitch Solutions



### Asset Quality

Kenyan banking industry's asset quality reflected by non-performing loans (NPLs) remained stable albeit an increase from USD 3.3 billion in 2019 to USD 4.1 billion in 2020 and USD 4.2 billion in the first quarter of 2021. The gross loans and advances also increased between 2019 and 2020, and this resulted in an increase in the NPL Ratio (gross NPL over gross loans and advances) from 12.5% in 2019 to 14.5% in 2020 and 14.6% in the first quarter of 2021.

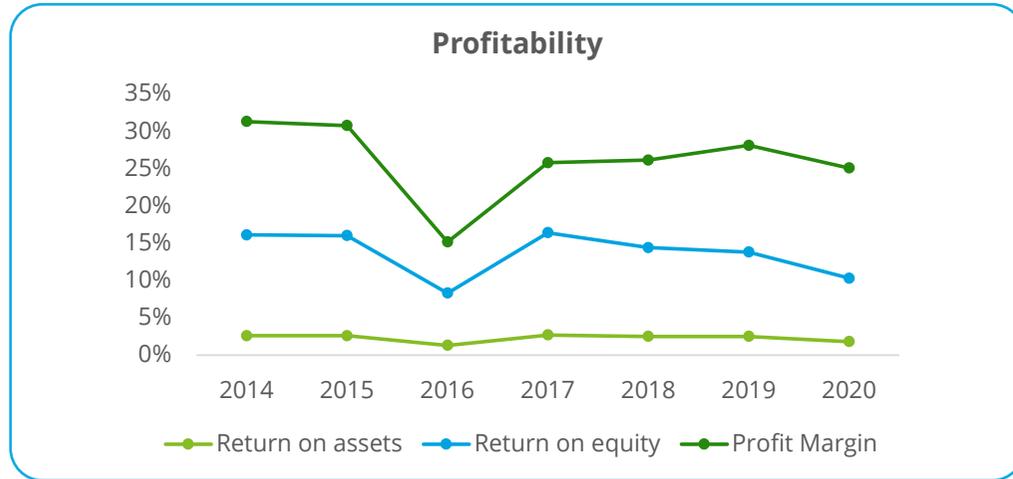
### Loans & Advances growth against GDP growth

The growth in the Kenyan banking industry gross loans and advances has generally been in line with the growth in nominal GDP between 2014 and 2020 and is projected by Fitch Solutions to follow the same trend through to 2023. Real GDP growth rate decreased between 2019 and 2020, in line with expectations resulting from COVID-19, but is expected to have increased gradually by 2023, though at a slower rate compared to the nominal GDP.



# Ugandan Banking Industry Performance

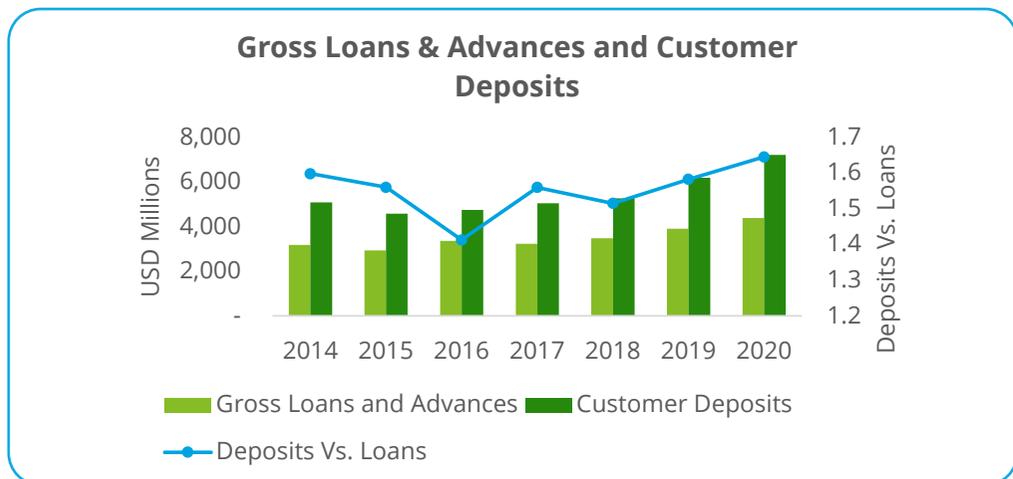
Graph 7: Source - BOU Banking Industry Reports 2014 to 2020



