

Beyond Deposits

Why African Financial Institutions Must Diversify Their Funding

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LONG-TERM LENDING NEEDS DURABLE FUNDING.

African banks and consumer lenders that fund themselves almost entirely from short-term deposits are building long-term businesses on short-term money. Diversifying into bonds, including green, social and sustainability-linked bonds, and into long-term loans from local institutions and development finance institutions (DFIs) is not a treasury nicety. It is a core strategic decision that shapes growth capacity, resilience in a crisis, and the cost of capital over a full cycle.

Across much of the continent, deposits remain the dominant funding source, often supplemented by the interbank market and central bank facilities. Deposits are valuable: they are usually cheap, and a sticky retail base is a genuine franchise asset. But a balance sheet funded by a single source carries concentrated risks that tend to surface at exactly the wrong moment. Our central thesis is that a broader funding mix leads to greater diversification in terms of duration and funding costs, strengthening the balance sheet and supporting the long-term sustainability of the business.

01

Duration

Align funding with the life of assets.

02

Currency

Control funding-related FX exposure.

03

Concentration

Reduce reliance on individual sources.

01 / THE BALANCE-SHEET CASE

Deposit funding and the balance sheet

So why should Financial Institutions look beyond deposits? Deposit funding constrains African lenders in four ways.

- **Tenor mismatch.** Most deposits are demand or short-term. Yet the assets the economy most needs, such as mortgages, SME term loans, infrastructure and payroll-deducted consumer loans, run for three to ten years or even more. Funding these from overnight money creates refinancing and interest-rate risk and pushes lenders to shorten asset tenors, which starves the real economy of long-term credit.
- **Concentration.** In many markets, a small number of corporate, government or state-owned depositors account for a large share of balances. The loss of one or two can trigger a liquidity squeeze. Retail deposits are more granular, but in thin markets they are also more exposed to confidence shocks and, increasingly, to instant switching via mobile money and digital banks.
- **Cost and competition.** As fintechs, mobile money platforms and money market funds compete for household savings, the "cheap deposit" advantage erodes. In high-rate environments, institutions pay up for term deposits that behave like wholesale funding without the tenor benefits.
- **Access.** Non-bank lenders, including consumer lenders, microfinance institutions and leasing companies, are frequently not licensed to take deposits at all. For them, diversified wholesale funding is not an option but the cornerstone of their business models. Their growth is capped by their ability to build a funding programme across banks, pension funds, bond markets and DFIs.

What a broader funding base can improve

A diversified funding base improves the balance sheet on five fronts.

1. **Asset-liability management.** Term funding lengthens the liability profile, narrows repricing and maturity gaps, and lets the institution lend at the tenors its customers need without taking on refinancing risk.
2. **Liquidity and regulatory ratios.** Long-term wholesale funding improves the Net Stable Funding Ratio and reduces reliance on volatile balances, strengthening liquidity positions under Basel III frameworks that African regulators are progressively adopting.
3. **Capital.** Subordinated and Tier 2 instruments from DFIs or bond markets support capital adequacy and growth, at lower cost than equity.
4. **Resilience.** No single depositor, lender or market can cut off the institution. When one source dries up, as interbank markets and Eurobond windows did in 2020 and 2022, others remain open.
5. **Ratings and cost of capital.** Rating agencies reward funding diversity and maturity matching. Over time, a stronger funding profile supports better ratings, which lowers the cost of every funding source.

The goal is not to replace deposits but to complement them: a stable core of deposits, with long-term local and international funding matched to the long-term assets that deposits cannot safely support.

02 / DOMESTIC & INTERNATIONAL CAPITAL

Start with local-currency funding

If not deposits, then what? Where to start? Local-currency bonds and term loans from domestic institutions are the most natural match for local-currency lending. Pension funds and insurers hold long-dated liabilities and need long-dated assets; banks and lenders need long-dated funding. Connecting the two is one of the most efficient ways to mobilise domestic savings for domestic credit.

The benefits are direct. Funding is in the same currency as the loan book, eliminating foreign-exchange risk. Tenors of three to seven years, and longer in deeper markets such as South Africa, Kenya, Nigeria, Namibia and Botswana, allow genuine matching of asset and liability duration. A listed bond programme also broadens the investor base beyond a handful of banks, and repeated issuance builds a public yield curve for the issuer that lowers the cost of each subsequent deal.

There are wider benefits too. Regular issuance forces a discipline of audited disclosure, credit ratings and investor engagement that strengthens governance. And institutions that issue help deepen the local capital market itself, which is a public good: every credible corporate issuer makes it easier for the next one and gives pension funds an alternative to concentrating in government paper.

