A Work Project, presented as part of the requirements for the Award of a Master's Degree in Finance from the NOVA – School of Business and Economics.

THE FINANCIAL SYSTEM IN MOZAMBIQUE: OPPORTUNITIES, BARRIERS & MARKET POTENTIAL

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January 2015

Abstract

This research is empirical and exploratory intending to analyse the attractiveness of banking in Mozambique, considering its positive outlook. To identify the opportunities and barriers, the methods adopted were elite interviews with banking executives, complemented by secondary data. The opportunities for new entrants seem to include *bankarization* and the emergence of micro and small-medium enterprises; other avenues seem to include investment banking, support of mega-projects (e.g. energy, infrastructures) through syndicates and cooperation with multilaterals, and the participation in developing capital markets. Conversely, the main barriers include shortage of talent, inadequate infrastructures, poverty, unsophisticated entrepreneurial culture (e.g. informal economy, inadequate financial reporting), burdensome bureaucracy (e.g. visas), foreign exchange regulation, as well as low liquidity and high funding costs for banks. The key conclusions suggest a window of opportunity for niche markets, and new products and services in retail and investment banking.

Key words:

Mozambique, banking system, retail banking, investment banking

List of Abbreviations

BCI	Banco Comercial e de Investimento	**IFB**	Instituto de Formação Bancária
BM	Banco de Moçambique	**IMF**	International Monetary Fund
BS	Banking System	**M-banking**	Mobile banking
BVM	Bolsa de Valores de Moçambique	**Mbcp**	Millennium bcp
CIs	Credit Institutions	**Mbim**	Millennium bim
CPI	Centro de Promoção de Investimentos	**MFIs**	Microfinance Institutions
FCs	Financial Companies	**NISS**	National Institute of Social Security
FDI	Foreign Direct Investment	**ROE**	Return on Equity
FIs	Financial Institutions	**RQ**	Research Questions
FS	Financial System	**SIMO**	Sociedade Interbancária de Moçambique
FSDS	Financial Sector Development Strategy	**SQ**	Strategic Questions
FX	Foreign Exchange	**MSME**	Micro, Small & Medium Enterprises
HR	Human Resources	**WB**	The World Bank

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Preliminary Note

The research for this thesis was performed following a recommendation from *Nova School of Business and Economics* in partnership with *BiG - Banco de Investimento Global*.

1 Introduction

This study focuses on analysing the FS in Mozambique, particularly the BS. The central purpose of the research is to explore the opportunities and barriers facing the BS, concluding about whether this is a favourable time to enter the banking market. The singularity of the Mozambican FS deserves special attention due to its size and complexity, and because Mozambique is a fast growing country with a FS struggling to follow economic expansion.

This dissertation intends to contribute to a deeper research of the BS due to disperse and out-dated information. Moreover, the access and use of financial services is increasing, improving economic activity and living conditions. Therefore, at the current development stage, Mozambique may offer attractive conditions for the establishment of banks.

The structure is as follows: (i) the next chapter presents the current BS framework (e.g. dynamics, main players, legal and regulatory framework, development strategy); (ii) chapter 3 discusses the strategic and research questions, the methodology and methods of this empirical and exploratory research; (iii) chapter 4 discloses and interprets the findings; and finally, (iv) chapter 5 draws conclusions and recommendations concerning the potential of the BS, as well as identifies some topics for further research.

2 Background and Literature Review

2.1 Economy, Financial System & Banking Sector

Mozambique is a country with potential for economic development (Mbcp, 2014), as it enjoys a *geostrategic position, being a gateway to southern Africa* (Ibraímo, 2011), and is rich in natural resources. The country is making an effort to eradicate poverty and qualify HR, alongside implementing reforms and maintaining institutional stability to have incentives for leveraging its resources (Mbcp, 2014). Over the past 10 years, Mozambique has been growing between 6-9% (WB, 2014[d]), one of the fastest growing countries in the world. Forecasted growth should remain high[1], sustained by the extractive industry and investments in natural gas (AICEP, 2014). The main growth drivers are FDI and public expenditure, and in 2013, the fastest growing sectors were the extractive sector and the financial sector, propelled by increased income and credit expansion. Other dynamic markets include construction, transportation and communications, associated with infrastructure development and large-scale projects (Santos, 2014).

The FS is undeveloped and based on the BS (Santos, 2014), being composed by banks (18), credit cooperatives (7) and MFIs (8), comprising also an "incipient" stock exchange (BVM), and non-banking FIs that belong to the informal sector (Jossefa, 2011). The FS encompasses 3 institutional categories: CIs (e.g. banks), FIs (e.g. activities that include credit, payment means, transactions in monetary market, financial and FX markets), and supervisors (e.g. BM[2]) (GLM & PLMJ, 2014). Improvements in the regulatory context, in the macroeconomics, as well as the increasing FDI in the financial sector, are stimulus to the FS growth and modernization (Mbcp, 2014).

Regarding the BS, it is one of the most dynamics in Africa, competing in a highly concentrated and asymmetrically distributed market [4 banks have 82% of total deposits and 78% of total credit

[1] More than 7.5% annually, from 2014 to 2019 (IMF, 2014; WB, 2014[b])
[2] The BM is responsible for conducting the monetary, FX and financial policies, acting as a government's advisor in the financial area, and controlling inflation (BMI, 2014).