## Profitability

The Ugandan banking industry managed to climb back to its profitability levels after experiencing a dip in its returns in the year 2016. The reduced profitability in 2016 was mainly as a result of increased interest expenses and bad debts provisions. Reduction in the provisions of bad debts has since seen the banking industry profitability levels rise back up. The ROE and ROA ratios in 2018 remained relatively similar to the 2017 ratios, with a decrease in ROE from 13.8% in 2019 to 10.3% in 2020 and a decrease in ROA from 2.5% in 2019 to 1.8% in 2020. The decline in the 2020 profitability is mainly driven by the adverse effects COVID-19 had on the economy.

Graph 8: Source - BOU Banking Industry Reports 2014 to 2020

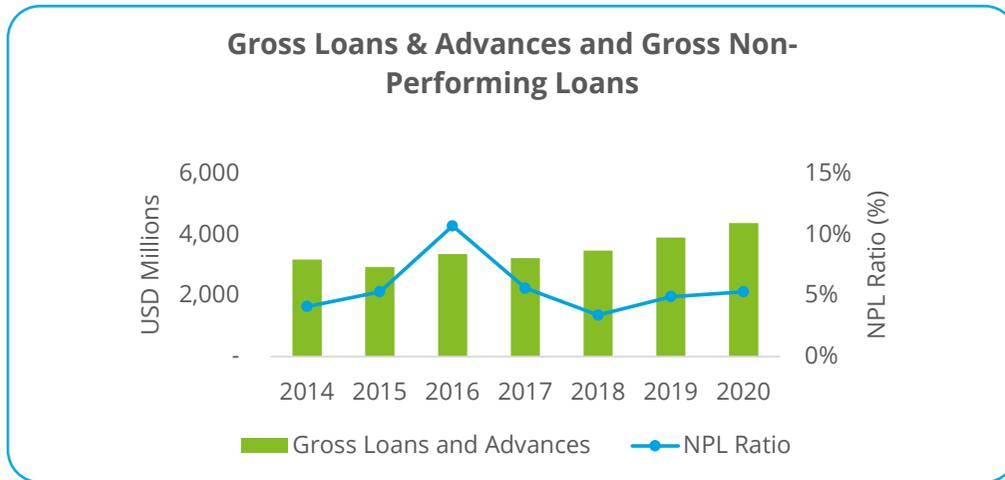


## Assets and Liabilities

The Ugandan banking sector has witnessed a steady growth in its gross loans and deposits from customers. The customer deposits to gross loans ratio declined between 2017 and 2018, as a result of the higher growth rate of gross loans and advances, which stood at 11% as compared to the 8% growth in customer deposits between 2018 and 2019. The ratio increased thereafter between 2018 and 2020.



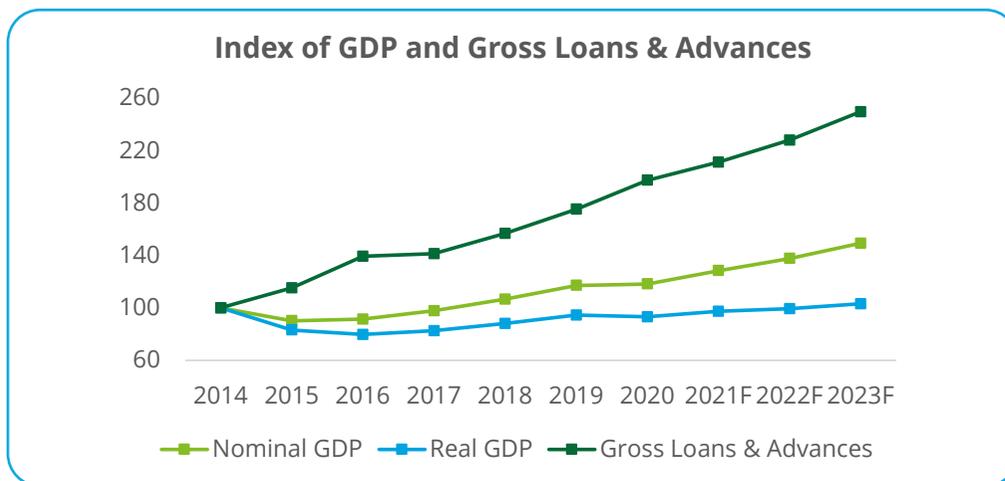
Graph 9: Source - BOU Banking Industry Reports 2014 to 2020



