Editorial

Financial systems and agricultural sector development in Sub-Saharan Africa

Background

A recent International Monetary Fund (2016) study has suggested that economic activities in sub-Saharan Africa (SSA) have markedly weakened in recent years, decelerating from 4.6 percent in 2014 to 3.4 percent in 2015, well below the 5-7 percent range experienced over the past decade. The decrease has been attributed partly to weak financial sector performance, including tightening borrowing conditions. Where financial systems operate effectively, they contribute to growth by mobilizing savings and channeling them to investors that have identified productive investment opportunities (Kuada, 2016). This is currently not the case in most SSA countries. Africa's financial sector has been generally described as underdeveloped, risk averse, highly concentrated in urban areas, and offering only a limited range of financial services. The poorer segments of the populations usually operate either in the non-monetized system or in the informal financial sector. For example, only 34 percent of adults in SSA had bank accounts in 2014 (European Investment Bank, 2015). Thus, policies aimed at deepening the financial markets and improving access to finance in key economic sectors, including agriculture and manufacturing remain key challenges in stimulating growth in Africa. The papers presented in this issue of *AJEMS* investigate some of these challenges and offer suggestions for addressing them.

Current research

Eric Osei-Assibey and Seth Obeng Adu argue in their study that one approach to filling the financial resource gap in SSA is to encourage private capital flows (including portfolio equity flows). They forward the view that countries with significant economic growth prospects tend to attract portfolio equity flows from international investors in search of high yields. But portfolio flows tend to be short term in nature, making them volatile and rendering countries depending on them vulnerable to disturbances within the international capital market. There is therefore the need for SSA countries that seek to attract such financial resources to pursue carefully crafted policies to guard against potential instabilities in the flows.

The study reported in the paper examines the determinants of portfolio equity flows into 14 SSA countries. Their findings are that financial development, trade openness, and political stability have significant impacts on the portfolio equity flows into the countries. The impact of trade openness has been negative, possibly because the countries in the sample imported more goods and services than they exported during the period covered in the investigation. Based on the results, they advise SSA countries to take a keen interest in developing their financial sectors in order to provide the appropriate mechanisms for portfolio equity flows to the region. In their view, prudent regulation of the financial sector, especially the activities of foreign banks is necessary to avoid capital flight and reduce the cost of capital.

Previous studies have suggested that banks have a crucial role to play in every well-functioning financial system, serving as reliable intermediaries between investors and depositors (Kuada, 2016). But their ability to play this role effectively depends on their performance – i.e. generating enough income to cover their operational costs

African Journal of Economic and Management Studies
Vol. 7 No. 4, 2016
pp. 442-445

2040-0705
DOI 10.1108/AJEMS-12-2016-122

(Andrianaivo and Yartey, 2009). Thus, the level of non-performing loans within the banking sector of any country is a source of concern since this reduces the overall performance of the banks. The finance literature considers loans to be non-performing when the principal and/or interests on these loans have been left unpaid for at least 90 days. Therefore, banks pay much attention to bank credit risk management in order to reduce the probability that borrowers will default on loan repayments, especially to the extent of creating non-performing loans.

Esther Laryea and her colleagues have examined the determinants of non-performing loans and bank profitability in Ghana. The results of their study suggest that the trend in non-performing loans in the Ghanaian banking industry has been volatile. This has made it difficult to predict the expected changes in the asset quality of the industry and has provided bank managers with the justification to increase their lending rates to compensate for the increased market risk. However, charging higher rates on lending may lead to high levels of non-performing loans among banks. Furthermore, highly capitalized banks take on more credit risk in the form of non-performing loans. They therefore advise the banks to adopt rigorous credit risk management policies in order to stem the increase in non-performing loans associated with increased lending.

In her study Vera Fiador investigates the extent to which corporate governance influence the efficiency of working capital management of listed firms in Ghana. The study is premised on the understanding that board structure, composition, and roles do influence the ability of boards to provide the necessary oversight required to ensure bank performance. The study set out to examine the influence that internal governance characteristics such as board size, board independence and CEO duality exert on the efficacy of working capital management and its components. She finds some board characteristics as significant in explaining working capital efficiency albeit with differential impacts on the various components. It appears from the results of her study that the working capital unit of the corporate finance function is driven more by tactical considerations (which rest with management) than by governance structures.

It is generally acknowledged in the economics literature that agriculture is Africa's largest economic sector, representing 15 percent of the continent's total GDP. However, while more than 25 percent of the world's arable land can be found in the continent, it continues to produce only 10 percent of global agricultural output. This implies that there is huge potential for growth in the sector and this requires a combination of good management, innovation, productivity as well as substantial financial investments. For example, Jayaram *et al.* (2010) argue that SSA must make an annual investment of $50 billion in order to reap its huge agricultural potentials.