(2014)]. The leader is Mbim, followed by BCI and Standard Bank; others include Barclays, Moza and Banco Único (Mbim, 2014), most of which have foreign shareholders (Mbcp, 2014). These banks invest heavily in technology and HR under a strategy focused on clients' needs, offering innovative products/services (e.g. leasing, cards) and developing specialized business segments (e.g. affluent, corporate and investment banking), besides retail banking. They seek to expand and promote *bankarization*[3] (people who have access to and use banking services, having a bank account).

Bankarization grew from 6% (2005) to 20% (2012) (BM, 2013), due to increased branches' *capillarity*, with 501 branches covering 63 districts (49% of total) in 2012, compared with 27 covered in 2005 (21% of total) by 228 branches (KPMG, 2013; Villalobos, 2014), and technological developments (e.g. m-banking). Remote channels more than duplicated, reaching 1,176 ATMs and 12,359 POS (2009-2014) (BM, 2014), and in 2011, SIMO was launched, to centralize the payment system (BM, 2013). Though, according to Manuel Chang (Mozambique's Finance Minister), *the country's coverage by banks is still very reduced* (Villalobos, 2014). 80% of the population is not *bankarized* as branches are concentrated in urban areas (Jossefa, 2011), not covering 42 districts (BM, 2013). M-banking seems critical, promoting *bankarization* and financial literacy (Vicente, 2013). The FS growth trend is expected to last due to increasing *bankarization* and investments (Mbcp, 2014).

The BS seems robust, registering high growth rates in total assets[4] [aggregate net assets of US$6.6bn in July 2014 (BM, 2014)] and profitability. In 2013, the average ROE of the 3 main banks was 20% (Dionísio, 2014[a]), while impairments decreased below 4% (AIP, 2014). A factor driving these indicators is the credit increase, which grew by 26.8% in 2013, reaching US$4.8bn (32.6% of GDP). Over the same period, deposits grew by 17.5% to reach US$6.2bn (41.7% of GDP) (BM, 2014). Other related factors are the efficiency improvements in financial intermediation and the innovation in the FS, both with a positive effect in cost reduction and higher profitability (Gove, 2013).

[3] Mbim, BCI, Standard Bank, Moza Bank and Banco Único Annual Reports and KPMG report, all published in 2013.
[4] The average annual growth in total assets was 26% between 2008-2013 (BMI, 2014).

The BS is proving its resiliency to external and internal challenges that affect the economy, maintaining adequate levels of solvency and impairments (Gove, 2013). In addition, the decrease in inflation, from 12.7% (2010) to 4.2% (2013), allowed a decrease in the Standing Lending Facility to 7.5% (WB, 2014[d]; BM, 2014), which associated with controlled inflation, might pressure banks' lending rates down, stimulating the economy. In general, banks charge their prime-lending rate of 15%. This rate level can be explained by 4 main factors: (i) higher operating expenses of banks, due to inadequate infrastructures, weak internal systems and security risks, which are reflected in the rates' calculation structure; (ii) limitations in assessing borrowers' creditworthiness, as banks compensate the potential impairments charging high rates; (iii) banks are major government lenders, with less incentive to finance the riskier private sector; and (iv) considerable mismatch between supply and demand, in which businesses experience difficulties due to lack of access to capital (BMI, 2014).

Despite endogenous and exogenous barriers [e.g. high cost of credit, weak HR, deficient infrastructures, and onerous regulations (República de Moçambique, 2013; AIP, 2014)], the BS seems viable and attractive to banks, due to profitability and economic growth, which raise opportunities, such as *bankarization*. In fact, in 2014, *fDi Markets* identified Mozambique as the preferred African location for foreign retail banks establishment (Porter, 2014). The BS outlook is characterized by increasing competition, seeking efficiency to maintain profitability (KPMG, 2013).

Legal framework, development strategy and capital markets

Banks are supervised and regulated by the BM, and must have a minimum capital of US$2.3m[5]. The CIs and FCs Law[6] and the Code of Banking Conduct (RSA, 2013: 821-831) constitute the main legal framework. Other measures[7] to increase financial inclusion have been launched (BM, 2013).

[5] RSA, 2013: 591 – Notice 4/GBM/2005, 25 May (MZN 70 million)
[6] RSA, 2013: 187-224; 225-261 – Law 15/99, of 1 November, updated by Law 9/2004 of 21 July; Decree No. 56/2004, of 10 December
[7] E.g. Notice No. 5/GBM/2009, of 18 May regulates the regime of fees and other charges, and Notice No. 4/GBM/2012, of 26 December, establishes a special regime applicable to banks and micro banks that want to extend their activity to the rural areas.

Regulation establishes tight procedures and deadlines for FDI[8] (e.g. licenses, profit repatriation, exemptions of duties, hiring foreign employees), as well as strict controls over FX transactions[9].

The government approved the FSDS 2013–2022, to improve financial inclusion, identifying policies such as, to promote m-banking, improve the interaction between banks and MSME, and provide basic infrastructure (e.g. energy) and financial literacy programs (República de Moçambique, 2013; Simione, 2014). Within the FSDS, the government requested support from the Programmatic Financial Sector Development Policy Operation (US$25m in 2014), which aims financial stability, financial inclusion, and financial markets development (WB, 2014[c]), as well as technical assistance from the IMF in the sector surveillance, payments' system, and in money market (Simione, 2014).

