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Banking and Capital Markets Outlook – An African Perspective

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Contents.

Key messages

Customers – A one-size-fits-all approach won't cut it

In a continent as fragmented as Africa, using generic classifications for customers is risky for financial service providers (FSPs). Therefore, it is more useful to adopt a persona-driven approach that allows FSPs to consider the needs and preferences of consumers at different life stages and age groups.

Transforming the tech infrastructure to unlock value for customers

To unlock unique value for their customers FSPS need to relook their product offering and transform their engagement channels. This will require a single view of their customers' data and therefore an overhaul of their tech infrastructure. Scarce skills, high costs and legacy infrastructure that are not cloud-enabled present major challenges for FSPs.

Gen AI in the clouds – technology with a human touch?

Generative AI can enhance customer experience, help to better segment the customer base, improve credit scoring, construct portfolios, detect fraud and it can assist with code generation for new services and products. Gen AI combined with other cloud-based applications may speed up the development and launch of new products and services.

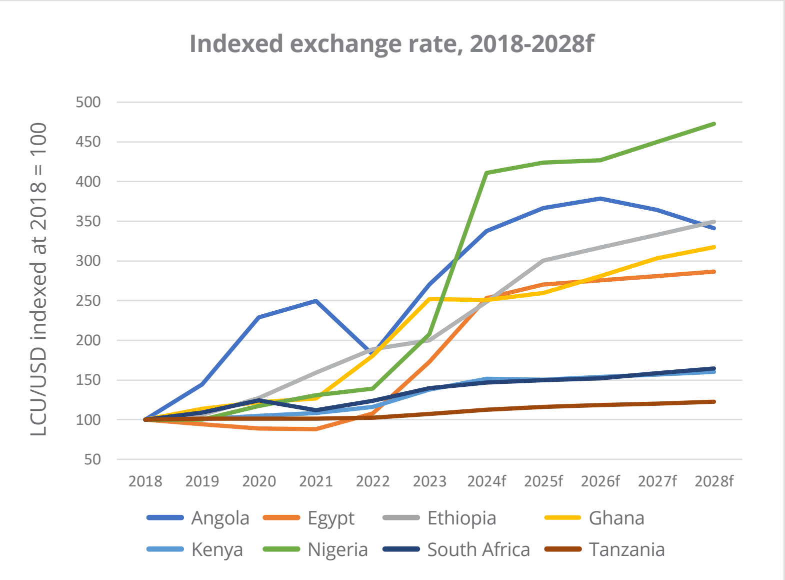
Banks need different talent – but which one?

Given the rapid evolution of technology and advancements in AI, traditional approaches towards education and talent development are fast becoming less suitable for organisations that seek to leverage emerging technologies and use the potential of AI. To avoid losing out on the best talent, FSPs need to be more creative on how to source and assess talent.

Difficult economic times ahead

While Africa is expected to be the second-fastest growing region in the world after Asia[i] and most economies will experience a rebound in growth, stubbornly high inflation and only slowly declining interest rates will pose ongoing challenges for banks and other players in the financial services industry in 2024. Further, persistently high population growth is resulting in low per capita growth rates. For 2024, the United Nations estimate that per capita growth rates for Africa will be like those of advanced economies and hence significantly lower than those of East and South Asia.[ii]

The currencies of most major African markets depreciated against the US dollar in 2023 and are expected to further weaken in the short term. [iii] This depreciation has driven up debt servicing costs for loans denominated in foreign currency and has made external borrowing more expensive. Such developments also have a negative impact on liquidity and access to forex in these markets.



Source: *BMI*

Currency depreciation in countries with high foreign debt levels may also struggle to service their loans and could potentially default on their debt obligations as recent examples in Ghana, Zambia and Ethiopia have shown. Sovereign defaults tend to make external financing much more difficult and hence may negatively impact on banks' ability to extend loans to corporate and private customers.

