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Developing Credit Reporting in Africa: Opportunities and Challenges

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Credit information bureaus are essential for the well functioning credit market. They allow lenders to better assess and manage risks, help good borrowers to gain access to finance, and are believed to help reduce overindebtedness.

Until about 10 years ago a few countries outside of OECD and Latin America had operational credit bureaus. In recent years, as retail growth picked up dramatically around the world and technology became more available, many countries in Eastern Europe and Asia, and now in the Middle East and North Africa established credit bureaus. Sub-Saharan Africa, excluding South Africa, is the only region without fully functioning credit bureaus to date. Quite a few countries, including Mozambique, Nigeria and Rwanda, have registries operated by the central banks. These, however, were primarily established with the purpose of supporting banking supervision. They focus on larger loans, and due to lack of adequate technology and incentives, are not able to provide timely and accurate information.

The demand for information by financial institutions on the one side and the pressure from the bank supervisors to improve risk management practices on the other, led to several initiatives in the Africa region to develop credit bureaus. Within the past five years important legal changes were made to enable private credit bureau operations in Ghana, Uganda, Tanzania and Zambia, and at least three private credit bureaus were initiated in Nigeria. Several countries, including Mozambique, Angola, Madagascar and Mauritius have initiatives to develop credit reporting to better serve needs of lenders. With these initiatives in place within 2-3 year time fully fledged credit bureaus are expected to operate in Ghana, Kenya, Nigeria and Uganda. Other countries are likely to follow soon.

The World Bank and IFC are actively involved in the development of credit reporting in the region. World Bank through its operations and IFC through its Africa Credit Bureau Program, provide assistance in at least 15 countries in the region. Significant experience is accumulated through this work, as implementation of a credit reporting project is never a replication of another country's or region's experience, but a process of designing the most suitable solution for the country's environment, taking into account global best practice.

This article identifies some of the key challenges and potential solutions faced by countries in Africa when developing credit reporting.

Africa credit markets - context

Africa credit markets are underdeveloped with the lowest levels of credit penetration in the world. In the region where political and macroeconomic stability is a relatively new concept, most banks until 2-3 years ago mostly focused on forex, trade and treasury operations. With the stabilization of macroeconomic environment, lower inflation and decreasing treasury yields banks increasingly turn to lending. Credit growth picked up significantly in many markets. Starting from a low base, 50-100% growth rates in terms of the number of clients are common.

But lending in Africa is challenging. Weak creditor rights and virtual inability to enforce contracts makes lending a risky business. Countries in Africa also lack infrastructure taken for granted in most countries in the world. Very few places have street addresses, use of multiplicity of languages complicates recording of names and often no identification documentation is available. This is on top of constant power outages and very expensive (if available) telecommunications. It is difficult to check corporate records to make sure company is registered. Most likely it is not possible to check if offered collateral is already used for some other obligation. As a result, most lending relies on local market and community knowledge. While perfectly acceptable practice, it significantly restricts ability of banks to scale up lending to support economic growth. Fuzzy information about borrower creditworthiness also does not help ensuring consistent underwriting practices and does make banks vulnerable to fraud.

As a result, in a market with seemingly untapped potential for credit extension credit penetration is strikingly low. Market estimates are difficult, as no cross country consistent data on credit client numbers exist. Some examples based on IFC estimates include Mozambique with 15 million people and 120,000 credit accounts, Angola with population of 20 million and 200,000 credit accounts, and Tanzania with estimated 2-3% of population served by banking system.

How can credit bureaus help?
In a country where only 1-3% of population is exposed to credit the first and foremost challenge is to develop a credit culture. In the environment where contract enforcement is weak credit repayment suffers. The banks achieving good repayment rates are the ones with strong credit risk management and very proactive approach for collections. Recent research indicates that credit bureaus are able to improve credit repayment rates by reducing moral hazard problem, as well as support access to credit. Credit bureaus are not going to solve all of the problems in African credit markets. But, credit bureaus can help to manage risks. Credit bureaus also allow borrowers to build reputational collateral and have more bargaining power for the terms of credit. The ability of credit bureaus to significantly improve access to credit, however, critically depends on the inclusion of information from non-bank sector. Clearly, having information just on existing bank clients does not expand the base of served clients and only has an impact on the risk management and potentially allows good borrowers to get better terms of credit. Including information beyond banking sector is the key, as it would allow a person paying electricity bill on time, for example, to demonstrate ability to pay even in the absence of formal income. This information can be used by lenders as a verifiable proxy of income and support credit decision. Combining such information with banking information would be ideal, but in reality is a major challenge due to the legal constraints and lack of a common platform to discuss information sharing among such diverse entities as banks, utilities, telecoms and firms selling goods using deferred payment schemes. As a result countries where a credit bureau initiative comes from banking industry, the initial solution is to focus on the exchange of banking information only, as in Kenya for example, and expand the scope in the future.