The capital market was created in 1998, diversifying financing sources to promote savings and investment (AIP, 2014). The BVM is undeveloped (4 listed firms), with a market cap of US$1.3bn[10]. It manages the secondary market (e.g. registration, clearing and settling), with transactions executed electronically, allowing an efficient and transparent trading (GLM & PLMJ, 2014). Though incipient, it shows some development (e.g. in 2012, the securities admitted for trading grew 28%) (AIP, 2014).

3 Strategic & Research Questions, Methodology, Methods and Interviewees

The following RQ were developed to answer the SQ below:

Strategic Questions (SQ)	Research Questions (RQ)
1. What are the opportunities and barriers for FDI in the Mozambican BS?	i. Which type of opportunities Mozambique offers in the BS? a. How does economic growth influence opportunities in the BS?
	ii. Which barriers are relevant to operate the Mozambican BS? a. How do these barriers affect the BS's development?
2. Is this a good timing for a bank to enter in Mozambique?	i. What is the potential for a bank entering in Mozambique?
	ii. What are the main challenges banks face in the near future?

The RQ will approach themes such as the macroeconomic context, the BS competitive environment, the legal framework, opportunities and barriers.

8 RSA, 2013: 791-804 – Law No. 3/93, of 24 July; Decree No. 43/2009, of 21 August
9 RSA, 2013: 643-701 – Law No. 11/2009 of 11 March - Exchange Law; Decree No. 83/2010 of 31 December – Exchange Regulation
10 BVM Website (market cap registered in October 3, 2014).

The interpretive research is the methodology elected, advocating that knowledge provides a context for thinking about action, without specifying it. "The link between understanding and action is seen as indirect because the world is complex and opinions for action are not always clear" (Fisher, 2010). Gaining a reasonable perception of the BS is possible if one can have an inside view. Only after, it should help using judgment to reach a better choice, reason why the method adopted was semi-structured interviews, to provide a vision of the local context from both the foreign investor and locals. Miles (1994) advocates that "qualitative data, with their emphasis on people's "lived experience", are well suited for locating the *meanings* people place on events, processes and structures, *(…)* connecting these meanings to the *social world*". The fact that this study can be seen as an "empirical and exploratory research", due to lack of investigation on the topic, influenced the method choice – semi-structured interviews –, selected as most suitable for many reasons, such as to allow some degree of control over interviews, to explore ideas to delve deeper into a topic and/or allow another topic to be raised within the defined framework, and to probe for further clarification. This type of interview permits collecting detailed information in a "conversational" and flexible style, while using a "guide" with questions/topics to be covered (Bryman, 2007; Harrell, 2009). Although the open-ended questions give the interviewee some latitude to answer, the researcher should be focused on the interview goals and may use probes to clarify/explore responses or cover additional information within the topic (Prasad, 1993; Fisher, 2010). These interviews may allow interviewees answering more "genuinely" rather than in a "politically correct" way (Ferraz, 2012: 57), disclosing more relevant information. The context of the research influenced the choice of "elite interviews", as the BS is highly hierarchized and individuals on "top of the pyramid" may have a wider and richer outlook over the sector. In this study, elites follow Hornby's (1983) definition, as a "group in society considered to be superior because of the power, talent, privileges etc. of its members".

9 "elite interviews" were performed with executives (4) and directors (5) of banks (5 residents, 2 former residents and 2 non-residents), all with relevant banking experience and responsibilities in Mozambique, working for banks with Portuguese (4), Mozambican (2), South African (1) and British (1) backgrounds, which show the perspectives of different foreign investors. Their multicultural background, associated with their status, contributed to enrich the research, providing scenarios about opportunities and barriers, and their experience both from local and foreign managers/executives represents a robust element of the research, as their view should be a reliable source to answer the SQ. The interviews were conducted face-to-face (4) and via Skype call (5), all in Portuguese and during c. 35 minutes each on average.

The research can raise ethical issues, because of sensitive information, reason why the interviews were realized under a confidential and anonymous fashion; to ensure the understanding of the participants' involvement, a consent form was signed and returned to the student. After consent, the interviews were recorded for the purpose of being transcribed, organized in sub-topics (e.g. *bankarization*, human resources) within each main theme (e.g. opportunities, barriers), and translated. Additionally, self-selected pseudonyms were used to protect the participants' identity.