Build relationships with external funders

Beyond local lenders, it is also beneficial for FIs to broaden their funding base by introducing tranches of external funding. External lenders range from DFIs to impact funds, private credit funds and international bond markets. DFIs can be particularly beneficial as they offer something local markets often cannot: large tickets at tenors of five to ten years, available through the cycle when commercial lenders retreat. Their lending is counter-cyclical by mandate, which makes a DFI relationship a valuable source of resilience in a downturn. Their value goes beyond the money. DFIs commonly offer:

- **Targeted lines** for SMEs, women-owned businesses, housing or climate lending, which help a lender enter new segments with dedicated funding.
- **Subordinated and hybrid capital** that can count towards regulatory capital, supporting growth without immediate equity dilution.
- **Technical assistance** on risk management, ESG systems, credit processes and product design.
- **A signalling effect.** DFI due diligence and ongoing monitoring act as an external validation that crowds in commercial lenders, impact investors and bond investors.

The other benefit of DFIs is that increasingly they can extend facilities in the FI's operating currency. Hard-currency funding for a local-currency book creates FX risk that can overwhelm the balance sheet in a devaluation, so when DFIs can offer local-currency facilities, it removes this layer of risk. Not all external funders are able to do this cost-effectively and hence their facilities may need to be hedged to avoid FX shocks.

03 / LABELLED FINANCING

Match the instrument to the lending strategy

In terms of the type of longer-term funding, it is important for Financial institutions to explore opportunities for issuing labelled bonds. Labelled bonds are the fastest-growing route to new investors for African financial institutions. Green bonds fund eligible assets such as renewable energy, energy efficiency, clean transport and climate-resilient agriculture. Social bonds fund SME finance, affordable housing, financial inclusion and lending to underserved groups. Sustainability bonds combine both, while sustainability-linked instruments tie the coupon to institution-wide targets rather than to specific assets.

For lenders, the fit is natural. Much of what African banks and consumer lenders already do, including SME, microenterprise, women-focused and first-time-borrower lending, qualifies as social under the ICMA Social Bond Principles. A credible labelled programme can offer several benefits:

- **A wider investor base.** Dedicated ESG and impact mandates, DFIs acting as anchor investors, and increasingly local pension funds seeking sustainable allocations.
- **Potential pricing and demand benefits.** Labelled issues often attract larger order books; any "greenium" is modest and market-dependent, but stronger demand improves execution and tenor.
- **Strategic and operational discipline.** A use-of-proceeds framework, second-party opinion and annual impact reporting force the institution to build the data, systems and governance that investors and regulators increasingly expect.
- **Positioning for regulation.** Central banks in markets including Kenya, Nigeria, South Africa and Egypt are introducing sustainable finance taxonomies and climate risk guidance. Early issuers build capability ahead of mandatory requirements.

The discipline must be real. Weak eligibility criteria or thin reporting invite accusations of greenwashing or social-washing, which damage precisely the credibility the label is meant to build.

04 / MANAGING THE TRADE-OFFS

Diversification needs limits and discipline

Funding diversification is a board-level strategic choice, not a treasury afterthought. Institutions that combine a stable deposit core with local bonds, local institutional term debt, DFI funding and labelled sustainable instruments can lend longer, grow faster, withstand shocks and, over time, fund themselves more cheaply. Those that rely on deposits alone remain hostage to short-term money and to the confidence of a few large depositors.

Whilst we are clear advocates of funding diversification, it is important to highlight that diversification brings its own risks, and each needs a deliberate response.

- **Foreign-exchange** risk is the most dangerous. Unhedged hard-currency borrowing has damaged many African lenders through currency devaluations. Local-currency-denominated funding should be prioritised and where hard-currency facilities are taken, it is worth looking at some degree of FX hedging.
- **Headline cost.** Term funding usually costs more than deposits. The right comparison is not deposit rate versus bond coupon, but the full cost of the liquidity, refinancing and capital risk that the term funding removes.
- **Covenants and cross-default.** DFI and bond documentation carries financial covenants and cross-default clauses. A diversified base can become a fragile one if covenants are set too tight or monitored poorly.
- **Disclosure and reporting burden.** Ratings, listings, ESG and impact reporting require investment in finance, risk and data teams. This is a real cost, but it is also capability the institution needs anyway.
- **Market depth.** Local markets can close in stress. A funding plan should ladder maturities and avoid bunching refinancing into a single year.

Funding diversification is a board-level strategic choice, not a treasury afterthought.

05 / BOARD & MANAGEMENT PRIORITIES

Five priorities for boards and management

To improve balance sheet diversification whilst being cognizant of the risks, we recommend that boards and management:

1. Adopt a funding strategy with explicit targets for tenor, currency mix and source concentration, reviewed annually alongside the business plan.
2. Establish a local-currency bond programme and cultivate pension funds and insurers as long-term anchor investors.
3. Build multi-year relationships with two or three DFIs, using them for long tenors, subordinated capital and targeted segment lines.
4. Develop a green, social or sustainability bond framework based on the existing loan book, with credible eligibility criteria and impact reporting.
5. Set firm policies on FX matching and hedging and ladder maturities to avoid refinancing concentration.

Done well, diversification does more than protect the balance sheet. It allows African financial institutions to channel domestic and international capital into the long-term lending their economies need, which is ultimately the most durable foundation for a sustainable business.

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