The weakening of currencies has also put pressure on prices for imported products, potentially exacerbating inflation in domestic markets and contributing to the ongoing cost-of-living crises in many African countries. Further, higher-for-longer inflation will reduce central banks' preparedness to relax their monetary policies and hence central banks will potentially maintain current interest rate levels in the short term. While banks initially benefit from higher interest rates; however, this endowment effect wears off and the risk of non-performing loans is increasing.

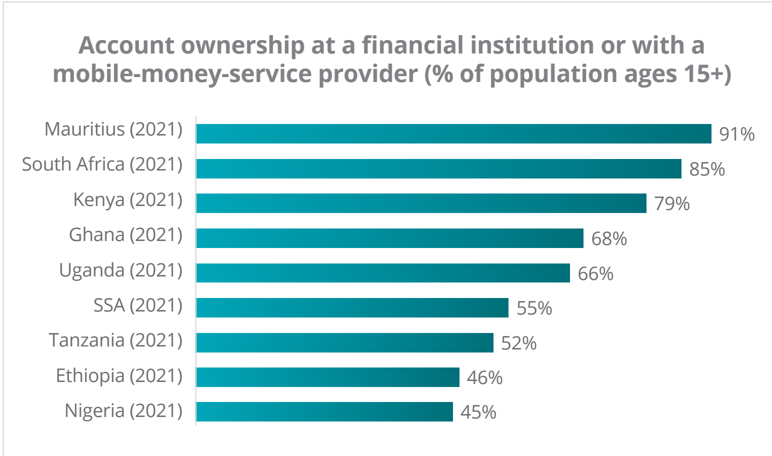
Both the continuously challenging operating environment as well as the pressure on consumers, require banks to relook their product offering as well as their engagement channels to customers. By doing so they will be better able to grow their client base or at least maintain their market share.

Customers – A one-size-fits-all approach won't cut it

Africa remains a very fragmented continent with high levels of poverty and inequality. This is also reflected in the broad range of retail banking requirements. On the one hand there is a need for basic saving and transaction products tailored to unbanked or underbanked customers and on the other hand there is demand for highly sophisticated financial products for middle class and high-income earners. Given these two broad categories, financial services providers (FSPs) often default to rather generic classifications of customers and target them with a set of generic products. However, such generic classifications often do not consider the needs and preferences of consumers at different life stages and age groups. Therefore, a persona-led approach might be more suitable.

Brazilian digital bank Nubank successfully used a persona-led approach to improve its user experience and to strengthen its relationships with their customers. This approach also helped Nubank to better communicate the value of its offering to their different customer groups. Nubank's decision to use a persona-led approach was partly based on the fact that a large share of Brazil's population was excluded from credit card products and that its initial conservative approach to credit card applications was not effective.[iv]

According to recent World Bank data, just over half of adults living in Sub-Saharan Africa have accounts with a financial institution or mobile-money service provider.[v] Persistently high levels of poverty and the dominance of the informal market in many economies across the continent, remain key obstacles for banks to grow their retail customer base.



Source: *World Bank*

Even in South Africa, which has the second highest account ownership rate (85.4% in 2021) on the continent, affordability is a critical factor for retail banking customers. A recent survey by the Financial Sector Conduct Authority (FSCA) highlights that almost 70% of South African banking customers regard the cost for banking services as too high.[vi]

Often the shift away from branches towards digital engagement channels is seen as an important step to reducing banking costs and to make banking services more accessible. While digital engagement channels play a critical role in bringing affordable and convenient banking services to customers, banks need to consider that certain customer segments might not be comfortable using them.

This could be due to the lack of understanding of the benefits of digital channels, lack of trust in these channels or the preference for cash. Especially the dominance of cash in the informal sector in which many unbanked or underbanked consumers transact, presents an obstacle to rolling out digital engagement channels to this customer segment.

While efforts are made by governments and financial services providers to reduce the use of cash, most economies are unlikely to go fully cashless in the short-term. In addition, while digital engagement channels might be very appealing to young consumers, for example, some banking customers will continue to prefer in-person services at branches. Therefore, banks need to reimagine how they utilise their existing branch and ATM network to best meet their customers' needs and to create a uniform and consistent customer experience regardless of engagement channel.