4 Discussion of Findings

4.1 Emerging Issues

The following figure shows the main topics addressed during the interviews:

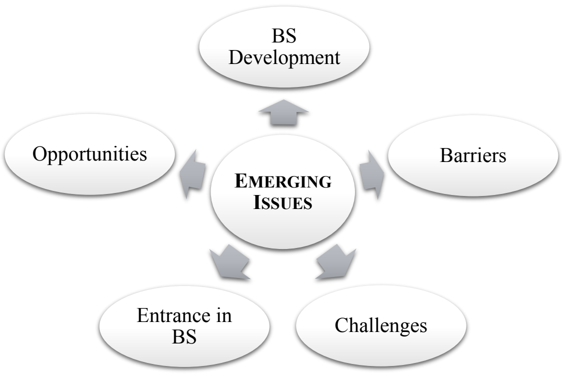

Figure 1: Emerging issues from the research

4.2 Banking Sector Development

Considering the African context, the Mozambican BS is largely developed [Matt] *and has huge potential* [Peter]. *It is characterized by the entry of new players, fierce competition* [Matt], *and a dynamic competitive environment. (…) It is not an incipient market* [John], being *in line with international standards (…),* which *derives from the fact that the market leaders are strong at their origin markets* [Peter]. *Nevertheless, there is a clear distance to the developed markets* [John], as the BS is *largely linked to banking fees (e.g. in raising money, in transfers). (…) Therefore, typically, larger banks have higher profitability, as they generate more commissions* [Ron]. In fact, *the sector's total assets are not high, but the financial margins offset the market's dimension* [Tom].

The BS expansion is, in part, due to the mega-projects, which generate employment and, in turn, increase demand for banking services [Kim]. Additionally, major banks implemented e-banking services, promoting bankarization. *It is curious to see the growth in cards, POSs and ATMs* [John]. Banks *have expanded simpler and transactional platforms, because individuals, in general, are very transactional* (e.g. *the m-banking does around 3 million transactions per month). (…) The distances are significant, and the network is insufficient (…), thus, people use more technology, more ATMs* [Eve], and *clients have adhered very well* [Lee]. The BS *shows growth, but poorly distributed (…), however, prospects have attracted private banks* [John], confirming *fDi Markets* study (Porter, 2014).

In conclusion, the BS is developing, reduced in total assets, and with profitability strongly linked to banking commissions. Although the banking network seems insufficient and poorly distributed, the sector shows progresses through the implementation of e-banking (e.g. m-banking, POSs, ATMs).

4.3 Banking System Opportunities

Opportunity 1 – Bankarization

Although *bankarization* is growing (Dionísio, 2014[a]), there is *a low bankarization rate* [Tom], as *the bankarized are around 3 million comparing to a population of c. 25 million* [John]. *More than 70%*

of the population is not bankarized [Alex] so, that is *an opportunity to stimulate expansion. (…)* In addition*, banks are concentrated in cities, allowing entry to explore the BS coverage deficit* [Matt]. Notwithstanding, this opportunity imposes *a challenge of bringing the BS to rural locations, (…)* where *is not viable to install branches due to lack of infrastructures.* On the other hand, *m-banking is increasing and experiencing a positive effect (e.g. money transfer and service payment by mobile phone); hence, the market is in transformation* [Kim]. *Dispersion is reduced through telecommunications,* reason why *(…) strong investments are being made to capture non-bankarized that use cell phone, and thus, even though not having a direct relationship with the bank, they end up having it via mobile phone. M-banking works successfully*, and people in general adhere to it *because it makes life easier, as clients take long time in banks' queues, and through mobile phone they do not even need to leave the place where they are to do a set of banking operations* [Matt].

To conclude, *bankarization* is growing, but still stands around 20% of the adult population, mainly concentrated in urban areas. Therefore, there is a vast market to address and a large coverage deficit to explore. In this regard, banks are focusing on m-banking, which is increasing and having a positive impact by facilitating life to clients in processing banking operations.

Opportunity 2 – Natural resources, mega-projects, & MSME

Mozambique is seen as a country with high growth potential in sectors such as mining, renewable energy and agriculture, among others (Ibraímo, 2011), which is achievable due to its richness in natural resources (KPMG, 2014). Thus, *in this regard the country holds some opportunities* [John], especially through FDI attraction, exportations and the mega-projects (Santos, 2014).

The mega-projects *develop the surrounding activities* [Ron]*, ending up leveraging the BS. (…)* In fact, those *projects are much bigger than the economy, so they are not for the Mozambican banks* [Tom], as they *do not have capacity to finance them* [Matt]. Moreover, *the large multinationals (…) come and then go, (…) so they will not be the ones making the difference* [John]. What happens is that *the BS will get much of the business around those mega-projects* [Tom], such as *treasury services, payments and adjacent services* [Matt]. *Corporates will need MSME to supply them (…), and thus, there is an opportunity to make the entrepreneurial chain grows.* Those MSME *are the basis for development* [Peter], *they generate wealth and employment, and (…) will contribute to bankarization* [John]; *that is where there is room for progress* [Alex] and *the potential boom resides* [Peter].

To conclude, Mozambique is very rich in natural resources (e.g. gas and coal), reflecting high growth potential in sectors, such as mining and renewable energy, which attract FDI and stimulate the mega-projects. Although *the BS does not play a major role in the mega-projects* [Peter], because it does not have the financial capacity to finance them, it supports other businesses entailed by them (e.g. treasury and adjacent services). *The most important* [for banks] *is to finance and support the MSME that gravitate around the mega-projects, which will thicken the value chain* [Peter], generating wealth and employment, and consequently, increasing *bankarization*.

