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Trust, Socioeconomic Factors, and Institutional Dynamics in Africa's Emerging Insurance Market

Nelson N. Nkwor
Alex Ekwueme Federal University
Ndufu-Alike, Ebonyi State, Nigeria

Nnachi Egwu Onuoha
Alex Ekwueme Federal University,
Ndufu-Alike, Ebonyi State, Nigeria

Abstract: *The study investigates the causality link between trust and insurance market development and the influence of socioeconomic and institutional factors on trust in insurance in the emerging market context. Relying on dual theories of bounded rationality and opportunism, the VAR Granger Causality Test and the Two-Stage Least Squares (2SLS) analytical approaches, and a contextualized understanding of Africa's insurance market, the study finds a unidirectional causal link from trust to the insurance market development, which suggests that market activities are driven by trust in insurance. Additionally, results show that trust in insurance is driven by socioeconomic and institutional factors in Africa's insurance market. Against expectation, however, income inequality increases trust in insurance. But as expected, corruption reduces trust in insurance, and human capital development increases it. The paper recommends reforms targeted at increasing trust within the socioeconomic and institutional framework. The findings provide useful insights into the growth paths of emerging insurance markets, which adds significantly to extant knowledge on the connection between trust and financial exchanges.*

Keywords: *Trust in insurance, financial service, insurance penetration, World Values Survey, Africa*

Introduction

In terms of economic development, the insurance sector is critical in protecting individuals, businesses, and economies from unforeseen hazards in Africa (see: United Nations for Economic Commission, 2015; Signé, 2021; Cenfri & FSD Africa, 2017; Alhassan & Biekpe, 2016; Ernest & Young, 2015; Tyson, 2015). In the context of emerging markets, such as those found across Africa's diversified environment, the forces driving the growth and efficacy of the insurance industry are critical. This underscores the significance of understanding the factors that boost or impede these markets as they evolve and adapt to shifting global economic landscapes.

The objective of this paper is to investigate the interplay between trust, socioeconomic conditions, and institutional dynamics in Africa's developing insurance industry. In doing that, two questions were addressed: First, what characterizes the causal connection between trust and the development of insurance markets in emerging economies? Second, do socioeconomic and institutional issues matter in the African context?

Trust, which is rooted in institutional fabrics (Kubbe, 2013), is a cornerstone in the market development ecosystem. It not only influences individual decisions to engage with insurance goods and their providers, but it also supports broader market development. As a result, it acts as both a driver for market expansion and a test of the industry's general health.

The socioeconomic environment of any region, especially one as diverse and complex as Africa, has a significant impact on insurance uptake and adoption. Income inequality, human capital development, and current levels of corruption all form the contours of trust and, as a result, are expected

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to influence the trajectory of the insurance business. Likewise, institutional dynamics provide a layer of complexity to these socioeconomic elements. For instance, regulatory frameworks, governance structures, and market competitiveness all contribute to an atmosphere conducive to the cultivation and maintenance of trust.

The global financial crisis triggered investigations into the financial services-trust nexus in the stock market (Guiso, Sapienza & Zingales, 2008), banking industry (Bulbul, 2013), financial advice-seeking and decision-making (Lachance & Tang., 2012; Burke & Hung, 2015), pension and investment (Van Dalen & Henkens, 2018; Koh, Mitchell & Fong, 2019), and insurance (Guiso, 2012; Geneva Association 2018 & 2019; The Institute of Customer Service, 2018 & 2019). The recent developments, for example, the pandemic, soaring inflation, climate change, and political conflict, heighten risks in emerging economies and further erode trust in the business environment. Authors document that the COVID-19 pandemic negatively impacts insurance businesses (Kirti & Shin, 2020) and social trust globally (Elgar, Stefaniak & Wohl, 2020).

Previously, Guiso (2012) investigated and found that trust influences the demand and supply sides of insurance markets. Geneva (2019), on the other hand, developed a tripod framework to show that insurers' and intermediaries' performance (on the supply side), as well as sociodemographic factors (on the demand side), affect trust in insurance. The empirical evidence of the causal direction of the trust-insurance link is nuance, according to Courbage & Nicolas (2019). This lacuna motivates this study, especially in Africa's market context, which mirrors an emerging. Africa's market is the lowest performer compared to other regions and the global average. As of 2019, the region's market penetration and density stood at 2.96% and 54 against the global average of 6.13% and 650 apiece (Sigma Re, 2019). The poor performance also reflects on the high protection gap in the region (Nkwor, et al., 2022).

The study is unique in that it appears to be the first to investigate the causal relationship between trust in insurance and market performance in the African context. It also included various institutional and socioeconomic elements as trust drivers, as opposed to Deloitte's (2019) study, which focused only on internal and socio-demographic factors.

The rest of the paper is structured as follows: Section 2 presents the concept and applicable theories of trust, while Section 3 discusses trust in insurance and market development. Section 4 develops hypotheses on socioeconomic and institutional drivers of trust in insurance, while Section 5 presents the methodology used in the study. The penultimate Section analyses the results, while Section 7 concludes the study with highlights on the implications of the findings.

