Challenges of the International Financial System in granting bank credit.

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Abstract

This article aims to analyze some critical aspects of the International Financial System - SFI in its current configuration, that is, as an alleged field of reflection and interpretation of the international economic and financial reality, as well as to highlight fundamental elements of bank credit for the understanding of relations between the financial system and banks in the granting of credit in the international sphere emanating from classic authors. In this sense, the article has an eminently exploratory character and seeks only to stimulate a debate in order to promote the construction of a fundamental milestone for the development.

Keywords: Financial system, credit, Bank credit.

Introduction

The International Financial System is the structure of agreements, rules, exchange or business relationships between currencies, activities, money flows, loans, payments, conventions and institutions in which international markets and firms operate. Ribeiro (2016) believes that in the 20th century, the international financial system underwent a great evolution, going through at least three main stages: the gold standard system, the Bretton Woods system, and floating exchange rates. The gold standard system was the monetary system in force from 1870 to 1914. In it each bank had a binding obligation to convert the bank notes it issued into gold or silver whenever requested by the customer. This standard was basically associated with the acceptance of a certain number of countries and, according to Krugman (1999), with obedience to three basic principles: the convertibility of national currencies into gold, freedom for international movement in the form of another. Thus, in 1944, representatives from 44 countries gathered at Bretton Woods to plan and sign the IMF agreement.

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In the context of the Bretton Woods conference, according to Lima (2004), the world was still breathing the air of World War II when the United States and England began to work on designing a new international financial system for post-war. There was also a hangover from the 1929 Crisis, and the great concern to inaugurate a new sound international economic order was essentially based on great fears: the return to the great economic depression into which the world had plunged after the crisis of 1929 and all the problems arising from it; and the aversion to the possibility of a "re-edition" of the horrors of war, which was essentially triggered under pressure from the economic scourges and social wounds produced by the great depression, which brought several dictatorial governments to power. According to Ribeiro (2016), the financial system that emerged at Bretton Woods would be largely in favour of the (US), which would then have de facto control over much of the world economy and its entire capital distribution system. It should be noted that the Bretton Woods conference founded the first fully negotiated international monetary order in history. Its aim was to restructure the world capitalist system from a minimum regulatory framework of international economic policy.

In analysing the crisis of the 1930s, authors such as Robert Gilpin (1972); Charles Kindleberger (1973) similarly concluded that the great depression was produced by the absence of world leadership after the English withdrawal. For the world economy to be stabilised, there must be a stabiliser, a single stabiliser. Historical experience suggests that in the absence of a dominant liberal power, international economic cooperation is extremely difficult to achieve or maintain and that conflict has been the norm. The quarter-century since the collapse of the Bretton Woods System has brought frustrated ambitions and uncomfortable compromises. Efforts to rebuild an indexed but adjustable exchange rate system have repeatedly failed. At the root of this failure was the inescapable increase in international capital mobility, which made exchange rate players more fragile and periodic adjustments more difficult (EICHENGREEN, 2008, p.183; BENCIVENGA; SMITH, 1991).

In general terms, the primary purpose of the financial system is to transfer the resources held by savers to the productive sector or to the consumer sector. It basically consists of the markets - where various agents carry out this transfer by means of buying, selling or exchanging financial captives - by financial institutions and the system's regulatory bodies. According to Franklin Allen and Douglas Gale (2000), financial systems are crucial for the allocation of resources in a modern economy. They channel household savings into the corporate sector and allocate investment funds among companies; they enable intertemporal smoothing of household consumption and corporate spending; and they allow households and companies to share risk. These functions are common to the financial systems of most developed economies, but the form of these financial systems varies greatly. In the United States and the United Kingdom, competitive markets dominate the financial landscape, while in France, Germany and Japan banks traditionally play the most important role.

Based on a qualitative methodology, based on the historical method, the paper has the theoretical rescue of the main currents on financial intermediation, and the historical review of the formation and functioning of the financial system has been done through the review of literature already existing in books and articles. The analysis shows that financial systems represent a cornerstone of economic development. To ensure that resources are efficiently mobilized and allocated among different actors, systems must be properly regulated and also expanded to offer a wide range of instruments and services.