Opportunity 3 – Corporate & mega-projects

The economic outlook is attracting investors (Mbcp, 2014), reason why FDI doubled in 2012-2013 (from US$ 0.7bn to US$1.4bn). In 2013, the CPI approved 515 projects, increasing 47.1% compared to 2012 (31.5% in total investment, from US$3.2bn to US$4.2bn) (Dionísio, 2014[b]). According to the CPI (2014), there are many investment opportunities, especially in infraestructures, energy and agriculture. Currently, there are mega-projects in coal, gas and oil, energy, and industrial and transport infrastructures (CGD, 2014). The increasing number of projects and interest in the country holds opportunities related with the intermediation process, such as in corporate and investment banking.

There are opportunities for both retail and investment banking [Tom]. However, *the BS is focused on retail banking, and investment solutions for individuals and institutions are basically the same, i.e., deposits and real estate for those that have financial capacity.* As the economy and *the BS evolve and become more competitive, there will be the need for new investment solutions (…) to establish a* *bridge between potential investors and businesses that need financing*. Therefore, it seems important to bring specialized business segments (e.g. investment banking), as well as *focus in market disintermediation and organize syndicated operations (e.g. bonds issuance, equity raising)* [Ron].

In conclusion, there is a growing interest in the country, which is being fed by FDI and the mega-projects. The new business environment raises the need for new investment solutions (e.g. bond issuance, equity raising), beside the ones offered by retail banking (e.g. deposits), to establish a bridge between potential investors and businesses.

4.4 Banking System Barriers

Barrier 1 – Bank's Size, Liquidity & Interest Rates

The BS does not play a major role in the economy [Peter], because banks do not have the capacity to sustain economic growth through their financing, reason why *a major barrier is the bank's size* [in total assets]. *Another difficulty is liquidity, as banks cannot finance themselves abroad (…), and they operate with local currency* [Metical]*, which is not abundant. Thus, the funding is costly* [Matt], *making it hard to finance the economy in attractive* [interest rate] *conditions* [Ron]. *The lending rates are high (…), because banks are too dependent from their social capital (…)* and *from the depositors' money (…), including pension funds (e.g. the NISS and the BM's pension fund). (…) Instead of using the "Standing Lending Facility" (7.5%), banks often use the prime rate, (…) which exceeds 13%, being indexed to their funding cost* [Alex], *conditioning the lower limit they can lend money* [Ron].

In summary, there are endogenous barriers to the BS development, as banks have limited financial capacity and high funding costs, which reflect their low liquidity and high interest rates practiced (exceeding 13%), making it hard to offer attractive interest rates and long-term financing conditions.

Barrier 2 – Infrastructures

In the infrastructural level there are major shortcomings that *condition the BS expansion, because to install a branch (…) banks need infrastructures, such as the Police, the BM or its representative, (…)*

and others that are required. (…) Those infrastructures do not exist [Kim], namely, *electricity and telecommunications that are not everywhere, and other* [Matt], like *proper roads (…), and living infrastructure* [Eve]. Even though *the infrastructural level has improved* [Lee] and *large investment in electrification has been made*, *only c. 52 districts (out of 128) are electrified, reason why in most districts it is not possible to install branches*. *Infrastructural limitations (…) are not critical in the large regional capitals, but outside are; as the more we move to the interior and north* [Matt], one is faced with *a completely different reality* [Ron]. *At a basic level, there are many things that remain to be done* [Eve], and *this represents heavy investments, with hard return* [Lee].

In conclusion, there are territorial asymmetries in the infrastructures' availability that constitute a barrier to the banking expansion, as banks cannot operate without basic infrastructures. Urban areas are equipped with the required infrastructures for banks' operations (e.g. energy). Nevertheless, in the interior and north those are inexistent or inadequate, making it almost impossible to establish a bank.

Barrier 3 – Human Resources (HR)

A critical barrier is the availability of qualified HR, as *there is not enough specialized HR to continue developing the BS expansion unlimitedly* [Matt]. In addition, the labor legislation restricts the participation of foreign labour (AIP, 2014).

Talent is limited because local education has many deficiencies. Thus, investment in training is relevant [Tom], and *banks are investing heavily on it* [Lee]. *There are programs to attract talented people coming out of universities (…), who are integrated into a development program for 2-3 years. Alternatively, the talents that are inside the bank may be subject to deeper training to achieve higher competences. There are the IFB and independent training programs to meet these needs* [HR] [Matt], however, *what needs to be done is more basic; it has to start in the primary education* [Eve].

Due to the *scarcity of local HR* [Ron], *foreign labour has to be hired* [Kim]. Nonetheless, *firms have restrictive quotas, (…) because the government believes that locals need to be trained* [John].

Moreover, *it could be an embarrassment if the country had to rely on it in a significant percentage.* Thus, foreign labour is hired *in the exact extent as required to fill out banks' difficulties, whether for the development of their activity, or to train local staff* [Matt]. Another limitation is that *most staff is concentrated in urban areas (…), requiring staff transfers sometimes (…) to address the shortcoming in the countryside* [Alex]. Lastly, *qualified HR will have to be "stolen" from other banks, which in turn will have a more expensive structure and a competitive disadvantage* [Ron], *disputing HR by wages that, in terms of the economy, are stratospheric.* Although *HR represent a problem very much alive in banking* [John], *there is no lack of human intelligence, (…) and there are extremely good local staff; this is an issue that will improve over time* [Eve].