Focusing on information sharing in banking sector
In most developed countries where credit bureaus were set up decades ago they did not start from collecting information from banks. Originally information came from retailers providing credit to their customers. Not restricted by customer confidentiality and (probably more importantly) not viewing credit as their core business but just means to sell more goods, retailers started exchanging information. With time, when banks saw the value of such information, they joined.

In Africa, where estimated share of bank credit is over 90%, much faster route is to get banks on board from the start. This poses two main challenges. On the one side, most banks operate in a competitive environment and are not willing to share information on borrowers, especially the good ones. Part of the reason for this is probably lack of understanding of a credit bureau operation model. Credit bureau does not sell a list of all clients with all the information to anyone willing to pay for it. Only entity supplying information can buy a report. Lender can only obtain report if customer asked for credit. Of course, lender must trust that a bureau will actually stick to the rule and keep information confidential. It is easy to wave such concern coming from a perspective of a country with strong contract enforcement and governance tradition. In emerging markets these concerns are more real. The issue can be solved however, as successful examples of operating credit registries in other emerging markets demonstrate, but significant lender education work is needed.

The other obstacle is the legal and regulatory environment. In every country, common or civil law tradition, banks are bound by strict confidentiality restrictions. In common law countries they are contractual. In civil law countries they are explicitly stated in the law. Banks are generally not allowed to disclose any information relating to customer accounts. International practice, even in countries with a strict bank secrecy, such as Switzerland, show that information can be shared if customer agrees to it. Solution is simple: a bank has to put in a sentence in the credit agreement stating that information will be disclosed to a credit bureau. It could be simple, but a combination of banks generally not willing to share information with a vague legal framework, results in banks discussing indefinitely solutions and not moving forward.

This problem is not unique to Africa. Eastern Europe, where no bureaus existed till 10 years ago faced same challenges. The response in several countries such as Russia and Kazakhstan was to mandate information sharing by banks to a private bureau. The result is, within 3 years of passing the laws both countries have very active credit bureaus running. Several countries in Africa opted for a similar approach. The new legislation passed in Ghana, Kenya and Uganda requires banks to participate in a credit bureau.

Public or private: Africa context

There is empirical evidence suggesting that private bureaus are best placed to serve the needs of lenders. On the ground experience shows that private bureaus are better placed to provide new services and in presence of competition are able to improve quality of information and deliver low cost solutions. However, voluntary bureaus – as until recently was always the case for private bureaus, do not have information from all, and often this means major, credit providers. Thus they have a major flaw – not being able to show complete picture of borrower indebtedness. Moreover, private voluntary bureau takes very long time to establish as many stakeholders must agree on the arrangement. An obvious solution for a bank regulator is to require information sharing. The next decision is where to house the registry: in the central bank or some other government entity, or allow private bureaus?

A variety of private, public, and private-public solutions are presently in the works in Africa. In Nigeria, the country with the largest population in Africa, two independent credit providers and a bank owned credit bureau are set up. Nigeria is the example of market driven approach, where information providers and lenders have realized the opportunity (providers) and the need (lenders) to start up a credit bureau. The government is working on legal framework in parallel.

In Kenya, for several years private operator CRB struggled to initiate a credit bureau. But due to the lack of interest among banks and vague legal framework progress was slow. The Central Bank took initiative and the banking law was amended in 2006 to mandate financial institutions to share information with licensed private bureaus. The Central Bank is the regulator and licensing body for private credit bureaus. The implementing regulations are expected to be published soon and at the moment at least four credit bureau providers are interested to operate in Kenya. In Ghana situation was similar. Several operators were ready to work with banks but were not able to get the data. The government proposed and the parliament passed a law requiring financial institutions to participate in a credit bureau at the end of 2006.