Functions of the Financial System and Business Information and Monitoring

The primary role of the financial system within the economic system is to facilitate the allocation of resources. This means, first, facilitating the exchange of goods and services; and second, facilitating the transfer of savings between suppliers and final consumers. (DE CARVALHO, 2002, p.705), lists and defines in detail the functions of the financial system. To better understand the role of the financial system in allocating resources, we will discuss 6 basic functions it performs: first, resource mobilization; second, resource allocation in space and time; third, enterprise information and monitoring; fourth, risk management and allocation; fifth, bond settlement and payment; and sixth, the generation and dissemination of useful information to various sectors of the economy. For the author, the resource mobilisation function refers to the aggregation of individual savings. Without such aggregation, individual agents would have to finance entire projects. Thus, the scale of each investment would be restricted to the level of wealth of those implementing it, yet few households have sufficient wealth to finance large projects. For companies to reach economically efficient scales it is essential that they have access to the savings of several investors. The financial system, by aggregating the savings of several individual agents, makes it possible to implement projects on an optimal scale.

The critical problems of adverse selection in investment financing mean that the value or viability of an investment is not evident until a thorough evaluation - due diligence - has been carried out. It is very difficult and costly to evaluate investment projects, the technical capacity of their managers and market conditions. In addition, each individual investor ends up having to make its own assessment, implying high information gathering costs per unit of capital invested. This is because the information collected on prospective investments can hardly be transmitted among investors in a systematic way because, first, an investor who has an accurate evaluation of a project may have incentives to take advantage of this information advantage for his own benefit and, second, investors may have doubts about the quality of the evaluation made by others. (DE CARVALHO, 2002, p.705),

After selecting the projects that will receive funds, it remains for the providers of capital to ensure that the resources are used appropriately so that their capital actually receives the promised remuneration. Management can distract projects from the targets set in the financing agreement by using resources inefficiently - unproductive consumption - or by adopting strategies that maximize their own benefit over the heads of investors. This phenomenon is known as "opportunism" (moral hazard). In order to limit the occurrence of opportunism, financing contracts establish conditions that limit the discriminatory power of project administrations. Ensuring that contractual clauses are respected requires continuous information gathering and supervision. This activity is called "monitoring". Economic agents are subject to risks of various kinds. The instruments and ways in which agents try to defend themselves against unwanted risks influence economic activities, and in particular investment decisions.

Modern Financial Intermediation Theory has its origin in the "old" Gurley and Shaw approach to financial intermediation (1955, 1960), which argues that the basic role of financial intermediaries - as transferors of resources from surplus to deficit units - is to remove a part of primary private securities from the market and replace them with the circulation of secondary securities, from their issuance. De Paula (2013) believes that the primary function of intermediaries is to issue debt against themselves, indirect debt, in requesting borrowable funds from surplus spending units, and to allocate these borrowable funds among the deficit units whose direct debt they have absorbed, in which deficit units issue primary securities directly to surplus units, and indirect financing, in which financial intermediaries, on the basis of available deposits - provided by surplus units - acquire primary securities from deficit units, which will make up their portfolio with securities, granting them credit.

According to Paula (2013. p.374), modern financial intermediation theory is based on the existence of market failures due to the presence of asymmetric and/or imperfect information, thus deviating from the classic paradigm of perfect markets. Thus, the main function of financial institutions is to reduce transaction costs resulting from information asymmetries and their functionality derives from the correction of such failures. Such institutions have privileged information which gives them a comparative advantage over capital markets - allowing them to efficiently monitor borrowers, minimizing the costs of agencying between borrowers and lenders.

Financial intermediaries have the capacity to absorb risks since their scale allows for diversification of the investment portfolio, understood as necessary to provide the security required by savers. Thus, financial intermediaries are not only agents that select and monitor borrowers on behalf of savers, but are in fact active counterparties that offer a specific product that cannot be offered by individual investors to savers, which is risk coverage. To do so, they use their reputation and their balance and off-balance sheet operations (SCHOLTENS and WENSVEEN, 2000). Thus, from the perspective of modern financial intermediation theory, according to De Paula (2013) a functional financial system would be one that provides the best distribution of information to guide consumers and savers in the intertemporal allocation of income and wealth, helping to overcome (partially) the asymmetry of information between savers and investors, which contributes to better risk management in financial intermediation activity. At the same time, it reduces transaction costs in the intermediation activity, thus contributing to a better allocation of available resources to boost growth (LEVINE, 1997; MERTON, 1993; SCHOELTENS and WENSVEEN, 2000).