In conclusion, there is insufficient specialized HR in the BS, and *it is necessary to pursue a heavy investment in this area* [Peter]. Banks have been offering training programs to qualify locals; however improvements must occur in basic education first. To fill the gap, banks hire foreign labour, conditioned by quotas in order to prioritize locals and train them as well. Furthermore, HR are concentrated in urban areas, implying staff transfers to the countryside when required. Lastly, banks dispute HR among each other, meaning higher wages and a more expensive banking structure. Despite the barriers, there are good and intelligent staffs.

Barrier 4 – Legal and Regulatory Framework

The BS and FDI legal and regulatory frameworks have been regularly updated, in order to facilitate operations and to approach international standards.

In general, *the banking regulation is normal; (…)* [a bank] *has an entry process, has to request a license and has to fulfil certain requirements, which is similar worldwide* [Eve]. In fact, *there is some familiarity with the Portuguese regulation* [Ron]. However, *there are some constraints* [Peter]. *The FX law regulates dollarization* [Kim], *limiting USD, which sometimes complicates the mega-projects management* [Eve], trade and remittances (e.g. *transferring over US$10.000 abroad requires deeply* *bureaucratic procedures)* [John], *and may difficult credit and banking expansion* [Eve]. Another limitation concerns obtaining visas, because *it is a time-consuming process that pushes investors away (e.g. considering that some business opportunities occur within weeks, if a foreign manager has to go to Mozambique for business or for a meeting, s/he does not have enough time to get the visa and go there). (…)* Therefore, if an investor *decides to establish a business abroad, an important criterion is how s/he will control it, (…)* and *the visas' issue limits the reaction speed of decision-makers* [Ron]. Regarding bureaucracy, *there is no "simplex"* [Matt], representing *a barrier to initiate activity. (…) The process is burdensome, and it does not always run smoothly. (...) It is important to be there or to have a local presence, because it is difficult to do things afar, even the simplest ones* [Ron]. *Some issues take longer than others, but it is not a country where everything runs as fast as desired* [Matt].

The BM plays an important role in the legal context; *regulators (…) certify that the regulation applied in Europe is transposed locally and is respected* [John]. Hence, for instance *in supervision and credit concession, the BM is doing a good job* [Alex].

To conclude, legislation in general is not an obstacle, as it has similarities to international standards. Conversely, the FX regulation constrains some businesses (e.g. trade) due to unavailability of USD. Other barriers include obtaining visas, together with bureaucracy, representing an onerous process that limits decision-making and requires a local presence. Despite the constraints, the BM is playing an important and active role in the legal context, showing a good performance at the supervision level.

Barrier 5 – Business & Political Environment

The WB's Doing Business 2015 ranked Mozambique in 127th (out of 189; sub-Saharan Africa average: 154). Similarly, the country was in 133th (out of 144) in the Global Competitiveness 2014-2015. These ratings have improved, showing progresses in the business environment. Nonetheless, there are conditioning factors limiting the BS development, which include the political environment. In general, banks in Mozambique lack expertise to deal with MSME, impeding their access to loans [only 25% of the MSME have used financial products or services to run their businesses, of which only 9% were banked (Simione, 2014)]. *There are major behavioural differences in the corporate culture (e.g. only large corporates have their financial statements audited), (…) which generate challenges in a bank that wants to be cautions* and has compliance criteria to follow [Peter], making MSME risky and unattractive to the BS. A vicious cycle is created, where banks charge high rates to MSME, and then, those firms do not borrow due to high cost of loans and fear of not being able to repay (Simione, 2014). *Therefore, a major barrier is the lack of local management and the difficulty of businessmen getting into the local mind-set* [Peter].

On the other hand, *the political environment limits firms' performance (…),* due to *political tensions (…)* that *reduce stability, constraining investment and the BS development* [John]. The BS may be affected, *not only due to instability, but also due to the impact that will have, eventually, in the bank, (…) as firms stop doing business, fail to work with the bank, the bank creates impairments…* [Peter].

Concerning corruption, it was ranked 2nd as the most problematic factor for doing business in Mozambique (WEF, 2014). As well, in the Corruption Perception Index, the country is ranked in 119th out of 177 (TI, 2014). However, according to the interviewees, it *is not one of the most corrupt countries* [Eve] and it does not represent *an environment in which corruption is felt in the day-to-day life* [Tom], seeming *more transparent, probably because Mozambique is used to deal with multilaterals governed by best practices*. Notwithstanding, *there is lobbying as anywhere else* [Ron]. Despite the risks mentioned, *the governance is quite conscientious* [Eve].

To conclude, there are barriers both in the business and political environments. Concerning the business framework, a barrier is the lack of local management and the unsophisticated entrepreneurial culture (e.g. most MSME neither have audited financial statements nor prepare them adequately), which limit credit to MSME, as banks charge higher interest rates. Regarding the political environment, the country went through some instability, which may represents *a risk, because* *investors that were planning in investing in Mozambique will wait until things stabilize* [Eve]. This scenario should affect the BS, as clients and companies may fail to work with banks. Another issue concerns corruption perception, which is high in world ratings, but among the interviewees it was not seen as a problem, as the country works with world institutions to adopt more transparent practices.