The study reported by Abdinur Ali Mohamed *et al.* address the issue of productivity. They use stochastic frontier of production function that relaxes restrictive assumptions in the Cobb-Douglas production function to decompose TFP changes in the agriculture sector in ten African countries. The results show that countries that received international support and governmental aid improved their productivity. In this way the study reinforces results of from previous research into productivity enhancement policies within SSA agricultural sectors.

Daniel Wilson Ndyetabula *et al.*'s study the role of value chain business associations in driving the growth of the emerging dried fruits and vegetables value chain in Tanzania. The author presents value chain business association as a fourth category of business associations – the other three being industry associations, product category associations and apex business associations such as employer associations. He argues that due to the fragmentation of value chains in the dried fruits sector in Tanzania, a value chain association would have a role as a driver of the value chain, since there is no lead firm in the emerging value chain. This will help promote efficiency and effectiveness across links rather than at individual levels of the value chain.

Nkechi Srodah Owoo reports a study of non-farm enterprise performance in Uganda. The study was premised on the understanding that rural non-farm economy provides a viable employment alternative and a means of sustaining rural livelihoods. The author shows that firm performance in Uganda tends to decline with increasing distance from markets and increasing volumes of rain. He therefore argues in favor of differential support policies and strategies in different regions of the country. For example, government support may target "leaders" in the business communities, who may be capable and willing to encourage knowledge flows and information exchanges to small non-farm businesses in the rural communities. Such support policies may produce dynamic and positive impact on Uganda's rural economies.

Joseph Mawejje and Musa Mayanja Lwanga's study is on inflation dynamics and agricultural supply shocks in Uganda. They argue that high inflation is detrimental to investment and growth, erodes the purchasing power, reduces household welfare, and exacerbates income inequality. The results of their study highlight the possible feed-through effects emanating from supply shocks in the domestic agricultural sector. They show that disequilibrium in the money, external and agricultural sectors feed into the Ugandan inflation process in the long run. However, the external and monetary sectors have larger long-run effects on inflation than the agricultural sector. Their findings suggest that in the long-run monetary policy will continue to play an important role in managing Ugandan inflation through money demand management. The inflationary effects of agricultural supply shocks could be mitigated with appropriate domestic actions, including fiscal policy that targets increased productivity and efficiency in agriculture. They therefore recommend the adoption of policies that focus on production, irrigation, storage, and transportation, with the belief that these policies can reduce the effects of agricultural supply variability on inflation.

Nnamdi Madichie and Okechukwu A. Madichie write on property development and housing problems in Northern Nigeria, highlighting the challenges of property development and management in the Bauchi, Gombe and Kaduna States in Northern Nigeria. They argue that the availability and affordability of good housing to Nigerians depends, to a large extent, on the funding cost of residential mortgages and increased liquidity in the mortgage market. The challenge in Nigeria (and most other African countries) is to design appropriate financial instruments and mechanisms that can bring down the cost of mortgage loan by improving market efficiency, lowering cost of funds and allowing for longer repayment period by the financial institutions. In their view, poor property development and management initiatives have had direct correlations with the weak property management practices in these States and thereby further restricted investments in the real estate sector in Northern Nigeria.

Financing inclusive growth

Put together the papers draw additional attention to the role of financial institutions in the development of SSA countries. Other studies have also shown that in spite of remarkable growth achievements in several SSA countries during the past decade, the growth has not translated into sustainable inclusive development and poverty reduction in most countries (Kuada, 2014). The weak growth during the past years has invited concerns about the prospects of reaching those who have been left behind during the earlier growth surge. It has also stimulated the debate on policy instruments that can ensure inclusive growth in Africa. An emerging conclusion from these policy debates is that agriculture remains a key driver of inclusive growth in SSA because it contributes significantly to increases in employment and poverty reduction. It has also been acknowledged that financial inclusion has an important role to play in the development of the agricultural sector, particularly in terms of reaching out to smallholders in the rural communities. It has, therefore, been suggested by some scholars that financial inclusion is a more viable agricultural sector development policy in SSA than agricultural credit schemes that have been popular some decades ago. Unfortunately, financial institutions in SSA are generally reluctant to finance investments within the agricultural sector. Financial sector development will therefore remain high on SSA's policy agenda in the years to come and therefore remains a fertile ground for research for contributors to *AJEMS*.

Furthermore, available evidence suggests that there is a substantial gap between the levels of financial sector development in many SSA countries compared to other developing regions of the world. Most banks on the sub-continent are still characterized by low loan-to-deposit ratios and lending is mainly of short-term nature. Research is required to inform policies aimed at making the financial sector more inclusive and turning the un-banked and under-banked segments of the economy into active participants in the domestic and externally initiated growth activities.

Some recent studies have suggested that the spread of microfinance services and mobile payment innovation systems in enhancing the inclusion of smallholders in modern financial systems and reducing the level of non-performing loans promises to be a viable alternative to traditional financial arrangement for the agricultural sector (Kuada, 2016). Here again, studies are required to evaluate the performance of the different services that are emerging and to provide policy guidance for the future.

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