# Southern Africa's largely conservative banking sector makes private capital all the more vital

By Martin Soderberg

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I don't think anyone would argue with me if I characterised Southern Africa's banking sector as largely conservative. While there are, of course, variations within and between countries, you'd have to search pretty hard to find banks taking significant risks. That's especially true for the region's biggest, most well-established banks, some of which can trace their origins back almost 200 years.

Source: Supplied. Martin Soderberg, managing partner at Spear Capital.

That conservatism isn't necessarily a bad thing either. Coupled with a robust regulatory environment (with South Africa again the leading example), it meant that most banks were able to ride out the 2008 Financial Crisis.

It's also allowed them to survive several subsequent financial shocks, including the Covid-19 pandemic and the more recent sector tremors that took down Silicon Valley Bank and Credit Suisse.

That conservatism does, however, mean that banks can't always play as big a role in growing businesses as they do in other markets. Given the opportunities and potential advantages of the region, that in turn means there's a substantial gap for private capital to step into.

## Understanding conservatism

Before looking at how players in the private capital sector (including private equity and venture-capital firms) can unlock those opportunities, it's worth taking a deeper dive into some of the underlying causes behind banking conservatism and its effects on businesses in the region.

In addition to the robust regulatory environment mentioned above (again, some countries are better at this than others), banks in Southern Africa typically prioritise risk management. That means that many adhere to conservative lending practices. It's an approach which aims to mitigate the potential for loan defaults and maintain the overall stability of the banking sector. That's understandable and has largely been a good thing, helping prevent ordinary people from losing their savings and reducing the need for massive government bailouts.

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But it also means that many businesses simply aren't able to use banks as a viable source of funding. It's worth noting, for example, that as recently as 2020, SMEs accounted for just 25% of South African business loans. That's despite the fact that they account for more than 98% of all businesses in the country and employ anywhere between 50%-60% of its total workforce. Similar stories can be found across the region, with many loan guarantee schemes relying on support from government bodies and aid donors.

And SMEs aren't the only businesses who might struggle to access funding from banks. For obvious reasons, larger companies that are struggling but can be turned around often also struggle to get funding from banks.

But these are precisely the kind of companies that can help fuel economic growth and, importantly, employment and development with the right kind of funding and investment.

## The power of private capital

With banks willing to play such a limited role, it falls to other players to fulfil the region's business funding needs. Private capital in particular has a critical role to play.

And, over the past few years, it's been playing that role to a growing extent. While much of the focus in recent times has been on record funding in the technology startup sector (particularly within the broader African context), private equity has been busy in other sectors too.

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In Southern Africa alone, R14.9bn in investments were concluded in 2022, with more than R206.2bn in funds under management (up from R195.1bn on 31 December, 2022). That money's also going into sectors including energy, logistics, and food processing, all of which are critical to the region's development.

While global macroeconomic factors mean that investment levels are widely expected to fall through the course of 2023, it's important that investors not lose sight of the region's potential. That's especially important for international investors looking for long-term returns.

## Opportunities outweigh challenges

For all the very real challenges faced by businesses in Southern Africa, the region still has a lot going for it. Aside from its abundance of natural resources, both extractable and renewable, it's also home to a young and growing population. Overall, that population is also increasingly well-educated and connected.

That's not only driving increased consumer demand but also means that the region is home to a growing body of skilled young people who are motivated to build and grow the kind of companies that improve lives across the region. As population sizes around the world stagnate and even shrink, that young population will prove to be an increasingly important engine for global growth.

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Further optimism can be found in the fact that free trade across the region and the broader continent is becoming increasingly easy thanks to initiatives such as the African Continental Free Trade Area (ACFTA) and improving bilateral relations between countries in the region.

Make no mistake, there are very real challenges in the region, but most of them are known and can be overcome. The rewards, however, are potentially much bigger.

## Making the most of the status quo

So, rather than bemoaning a conservative banking sector (which, by the way, is increasingly embracing innovation), it's important to remember why it's that way and what potential economic disasters its conservatism's helped avert.

Perhaps more importantly, players in private capital must realise how big a role they can play in growing businesses across the region within that context. And for those not already involved in Southern Africa to realise how big an opportunity there is. That opportunity is particularly big if they partner with parties that have extensive, on-the-ground experience and a strong track record of growing the kind of companies that will fuel the region's growth in the coming years.

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