Barrier 6 – Country's Poverty

The BS is a sector closely related with economic growth, and thus, it usually follows what happens in the country [Eve]. Being economically poor does not facilitate banking expansion, as it conditions infrastructure and social development [Mozambique HDI rank: 185th/187 countries (UN, 2013)], and inhibits *bankarization*. *Poverty is a barrier* [Eve] *because, although the economy has been growing 6-8%, one cannot forget its basis, with a GDP of around €17bn* [John]. Mozambique *has to grow without compromising its sustainability, i.e., the country needs large investments* (e.g. in infrastructures, HR), *but it cannot overspend,* which may imply slower progresses. The banks' role *is to support somehow, trying to mitigate those problems* [Eve].

In conclusion, the country's poverty *is a barrier in itself* [Eve] that constrains the BS growth, as it obstructs infrastructural and social development, and limits *bankarization.* In addition, even though Mozambique is growing fast, the country cannot compromise its sustainability and so, development may take longer than desired.

4.5 Entrance in the Mozambican Banking Sector

Considering the opportunities and barriers aforementioned, together with the outstanding economic outlook, it is relevant to understand the potential of a bank entering in Mozambique, i.e., can a new entrant expect a profitable future for its business in a reasonable period of time (e.g. 3-5 years)?

A bank that wishes to enter has to think in a very long-term, (…) because it has to make heavy long-term investments [Peter], *and then, making profit, building the systems, and training HR represent a huge challenge* [Eve]. *There is also fierce competition (…)* so, *a new bank should be large and have* *support from a parent with resources (…),* being aware that *it has to deal with 3 large banks (75% of the market)* [John]. Nevertheless, *if a bank with enough capital enters (…) to explore current gaps, it will have unlimited opportunities* [Matt], *due to the natural resources expansion (…), investments in gas, infrastructural projects, and the development of transports, communications and services* [Kim]. Location is relevant, because *the economy and the decision-making power flow in the south* [Maputo] [Lee]. Hence, a bank should *start in Maputo and the regional capitals, and only then, it should go to the interior* [Matt]. *Bringing innovation is also critical, as the market is highly sensitive to it. (…) Firms should consider new ways of functioning* (e.g. e-business), *new products and services* [Peter], *so a bank that wishes to establish to do the same as others has a competitive disadvantage, and probably the investment will not have return. (…) To be well positioned and have profitability in 5-10 years, it is important to be in the market soon. It is a trade-off: entering sooner and gaining capacity to better capture opportunities, or entering later and being poorly prepared* [Ron]. *There is room to work the market, to build quotas, and to create a network, so that, in the long-term, the bank can be positioned to capture the banking business potentially provided in the future* [Tom].

In conclusion, *a bank that wishes to enter will find many opportunities* [Tom], especially due to the infrastructural development. However, *it is a potential that should be realized in the long-term and deeply working the market* [Tom], because it requires heavy investments (e.g. HR, branches' network) and, taking into account the economic context, it *will not generate profits in 2-3 years from now* [Tom]. Thus, a new entrant should be financially robust and sizeable, due to strong investment requirements made in a developing economy, and the fact that it competes with 3 large banks that concentrate 75% of the market. In this regard, innovation is determinant, because the market seeks new products and services, as well as location to establish a bank, because the economy and decision-making flow in the regional capitals. Banks have room to work the market, to prepare and position themselves to capture the opportunities already mentioned previously (e.g, *bankarization*, MSME).

4.6 Challenges

The BS will face challenges mainly driven by economic growth, due to its difficulty bridging it with economic development, alongside the barriers limiting its expansion.

The major challenge is following economic "explosion" (…), having *sufficient resources to provide credit to develop the economy. (…) Banks need to act not only as a local credit, but getting together to find external resources to help the country growing and developing* [Eve]. *Most projects, and the future sector profits, are related with FDI, and the challenge is to offer an attractive value proposition (…),* as well as *continue growing, while providing a quality service* [Tom]. Hence, *banks need a recapitalization* [Alex] *in terms of equity, liquidity and HR (…), in order to work with multilaterals that support the mega-projects*. *(…)* Other challenges concern *funding, which is scarce and expensive* [Matt], *requiring controlling interest rates, as well as credit and impairments* [Alex]; *capturing and coaching* MSME, as they operate differently than international standards [Peter]; and *increasing bankarization* [Eve] *to rural areas* [Kim], *as banks are located where it is "possible". Hereinafter, we are dealing with very difficult places to work* [Peter], *due to lack of adequate infrastructures and HR* [Alex]. *There is inconsistency in the Governor's speech (…), because extending to rural areas (…) is extremely costly and burdensome (…); it is a brutal challenge* [Peter].

To conclude, a major challenge is "following" economic growth, as banks may not have the financial capacity to support it. Therefore, it is important to find external support and attract FDI to be able to develop. Another challenge is to keep providing a quality service while growing. For that, banks need a recapitalization in terms of equity, liquidity and HR, to be able to work side-by-side with world institutions. Other challenges are related with funding, because it is scarce and expensive; reaching MSME and working with them, as they "behave" in a different fashion; and increasing *bankarization* to rural places, due to lack of proper infrastructures and HR, seeming that m-banking is a viable alternative (Vicente, 2013).