The financial system in the orthodox vision

For this theoretical approach too, financial intermediation plays a key role in the process of economic growth. Macroeconomic identities are taken up again. The economic system itself contains the elements that will lead to growth. In order to determine the level of investment of an economy it will be necessary to determine its level of savings. In this sense, there is a whole theoretical formulation to study the formation of savings. It can be of domestic origin or come from abroad. The final results on total output and income will be the same in both cases, assuming that the country does not have a serious imbalance in its balance of payments.

A distinction is also made between public and private savings. In this case, the results on the economy are not similar because economists along these lines think that the state's action to mobilise resources has precise effects: in most cases, they result in inflationary pressures, whether from the issue of currency or from the disturbances resulting from' an excessive growth of public debt. On the other hand, the theory states that, since the marginal propensity to consume in the public sector is higher than in the private sector, an increase in the government's disposable income will be relatively less successful in increasing the total amount of savings.

On the private savings side, it is determined primarily by income. Several theoretical nuances are introduced but income is the key factor in determining individuals' consumption and savings decisions. Once the origin of the resources that will finance the economic expansion has been determined, and remembering that, for this theoretical position, these resources come from variables internal to the model - which is not the case in Schumpeterian formulation, for example - the financial system as a participant in the growth process that originates in investment is changed.

Gillis defines four major functions of a financial system: 1. money supply; 2. financial intermediary, by collecting savings and distributing them among investors; 3. performance of a diversification of the role of conversion and distribution of risks by the possibilities offered to savers and investors; 4. participant in economic stabilization policies, especially in combating inflation. The financial system helps productive sectors to make portfolio decisions and manage their resources in a clear service delivery relationship. GILLIS, Malcom and alli. Economie du développement, Brussels, (DE8OECKWESMAEL, 1990), apud (TEDESCO, Lins, 1995 p.11).

Financial systems represent a cornerstone of economic development. To ensure that resources are efficiently mobilized and allocated among different actors, systems must be properly regulated and also expanded to offer a wide range of instruments and services. For Gulde-Wolf (2016), deepening financial development also supports the creation of a wider range of products and services, improves risk management, makes payments easier and helps lenders better monitor their clients. It also provides tools, such as insurance packages, and information to help families and businesses cope with adverse events, which makes consumption and investment more stable. However, countries also need to be aware of the risks to the financial system and its impact on the economy, as regulation in many countries is not yet fully aligned with global best practice and implementation remains weak, improving regulatory frameworks and strengthening supervisory capacity and oversight powers are essential. Gulde-Wolf (2016) believes that among many other reforms, harmonisation of regulations and supervisory procedures to avoid regulatory arbitrage and the establishment of an appropriate mechanism for the resolution of non-viable financial institutions are priorities. Finally, financial supervisory bodies should carefully monitor the risk related to monetary transactions through mobile devices as they gain popularity among the low-income segment of the population, ensuring the security of household resources and enabling them to make transactions more easily, save for more difficult periods or take out a loan to open a business.

Financial System and the Granting of Bank Credit

The extra purchasing power created by banking will then lead to an expanded product and additional income for economic agents. Lins (1995, p. 9) argues that this purchasing power created through credit to the productive entrepreneur has effects on the general evolution of the economy. Consumer credit is merely a transfer of resources between agents. Investment can modify part of the economic structure. Newly created credit, not being the counterpart of a quantity of money already present in the economy and being an increase in demand with no corresponding additional supply, has inflationary effects through the growth of money supply in the economic circuit. As supply grows as a result of investment expansion, there will be downward pressure on prices and the economy will gradually return to equilibrium.

The banks' vision through investment theory puts them in a position of independence from their customers, especially corporate initiatives. Lins (1995) argues that the independence and strength of financial institutions rests on their ability to create resources and mainly on promoting a concentration of these resources. Banks therefore interfere in the allocation of credit, which will serve as a basis for the expansion of productive capacity, since demand for the resources they will offer will be determined by companies' investment decisions. In this way, financial institutions participate at various levels in the development process: by being holders of credit, by participating in some way in the decision on the use of credit - by determining the conditions of the credit agreement - and by the consequent increase in their political and institutional participation in economic organization. Banks come into play in the event that the securities are not paid, in order to provide the necessary currency and, more importantly, by pooling all these securities and setting up a credit fund. Thus bank credit came into being. As the banking system develops, producers' surpluses (idle capital) are deposited in the banks and allow the credit system to expand as well as its value outside the productive sphere.