In Uganda, the Central Bank issued a regulation for mandatory participation by financial institutions in a credit bureau and ran a tender to select a bureau operator. The selected provider will have a monopoly for credit reporting activities for a period of three years after which the market will be open for other participants.

In Tanzania, the law establishes that that Bank of Tanzania operates a data bank and licenses credit bureaus. The Bank of Tanzania is presently working on the regulations and it remains to be seen the structure of the implications for the industry. One opportunity could be to establish system pioneered in Ecuador and presently being implemented in Morocco, where the Central Bank operates a databank aggregating information from all lenders and then makes it available to licensed private bureaus. The central bank in this case does not provide reports directly to lenders.

In Angola, where credit market is booming, no initiatives came from the private sector to set up a credit bureau. The National Bank of Angola works on a project to establish a credit registry owned by the National Bank but implemented by a qualified provider. Mozambique, which has an operational public registry is looking to enable private registry operation and expand the scope of credit reporting in the country.

In each of these countries a different approach is taken to suit the existing market environment, but in all cases regulators had to play a strong role to facilitate the development of credit reporting in these African countries.

Small size markets and economic viability

One of the major challenges with the development of credit reporting in Africa is the small size of the credit markets. As mentioned above, a country with a population of 15-20 million is likely to have about 200,000 credit accounts. Credit bureaus rely on economies of scale. They need to recover large up-front investment through the sale of credit reports. In developed markets bureaus receive millions enquiries per month and can charge low prices. In small markets where they are likely to receive 10,000-50,000 enquiries or less the price of the report must be high. But if report price is too high, this will further reduce demand, especially for small loans. Potential solution is to allow hub and spoke systems. Such system allows for the hardware to be located in one country (hub) where all the information is processed, while other countries (spokes) have local offices for customer support which are connected to the hub. Several examples of such system have started operations in recent years. TransUnion Central America (TUCA) was established in 2005 and is the private credit bureau that provides services to Guatemala, Honduras, El Salvador, Costa Rica, and Nicaragua. The spokes leverage the more advanced technological system present in the hub thus allowing for economies of scale, improved efficiency, and higher profitability. In addition, the creation of a single cross-border private credit bureau enables the delivery of standardized products and services with superior information quality. TransUnion in South Africa also operates bureaus for Namibia, Botswana and Swaziland out of South Africa.

In Africa, given the small size of the markets such approach is the only economically viable solution to enable high quality credit bureau for many countries. The cost of starting up a bureau may be reduced by US$ 500,000 or more by allowing hub and spoke operations. Such model also reduces operating costs as core IT personnel is located in one country and some of the maintenance cost is reduced. As a result the price of the report may be at least US$2-5 higher in a localized bureau than in a regional one.

Going Forward

The development of credit bureaus in Africa presents a significant opportunity to improve overall credit culture and support the development of credit markets. But this process takes time. In most cases there is a need for legal change which in most optimistic scenario takes 2-3 years but in most cases takes five years or more. Based on the experience in other regions, it takes the minimum of 18 months from the moment "the bureau" is created to the moment it goes life, as lenders struggle to provide the data. As yet there is no reference point in Africa for this process. None of the bureaus are fully operational in the region. Several bureaus have technological solution deployed but the key resource of the bureau is the data, which must come from lenders. Obtaining data presents major challenges. Banks do not always have the required data. If they do, it is not necessarily in an electronic format. The difficulties are multiplied by the lack of unique identifiers. Without reliable ID numbers, no consistently recorded names and absence of address it is difficult to merge records once they are loaded. In some countries such as Uganda and Nigeria the intent is to use biometric identification, which promises to be a major breakthrough in resolving borrower identification problem. Realistically, from the start of the discussion to create a credit bureau to a fully operational bureau running in a country at least 5-7 years is required.

While this is a very long period compared to other projects in the financial sector, such as starting up a bank or a microfinance institution, development of the credit reporting is an infrastructure project. Once set up, the credit registry will affect every economically active individual and firm in a country, and affect operations of every lender. It has massive implications for the nurturing of the credit culture and changing overall economic behavior of agents in the economy. To ensure success, however consistent effort and focus is required over this period of time to ensure the progress. Long term donor support, enabling the countries to have access to international expertise, learn from other regions, and see the changes implemented is critical. With the radical changes financial systems in Africa go through, they simply can not afford now not to improve their information infrastructure.