5 Conclusion & Future Research

Recently, the FS in Mozambique has witnessed considerable growth. The sector's size in net assets remains relatively modest (US$6.6bn in July 2014), based on banks, of which 3 (out of 18) represent 75% of total credit and deposits. The sector seems robust and resilient, registering high growth rates in total assets (20% between 2012-2013) and profitability (20% ROE), together with adequate levels of solvency (3 main banks: 15.5%) and impairments (3 main banks: 1.8%) (BM, 2014, BMI, 2014 and Dionísio, 2014[a]). These indicators are mainly driven by the increase in credit and deposits, as well as efficiency improvements in financial services. The government also intervened, approving the FSDS for 2013-2022, which aims to eliminate barriers to improve financial inclusion. Alongside the banking progress, the economy is growing, mainly due to the discoveries of gas and the coal basins, which are stimulating FDI. This uncovers the following opportunities, identified during the research:

› *Bankarization* [O1], which although increasing, still stands around 20% of the adult population, with branches concentrated in urban areas. Thus, there is a large market to address and a large coverage deficit to explore. In this regard, m-banking is being implemented and adopted, facilitating clients' life in processing banking operations.

› The emergence of MSME [O2], as the mega-projects, boosted by the country's richness in natural resources (e.g. gas, coal), stimulate the development of businesses, such as treasury and adjacent services that generate wealth and employment, contributing also to *bankarization* [O1].

› The need for specialized banking segments [O3], due to increasing number of projects and country's attractiveness, reflected in higher FDI. The sector is focused on retail banking and, as the economy evolves, there is an emergent need for innovative investment banking solutions to establish a bridge between potential investors and businesses, namely in capital markets, corporate and project finance.

Conversely, the banking system barriers identified during the research are:

› The lack of specialized HR [B3], which are scarce, expensive and difficult to retain, as well as concentrated in urban areas. Hence, banks dispute HR among each other, having higher operating costs, and they also need to do staff transfers when required, to address the lack of HR in the countryside. Moreover, banks often need to hire foreign labour, which is restricted by quotas. Under these circumstances, training of local staff is crucial, and requires heavy investment and commitment from banks.

› The lack of adequate infrastructures and the territorial asymmetries in its availability [B2], in which the main urban areas are equipped with the required infrastructures for banks' operations, but in the rural areas those are inadequate or inexistent, making it financially unviable to establish branches. In fact, the infrastructural deficiencies aggravate the HR's barrier [B3], as schools and universities do not produce enough talent. In general, these shortcomings impede the country's development and do not eradicate or reduce poverty [B6], which in turn, feeds a vicious cycle by conditioning infrastructural and social development, as well as limiting *bankarization*.

› The lack of local management and the unsophisticated entrepreneurial culture [B5] (e.g. most MSME do not have audited financial statements, or do not prepare them adequately), which limits banks' financing to MSME, as they try to mitigate their own risk by charging high interest rates.

› The political environment [B5], as it currently experiences some instability that may inhibit FDI and impact adversely individuals and firms, representing a risk to the BS development.

› The FX law, visas and bureaucracy [B4] also represent barriers. FX law constrains businesses (e.g. trade, dividends repatriation) due to unavailability of FX currency. Obtaining visas and bureaucracy represent a time-consuming process, requiring local presence that limits decision-making.

› Banks' limited financial capacity and high funding costs [B1], which reflect their low liquidity and high interest rates practiced, inhibiting attractive financing conditions.

New entrants should be financially robust, focused on innovation and have a long-term approach, because this market requires heavy investments (e.g. HR, network, IT); competing with 3 large banks (75% of the market); needs new products and services, which may be critical (e.g. m-banking, factoring, leasing, specialized business segments, such as affluent and corporate); and it does not promise short-term profits. To enter the retail banking market, the opportunities seem to reside in *bankarization* and financial literacy, m-banking, MSME and corporate financing. In fact, according to *fDi Markets*, Mozambique is the current preferred African "hub" for foreign retail banks establishment (Porter, 2014). Another alternative could be to focus on investment banking, to support the mega-projects, address FDI, develop capital markets and the relation and cooperation with multilaterals. Therefore, considering opportunities and barriers, and besides having 3 banks controlling the sector, a new entrant may consider electing retail banking focused on specialized segments, such as m-banking, and micro credit to support the MSME development, as well as investment banking, to finance mega-projects, organize syndicated operations (e.g. bond issuance, equity raising), leverage multilateral credit lines with governmental involvement and, also, develop capital markets. Apparently, there is a window of opportunity to enter the market for investors that plan and have the financial muscle to be profitable in 5-10 years, as it seems that a new bank, although facing the challenges posed by the barriers, may be rewarded in the long-term, due to the opportunities that the economy and the market seem to represent.

For <u>further research</u> could be relevant, as advocated by Vicente (2013), addressing how the m-banking role and importance in Mozambique would impact the BS if a panoply of products/services (e.g. money transfer, insurance) are developed. It could also be valuable to pursue a deeper research on the BS competitive environment and its players financial and strategic positioning, namely, the window of opportunity in capturing MSME, investment banking and insurance, and the capital markets development in the regional environments (e.g. stock exchange, brokers, asset management).

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