Credit analysis is fundamental in the credit decision-making process, since it presents the debtor's present situation, drawing up an opinion that clearly and objectively demonstrates the customer's economic and financial performance. According to SOUSA (2012) the main objective of credit analysis is to define analysis procedures in order to identify the degree of risk in the granting of credit by developing tools that allow the identification of risks in the information provided in order to reduce the risk of default. Banks assess risk and credit quality through quantitative and qualitative indicators. In this way, credit analysis can be done in a subjective or objective manner, according to the indicators used (SOUSA, 2012): a) subjective analysis: based on the experience acquired and the sensitivity of each analyst with regard to the viability of the credit; b) objective analysis: focuses on statistical methodologies in order to ascertain mathematical results that test their ability to pay.

Six elements are identified to be taken into account when talking about bank credit: purpose, term, price, amount, risk and guarantees, these being dependent on each other. When the customer applies for credit, it is essential for the financial institution to know what use the customer will make of the financing. In this way, the purpose of a credit is understood to be what will be bought with the amount made available by the bank, as well as its use. There is a need to ensure that the purpose of the credit is legal and that it is in accordance with the credit policy defined by the bank. In this sense, the amount of credit is directly related to the purpose of the credit, and is determined according to the value of the good to be purchased and the customer's own needs. The amount must be justified by actual needs and limited to those needs in order to eliminate the possibility of excesses leading to losses (SOUSA, 2012).

Table 3 - Role of financial intermediaries in the different approaches

Approach	Function

"Old" Theory of Intermediation Financial	The primary function of intermediaries is to issue debt against themselves, indirect debt, in soliciting borrowable funds from surplus spending units, and to allocate these borrowable funds among the deficit units whose direct debt they have absorbed.
Information asymmetry	Banks can form long-term relationships with firms, and through monitoring partially bypass the moral hazard and adverse selection problems that are inherent in financial intermediation. Financial institutions are thus coalitions of agents that benefit from gains of scale in monitoring activity, reducing the cost of obtaining and/or processing information, acting as delegated monitors for the benefit of savers by monitoring the behavior of debtors.
Transaction Costs	Financial institutions function as a coalition of agents that seeks to exploit economies of scale derived from the use of transaction technologies and economies of scope as a function of their portfolio diversification; that is, banks provide liquidity to financial assets and diversify opportunities for savers and investors, and their functionality rests on reducing the transaction costs of financing activity.
Regulation	It highlights the importance of regulations on money creation and savings and financing processes in the economy, since regulation affects the solvency and liquidity of the financial institution, since banks in particular for their typical activity as maturity transformers face the risk of insolvency and illiquidity.
Risk Management	The main function of financial intermediaries is risk management in its different forms - maturity, default and market. Financial intermediaries manage risk more efficiently and less costly than other economic agents, because their scale of operation allows for diversification of the investment portfolio, understood as necessary to provide the security required by savers.

Source: Paula (2013)

Conditioning Factors for Granting Bank Credit

According to Lins (1995, p.6), interest rates directly influence economic agents' taking out of credit because they are the basic price of this credit. Moreover, as a holder of resources, interest rates are a parameter considered in a decision between a productive investment and the application of these resources available on the financial market. The reference interest rate for the economy as a whole was that practiced on the open market in operations with public securities. For Jossefa (2011), The financial system plays a multidimensional role in the process of economic development because the interaction of economic agents in economic activity involves information or transaction costs resulting from market imperfections, which should be minimised. To this end, the existence of financial intermediaries is important. The presence of financial intermediaries helps to mitigate the problems arising from transaction and information costs, a fact which helps to influence savings and investment decisions and, as a result, economic growth.

Financial intermediaries can influence growth through the following channels: reducing information acquisition and processing costs, and thus improving the allocation of resources to households; strengthening the monitoring of business operations, which can, on the one hand, reduce credit rationing levels, and, on the other, facilitate the flow of resources from savers to investors. Jossefa (2011) considers that risk diversification, a fact that may induce savers to direct their investment portfolio towards projects with high expected returns; mobilising individual savings in order to deepen the economic growth process, a fact that allows better use of economies of scale; the use of money as a more effective means in the trading process, allowing transaction costs to be reduced, thereby promoting greater specialisation, innovation and economic growth (MISHKIN, 2000; BENCIVENGA and SMITH, 1993; LA FUENTE and MARIN, 1996; DEVEREUX; SMITH, 1994; OBSTFELD, 1994). A financial system with intermediaries that fully comply with the financial functions generates added benefits for economic growth. Indeed, the importance of the financial system in economic growth lies not only in the need to increase the quantity of investment, but also in its quality (BECSI and WANG, 1997).