Transforming the tech infrastructure to unlock value for customers

To stay competitive and relevant, banks need to relook their product offering and need to transform their customer engagement channels. However, this is often easier said than done. To offer new services and to develop new engagement channels, banks must find ways to create a single view of their customers' data. This will require an overhaul of the tech infrastructure within banks.

Large, incumbent banks understand that they need to transform; however, high costs and scarcity of skills that are required for them to carry out the transformation, might make them hesitant to start. Given their current market dominance, incumbents might get away with delaying their transformation journey for a couple of years; however, if they remain inactive for too long, they will lose out against emerging challenger banks.

Most banks already invested in broad analytics capability and new platforms. However, most often these platforms are not cloud-enabled and hence not suitable to run the most advanced AI-powered analytics tools on them. These past investments often resulted in a multi-layered tech infrastructure that might be very difficult to undo completely in the short term. Further, the various parts of existing systems are not integrated into each other and hence are unable to communicate efficiently with each other.

This multi-layered infrastructure with limited integration often leads to siloed data which in turn complicates the use of advanced AI-driven applications that benefit from single-view data. This might prevent banks from creating the most suitable products for their clients and unlock the best value for them.

Given the complexity of dismantling legacy systems, banks have a few options of how to modernise and to build systems that support cloud-based applications to their full extent. For example, they can modernise on the edges or add digital wrappers on the legacy system. Often this is done to overhaul the frontend and enhance customer experience, but this does not necessarily lead to the transformation of the core. While digital wrappers and an enhanced frontend might be effective ways to start the transformation process, banks also need to focus on thinning out or shrinking the core. Alternatively, banks could opt to build new functionality on the outside of the existing structures and then at a later stage migrate to the new digital system.

Recently established banks that might be regarded as born-digital, have the advantage that they do not have to deal with large, siloed legacy systems. However, they typically lack the depth of customer data or trust in the market that incumbent banks have. Without access to sufficient customer data, digital tools may be less effective and hence they cannot fully exploit their advantage of being digital-native companies.

Gen AI in the clouds – technology with a human touch?

Generative AI (Gen AI) is one of the most talked about technologies in recent years and will potentially be among the biggest disruptors of modern life going forward. In the banking sector, Gen AI has multiple applications. For instance, Gen AI can enhance the customer experience, help to better segment the customer base, improve credit scoring, construct portfolios and it can assist with code generation for new services and products.

Banks already use chatbots to engage with customers, and thanks to the ongoing advancements in Gen AI technology it is expected that in the short term more sophisticated and more human-like chatbots will be deployed in the sector. Overall, this could enhance the customer experience and increase convenience as such tools can service customers in real time, at any time from anywhere. While tech-savvy customers will be the first to drive uptake and will be more likely to be accepting of such tools initially, customers in underserviced areas could greatly benefit from these tools as they, for example, will cut the need to travel to a branch. This in turn will make banking services more affordable and accessible.

In recent years, FSPs trialled robo-advisory services with mixed results. Due to limited and often fragmented datasets and the complexity of products, the results were often underwhelming and seldomly became mainstream. However, as technology advances and data management becomes more sophisticated, more companies are likely to consider such service offerings.

In some markets including some West African markets, AI is used for credit scoring. A lot of these markets lack established credit bureaus and FSPs do not have access to adequate credit records. Therefore, using AI to assist with creating credit scores becomes attractive as an alternative. In addition, many FSPs in these less established markets did not build complex legacy systems and now might be able to deploy AI-based applications faster than companies in more established markets where most FSPs must still overhaul their legacy systems.

Gen AI also allows banks to combine and analyse existing customer data with real-time customer behaviour to not only create personalised services, but also to enhance security. Gen AI will be able to pick up unusual activities such as suspicious account movements and immediately trigger the necessary responses and in so doing, safeguard customers.

In addition to an enhanced customer experience, the deployment of Gen AI-powered tools will also be beneficial for FSPs as these tools will accelerate the speed to market and reduce the cost for new services and products. It also has the potential to enhance customer loyalty by offering much more personalised and tailored products.