### Asset Quality

The asset quality of the Ugandan banking industry kept improving, as evidenced by the decline in the gross NPLs from 5.6% in 2017 to 3.4% in 2018. The improvement in asset quality is mainly attributable to better performance of the economy and increased loan write-offs. However, the asset quality declined between 2018 and 2020, evidenced by the increasing NPLs. The increase in NPLs in 2020 was mainly driven by the adverse effects of the COVID-19 pandemic. The industry's gross loans and advances increased from USD 3.9 billion in 2019 to USD 4.4 billion in 2020.

Graph 10: Source - BOU Banking Industry Reports 2014 to 2019, Fitch Solutions

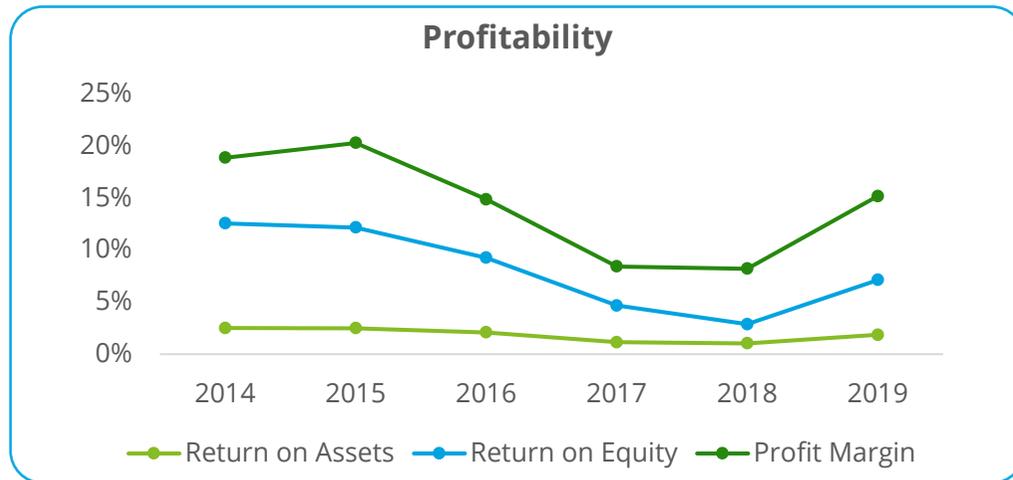


### Loans & Advances growth against GDP growth

The gross loans and advances increased at a higher rate than the growth in GDP (both nominal and real) between 2014 and 2020 and is projected by Fitch Solutions to follow the same trend through to 2023. Real GDP growth rate decreased slightly between 2019 and 2020, in line with expectations resulting from COVID-19, but is expected to have increased gradually by 2023.