In the Hillerding model, banking activities arise from the expansion of commercial activities among capitalists. Initially, transactions are made through the exchange of bills of exchange between different capitalists. This movement is linked to the process of circulation of goods, because a producer delivers his goods but does not always receive payment in cash, his customer presents him with a bond with a certain time. This bond can be used by the producer as a means of payment for raw materials, for example. This is a kind of multiplication of credit by the circulation of these securities. The quantity of goods in circulation grows without the demand for money having to grow as well. This mechanism can be reproduced without the intermediation of banks. The banks come into play if the securities are not paid for, in order to provide the necessary currency and, more importantly, by pooling all these securities and setting up a credit fund. This is how bank credit came about. As the banking system develops, producers' surpluses (idle capital) are deposited in the banks and allow the credit system to expand as well as its valuation outside the productive sphere.

Hilferding has defined the main activities of banks: 1. they are insiders in payment relationships. which they expand by concentrating these payments and offsetting their local differences; 2. they transform inactive monetary capital into active monetary capital; 3. they collect in the form of money the rents of all classes and make them available to capitalists. The banks now remunerate the deposits entrusted to them and, in order to enable them to expand, they open branches. As banking activity develops, the company sees its relations with the banks modified. Intercapitalist competition makes credit an important instrument in the struggle for markets. Credit. (LINS, 1995 p.9).

African Financial System

When the financial crisis hit Africa in 2008, the continent was on the rise. It recorded a growth rate of over 5% between 2003 and 2007, systematically exceeding the world average. This growth, stimulated by an important set of reforms, was also both the consequence and the conduct of historically high levels of domestic inflows and resources. According to Dahou et al, 2009, financial flows to Africa have recorded unprecedented levels of growth in recent years, thanks to rising commodity prices, African exports almost doubled between 2000 and 2006, from $159 billion to $290 billion. Capital flows, including foreign direct investment (FDI), portfolio equity and loans have increased fivefold in this period and exceeded $60 billion. On the eve of the crisis, more domestic resources were also available for African governments and private entrepreneurs than ever before. Governments totalled revenues as a percentage of GDP, which increased from an average of 21% to over 26% between 2001 and 2006 for Sub-Saharan Africa as a whole - reaching a total of $185 billion, representing almost six times the volume for the subcontinent. In addition, between 2002 and 2007, the capitalisation of African stock markets increased from $250 billion to more than one trillion. (DATHEIN, 2003). The author believes that despite these positive developments, African growth has not yet proved sustainable and fully inclusive, even before the crisis. While GDP growth and macroeconomic stabilisation have reassured and encouraged private investors, they are still highly dependent on commodity prices, leaving the continent extremely vulnerable to deceleration. This was illustrated by the Crisis, whose main channel of transmission on the continent was the collapse of export earnings after the decline in global demand for mineral and fossil resources. Therefore, one of the most pressing issues for Africa is to channel existing resources into productive investment so that they can stimulate productivity, create employment, provide individuals and businesses with basic services, and contribute to efficient management of natural resources.

In Africa, the quantity of quality human resources to meet the growing challenges of globalisation and national and continental development is insufficient, and the few Africans with adequate education and training work and reside, in large numbers, outside the African continent. On the other hand, the many skilled foreigners who work and reside in Africa are mostly involved in production processes oriented outside Africa. Legislation regarding nationality and employment in most African countries is still extremely rigid, closing the door to immigration of skilled labour from other parts of the world. However, the world insists on making us believe that humanity has become aware of the urgency of economic development on a global scale and with an emphasis on Africa. The Millennium Development Goals (MDGs) and the Monterrey Consensus, among others, bear witness to this belief. Africa has a relatively short time to face and overcome a number of barriers to its desired economic growth and development. Characterising the continent in this way does not symbolise or presuppose, let alone imply, any kind of African pessimism. It is necessary to reflect on the current state of affairs in Africa of the factors that we believe are driving growth and economic development. Abreu (2007, p.45).

The private sector plays an increasingly important role, not only in mobilising funding, but also in building skills and know-how and promoting innovation. In this regard, large philanthropic foundations are playing an increasingly important role, engaging in mixed lending and investments with social impact (AfDB et al., 2015). Several studies indicate that in recent years many developing countries have been a laboratory for financial sector reform. (Detragiache et al. 2008) believe that a rigorous evaluation of these efforts is still work in progress, but available reports suggest that the main weaknesses have been difficult to address.