Using AI and other digital solutions in a cloud environment gives companies a great advantage. Cloud-based applications afford companies the opportunities to build and launch products much quicker and at a lower cost. It also provides companies new flexibilities as they do not have to create the perfect product immediately, but rather build a product quickly, deploy it and use customer feedback to enhance and refine the product. Using user feedback also allows companies to better understand their customers' requirements and tweak their products accordingly. As much as AI technology is attractive and able to unlock value for both the FSP and the customer, FSPs need to tread carefully to avoid violating privacy laws.

Banks need different talent – but which one?

Considering the increasing importance of technology in financial services and the need to innovate their product offering, banks are required to relook their talent models. This does not mean a complete overhaul or change of talent models, but rather to make current models more nuanced and able to respond to the evolution of work and the need for new skills.

Many financial services providers have put mechanisms and plans in place to manage succession planning at the top of their organisations. This is partly due to regulatory requirements but also due to the risk that insufficient succession planning may pose to an organisation.[vii]

Despite the deep pockets of many banks to offer competitive compensation packages to their executives, a range of push and pull factors have heated up global competition for top talent. While not the sole reason, compensation is an important pull factor for executives to join companies abroad. Compensation in so-called hard currencies, e.g., US dollar, British pound, Swiss franc, the Euro, or Canadian and Australian dollar, has become increasingly attractive in times of local currency depreciation. This pull factor is often accompanied by push factors including uncertain political and economic outlooks in domestic markets.

Offering compensation in hard currency would help to cushion the impact of currency fluctuations but is not the most attractive option especially for shareholders. A more acceptable option might be to restructure compensation packages to include long-term incentives such as share plans.

In addition to competitive compensation, factors such as career development opportunities and a sense of purpose have become important drawcards for companies to attract and retain top talent. In many organisations, succession and retention planning is focused on the c-suite level. However, it has become increasingly important to extend such planning at least two to three levels down in the organisational hierarchy. This is especially critical for talent with scarce and emerging skills related to technology, digital and artificial intelligence.

Given the rapid evolution of technology and advancements in AI, traditional approaches towards education and talent development are fast becoming less suitable for organisations that seek to leverage emerging technologies and use the potential of AI.

In contrast to other qualifications such as Chartered Accountants, the skills requirements for digital jobs are often much more difficult to qualify and it might be challenging to assess the skillsets of graduates and candidates.

Often university curricula are not yet aligned to the continuously changing digital skills requirements, hence banks cannot rely on universities or other tertiary institutions to develop and supply the skills they need. Banks therefore, need to relook their recruitment processes and incorporate new ways of identifying and screening talent.

Given the difficulty of defining and articulating the exact skill set required for emerging jobs, banks might default to settling for what they perceive to be a 'safe skills' package. While labour laws play a critical role in protecting workers, in some incidences they might be seen as an impediment to hiring by some companies. For instance, if it is too difficult to lay off staff, companies might find it too risky to look beyond the 'safe skills' package and not give new less qualifiable skills.

To avoid losing out on the best talent, banks need to be more creative on how to source talent and should develop recruitment processes that can assess critical abilities such as critical and independent thinking or problem solving. In this context, banks should consider establishing specific programmes that are targeted at testing and incubating talent in non-traditional ways that do not expose them to the risk of getting stuck with the unsuitable talent or the risk of not hiring the best available talent.

Way ahead

The financial services industry is at a critical juncture due to advancements in digital technology and the disruptive power of Gen AI. Some financial services providers have already started their Gen AI journey, recruiting, or training talented individuals who can drive transformation. Others are canvasing the market for acquisition targets that would enable them to acquire much needed expertise and skills. Transformational leaders should prioritise working with technology providers to explore the most suitable solutions for their business needs. Further, they should identify use cases to test emerging technologies that will enhance their businesses. However, rushing into new technologies without a plan could lead to unmitigated business risk in the current turbulent operating environment. While FSPs will be at different stages of their digital, AI-powered transformation journey, it is critical that all leaders remain informed about the latest developments of capabilities of innovative technologies.

Endnotes

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