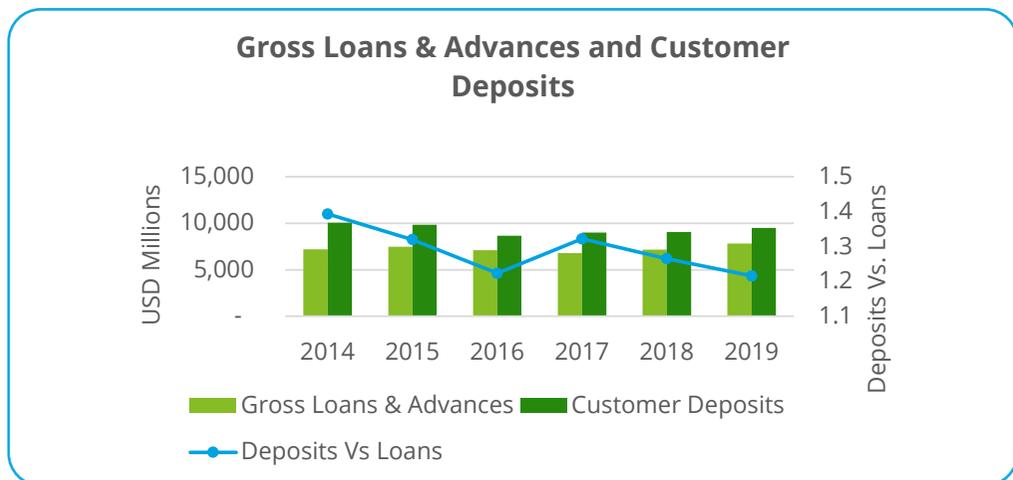


# Tanzanian Banking Industry Performance



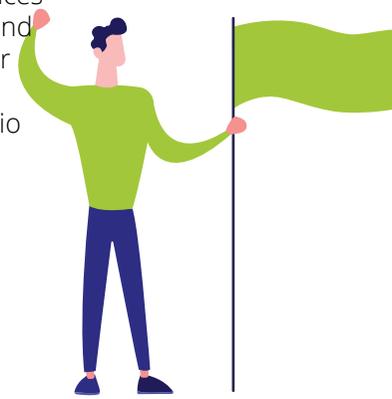
## Profitability

The Tanzania banking industry has witnessed worsening profitability from 2015 to 2018. The decline in profitability was due to increase in non-interest expenses and provisions for bad and doubtful debts in some banks. However, the industry's profitability increased between 2018 and 2019, driven by increase in interest income that was consistent with growth in loan portfolio and decrease in interest expenses. The Return on Assets (ROA) and Return on Equity (ROE) ratios have been on a downward trend over the years but registered an increase between 2018 and 2019. ROA increased from 1.04% in 2018 to 1.86% in 2019, while ROE increased from 2.88% in 2018 to 7.13% in 2019.



## Assets and Liabilities

Complementing the poor profitability state of the banking industry, is the lack of enough growth in the banking assets that generate income. Profitability levels will remain low because the growth of the top line (consisting of interest income) is dependent on the growth of the banking loan portfolio. Over the past few years, customer deposits and loans and advances have both witnessed a slow growth. However, gross loans and advances grew by 10% compared to the growth in customer deposits at 6% from 2018 to 2019. This further contributed to the decrease in the customer deposits to gross loans ratio witnessed between 2018 and 2019.



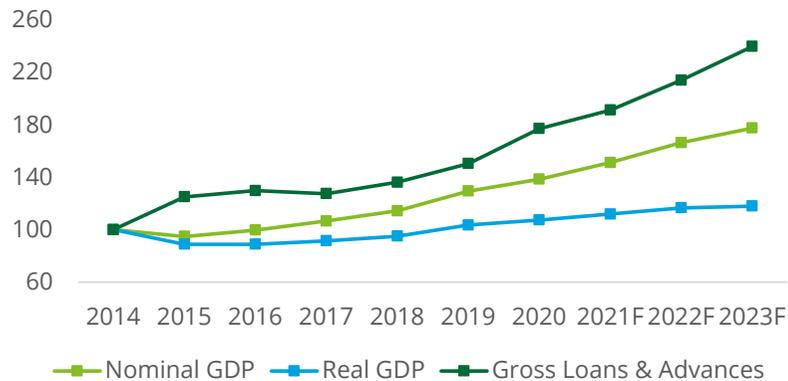
**Gross Loans & Advances and Gross Non-Performing Loans**



### Asset Quality

Asset quality of the banking industry improved as evidenced by the decline in the ratio of the NPLs to gross loans from 10.5% in 2018 to 9.6% in 2019. The industry's gross loans increased from USD 7.2 billion to USD 7.8 billion from 2018 to 2019. The improvement is attributed to various measures taken by Bank of Tanzania, including requiring banks and banking Institutions to enhance credit-underwriting standards and loan recovery efforts.

**Index of GDP and Gross Loans & Advances**



### Loans & Advances growth against GDP growth

The gross loans and advances grew significantly in comparison to the growth in GDP (both nominal and real) between 2014 and 2020 and is projected by Fitch Solutions to follow the same trend through to 2023. Real GDP growth rate decreased slightly between 2019 and 2020, in line with expectations resulting from COVID-19, but is expected to have increased gradually by 2023.



# End Notes

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13. [Bank of Uganda, quarterly state of the economy reports – December 2020:](#)
14. [Bank of Uganda, Financial stability report - June 2020](#)
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