Foreign banks operating in poor countries, the geographical and cultural distance between headquarters and local subsidiaries is likely to be especially large. In addition, many, if not most, of the potential usable collateral borrowers and reliable accounting information are difficult to inform. Thus, the problems highlighted by bank consolidation studies in advanced countries can be compounded when foreign banks operate in poor countries. Consistent with this view, several studies have found that banks in poor countries lend predominantly to multinational corporations, large domestic firms, or the government. Detragiache et al (2008). Financial markets can play a critical role in this respect. The savings-investment-growth link remains central to the issue of financial sector development, and the ability of financial institutions to play their full role as intermediaries, placing well-functioning infrastructures in the banking sector and capital markets is crucial as it catalyzes domestic and foreign resources for growth and investment. (DAHOU et al 2009).

Most developing countries, and Africa in particular, have inefficient and high-risk financial systems, which to some extent constrains foreign direct investment in the sector, a key element in promoting economic growth and development. Thus in these countries, the search for efficiency in the financial system and its multiplier effect has been one of the measures or the cause of programmes to restructure and modernise banking services.

Financial system performance in African countries indicates limited mobilisation of domestic resources; its channels for productive investment - the mobilisation of savings - have been very slow and private sector lending very problematic, especially for small lenders (Aryeetey, 2009). One of the good news is the easing of inflationary pressure; the improvement in the food crisis; China's continued support even though it has shrunk the Asian giant's economy; and the maturation and robustness of sub-Saharan economies compared to a few years ago to cope with situations of this magnitude. (Aryeetey, 2009), apud Fernandes (2012, p. 3).

Strengthening domestic resource mobilization will be crucial to counterbalance the decline in development aid. African governments need to make greater efforts to strengthen tax systems, expand the domestic tax base and strengthen local financial markets to attract other private flows. These domestic resources, however, will not be sufficient to meet financial needs. More and better aid will remain a key complement, especially in low-income countries (AfDB et al., 2017). For the African Development Bank, private capital flows can also contribute significantly to the development of local entrepreneurship, including in stimulating technology-based innovation in local financial services.

The availability of fiscal and monetary policy expertise to developing countries is very valuable. As public authorities and independent economists in emerging countries reach ever higher standards of training and professional expertise, this function becomes increasingly important. For Mozambique, from an economic policy perspective, the Mozambican economy from 1975 to 1984 was marked by excessive reliance on the state's ability to direct production and distribution of goods and services needed in the economy, through centralized economic planning, based on a series of measures to regulate corporate economic activity, which included not only those considered strategic sectors. (WOLF 2009. p.190).

Final Considerations

For a well-functioning financial system, macroeconomic reforms with diversified financial products, stability, effective enforcement of laws and regulations, and functioning asset registration systems are needed. Transparency and availability of information are also essential to reduce screening costs and prevent adverse selection. Fortification of an institutional framework makes it central to the smooth functioning of financial systems that well-established property rights, together with efficient judiciary, promote investor confidence and decrease sorting and monitoring costs. In most African countries, institutional capacity tends to be lacking when it comes to property rights, cadastre systems and non-compliance with contracts. The main reason why individuals do not apply for or receive loans is insufficient collateral, which is the result of an inefficient system of registration of movable property and lack of adequate resources such as documentation for property claims. In fact, collateral requirements in Africa are extremely high compared to other regions.

On the supply side, banks tend to favour large companies and active governments to minimize risk, and similarly, due to lack of information on creditors and perceived risk of default, there is a fragmentation of the financial system with large parts of the population without access to formal financial institutions. Despite the size of the informal sector in most African economies, financial institutions tend to operate only in a fraction of the market and generally do not take into account the informal sector. This is attributed to the fact that since these enterprises are not registered, it becomes much more difficult to execute contracts and therefore more expensive for banks in terms of monitoring and screening costs.

A typical feature of most banking sectors in African countries is the high concentration ratio with a large share of assets held by the largest banks and this leads to excess liquidity and risk aversion. At an aggregate level, the World Bank estimates the average market share of the largest banks in Africa at around 73%. This oligopolistic banking sector has negative consequences, among which are high interest rate spreads that take credit away from the private sector, making loans very expensive. In this context, banks tend to favour government assets, resulting in low intermediation rates and a smaller share of credit allocated to the private sector.

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