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# FINANCIAL MARKETS PROJECT; SENEGAL

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## FINANCIAL MARKETS PROJECT

Mission to USAID Dakar, Senegal, March 9-13, 1986

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### Purpose of Mission:

1. Investigate whether Senegal should be selected as one of the countries targeted by the Financial Markets project. Key criteria are:
  - Appropriateness of local environment (problems to be overcome which lend themselves to feasible solutions).
  - Views and support of country USAID Mission.
2. If answer to 1) is affirmative: define the rationale and scope of a Financial Markets project effort in Senegal.

### Summary of Findings:

Consultants and USAID Mission agree that Senegal is a highly appropriate target country for Financial Markets project (USAID Dakar will recommend that such a project be undertaken at the earliest possible moment). This project would provide timely assistance to USAID Mission in identifying feasible, realistic ways, acceptable to local authorities, to relieve the semi-paralysis of the local financial markets, which are currently unable to provide necessary forms of credit to sectors, such as small-to-medium sized enterprises, which USAID (and international donors) wish to see developed. In addition, the need to finance privatization (acquisition by the local private sector of equity in parastatal companies and banks) cannot be made unless certain mechanisms can be put into place and certain financial markets bottlenecks overcome.

### Methodology:

The current state of Senegal's financial markets, and the identification of problems and possible solutions, were reviewed in depth during interviews with the following three groups of people:

1. USAID Mission:

This mission began and ended with lengthy, substantive sessions with USAID Director Sarah Jane Littlefield. Meetings were also held with Deputy Director Carol Tyson and Economist Jackie Damon. Harold Lubell attended many of the outside meetings.

2. A representative cross-section of local commercial/development banks (meetings with senior managers):

- a. Locally-controlled banks (Sofisedit, BSC, Union Senegalaise de Banque).
- b. Foreign-controlled banks, (Citibank, Banque Senegalo-Koweitienne).

3. Relevant government bodies:

- a. Ministry of Finance:
  - Treasury Director-General
  - Money and Credit Director
- b. Central Bank of West African States (Senegal country director).

### Assessment of Problems in Local Financial Markets and Their Causes:

There are three fundamental problems that afflict almost all Senegalese banks and have caused a near-breakdown in the credit availability system:

1. An extremely heavy preponderance of the State and of State enterprises in the country's credit markets (most of such enterprises are heavily indebted and have substantial losses).
2. Various forms of pressure exercised in the recent past to induce local banks to lend to such state-sector borrowers.
3. A lack of management competence and of disciplined lending practices in most local banks.
4. Insufficient deposits (deposit rates are unattractive compared to deposit rates available in France, leading to capital flight given the ready convertibility of CFA Francs to French Francs).

5. Heavy losses in most banks resulting from the above four elements.

These five factors led to the present situation in which a large percentage of local bank assets are tied up in (1) loans to the State; (2) loans to parastatal companies (some of which are bankrupt); and (3) loans to other borrowers who cannot pay because the State or the parastatals owe them money. The result is a situation of illiquidity throughout the local banking system, with many banks undercapitalized, losing money and unable to attract deposits. The consequence is the inability of the local banking system to provide adequate credit to the private sector, especially small-to-medium sized companies. The only credit available, if at all, is short-term overdrafts at an average interest rate of 15%.

This situation is in sharp contrast to other countries sharing the same central bank such as Ivory Coast or Togo, where banks are healthier and there is adequate liquidity in the system. Therefore this is a country problem peculiar to Senegal, not a problem inherent in the West African monetary system (CFA Franc zone).

The lack of liquidity and deposits means that all loans must be funded through the Central Bank rediscount window, which in turn imposes sectoral credit ceilings which are quite restrictive. No more than 3 or 4 local banks can meet a legitimate demand for new credit even for credit-worthy borrowers.

In such a situation, the credit necessary to effect privatization by distributing shares to a broad private-sector group is lacking. The local banking sector itself is heavily government-owned, which most parties interviewed agree has led to many of the present difficulties. Furthermore, there are too many banks which provide the same types of services and credit, doing so inefficiently, at very high cost and without catering to the needs of the market.

#### Possible Solutions (Meriting Further Close Study):

- o Enhance credit availability: an effectively-managed bank with a source of deposits or other outside funding can lend to borrowers outside credit ceilings provided the rediscount window is not resorted to. Credit reallocation to promising projects and sectors could thereby occur (if desired, the source of such deposits could have a say in how credit reallocation occurs and how it is managed, for instance to finance privatization and healthy small-to-medium sized enterprises).
- o Financing privatization: banks with the ability to make incremental loans could be induced to do so to finance private-sector purchase of the State's share in various enterprises (the State's equity holdings in local banks themselves could be one of the more obvious places to start,

not only because these could be attractive private-sector investments, but because such an effort could be coupled with additional equity-raising to bolster the banks' capital and liquidity).

Such financing would likely require altering credit ceilings. Given the multi-country Central Bank it may be difficult to get agreement on ceiling reallocations; however, it appears possible that the IMF could agree to a special lending ceiling to finance the purchase of equity from the State, since such new credit would retire State debt rather than enter the local economy.

- o There is a belief among key local people in banking and government that a local merchant banking entity is needed, to perform the following functions among others:
  1. Provide a source of targeted funds to the banking sector to achieve the purposes cited above.
  2. Assist in the privatization effort.
  3. Coordinate and participate in the share market as it begins to appear, helping the authorities establish and enforce some basic rules to the operation of such a market.
  4. Identify, package and seek finance for worthy new projects in the local economy.

Next Steps:

It is recommended that the Financial Markets project schedule a study of Senegal's banking system and its current problems in order to point the way toward concrete, pragmatic solutions which are supportive of USAID's country goals, including privatization and promotion of smaller businesses. The major problems to be examined include:

- o Lack of credit availability to key sectors, and the root causes of this problem such as bank illiquidity and undercapitalization.
- o The need to prepare the ground-work for privatization and the role of financial institutions in raising equity and distributing shares for this purpose.
- o The need to explore whether solutions can best be found through existing local entities, or whether the creation of new private-sector financial institutions should be encouraged.

This project is best done in the near future (June) and will require a maximum of 2 weeks for a 2 person team.