The concept and applicable theories of trust

Two constructs stand out in the conceptual definition of trust - *trust as a willingness to vulnerability, and trust as a decision to accept vulnerability*. Li (2012) asserts that trust subsists in scenarios of high uncertainty of unmet expectations, the vulnerability of control, stakes of unmet expectation or control failure, and long-term interdependence. Such scenarios are created by information asymmetry and the opportunistic behavior of contracting parties in the economic marketplace (Furlong, 1996), which gives rise to the economic definition of trust as "the act of empowering another person with the management of some of the resources owned by the agent expressing trust" (Guiso, 2012, p.12).

The twin theories of bounded rationality and opportunism frame trust between agents that generate economic exchange from social relations. In a situation of limited information and probable conflicts of interest, agents make trust decisions for transactional exchange based on these dual theories. This is because a sensible decision that gives a satisfactory rather than optimal outcome is good enough, as it is impossible to write complete contracts that cover all possible contingencies.

Trust could be either generalized (social) or partialized. While social trust refers to trust towards other people in general, the latter is trust towards close associates like family or friends, etc. This study focuses on generalized or social trust because it has evidence of influencing economic prosperity and the performance of institutions compared to personalized form (Kolstad & Wiig, 2012).

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Trust in insurance

Insurance is a trust-sensitive business given that it is a contractual relationship embedded in many conditions precedent to payment of claims, and as such, makes insurance more vulnerable to abuse compared to other financial exchange contracts (Guiso, 2012). For example, the conditions, complexity, and ambiguity in the wording of insurance policies often than not give room for varying interpretations but also for opportunistic behavior of parties, which Geneva (2019) noted gives rise to distrust in insurance. Information asymmetric nature that implicates moral hazard further incentivizes opportunistic behaviour of parties which is no thanks for trust narratives in the insurance market.

By this, trust exercise in insurance by the contracting parties is reciprocal. Each party expects not to be a victim of the opportunistic behavior of the other. Trust gaps in insurance may have attenuated the demand for insurance by consumers (Institute of Customer Service, 2019). Guiso (2012) empirically shows that trust in insurance can be measured by trust in other people and trust in banks (due to the spillover effect) in addition to trust in the satisfactory services of the insurance company. The author's linking of trust in insurance to that of the bank is based on the spillover effect. Studies have established links between banking and insurance (see: Beck and Webb 2003; Webb et al. 2005), either as a complement or substitute (Liu and Lee, 2019).

Trust in insurance vs. Market development

As earlier pointed out, trust-insurance empirical discourse is still very limited in the scholarship space. Still, it is central to insurance market development (IMD), especially in claims management (Gennaioli, Porta, Lopez-de-Silanes & Shleifer, 2020). Courbage and Nicholas (2019) used survey data from Western matured markets to show that sociodemographic factors such as age, gender, and insurance literacy matter in customers' trust in insurance. Focusing on the suppliers' side, Guiso (2012) used Italian SME data to show that efficient service provision in terms of policy wording and claims management influences trust in insurers, while Chen and Mau (2009) found that sales agents' ethical behavior influences customer's trust in insurance. Geneva (2019) proposed that data management could be a strong determinant of trust in insurance as the industry is fast imbibing digital technology in its operations.

Guiso (2012, p. 21) asserts that the "trust people put in the player in insurance markets has relevant effects on people's decisions to insure and how much insurance to buy in high trust community insurance markets are more likely to prosper." Using an experimental design, de Meza et al. (2010) argued that trust does not only matter in economic performance because it aids transactions as found by prior studies (see, for example, Knack & Keefer 1997 and Zak & Knack 2001) but its responses to persuasions. As such, trust matters in insurance selling through intermediaries apart from the opportunistic behavior inherent in economic transactions. That is why chronic cheating experienced in the financial markets over time affects the investors' willingness to take investment risks, which in turn, affects the activities of honest intermediaries like insurance in the financial markets (Guiso, 2010).

Indeed, insurers' performance benchmarks the level of IMD, and the level of market penetration measures it. Logically, high penetration should boost customers' confidence that the company will be able to settle their claim obligations when due. Arguably, a developed market encourages competition that will engender efficiency and product innovation to ensure that customers receive value for money. Of course, a competitive market provides alternatives both in product and in the service providers (insurers) as well. The switch cost will be minimal in a developed market, unlike in developing ones like Africa. On this premise, a bi-directional causality link is expected between trust in insurance and insurance market performance.

H1: Trust in insurance causes insurance market development and vice versa.

Drivers of trust in insurance

Corruption. A high index of corruption scenario weakens citizen's trust in the institutions and democracy of the States, and it has a 'vicious cycle' effect with mistrust (Cho & Kirwin, 2007; Morris & Klesner, 2010) and

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that has impacted negatively on the growth of African economies (Isbell & Seabo, 2020). Even in the developed economies of Europe, more trusting societies tend to have less corruption, and corruption reduces both interpersonal and institutional trust (Kubbe, 2013). This is in line with the reciprocal relationship between trust and corruption suggested by Uslaner (2008, 2013).

The annual ranking of countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys, is from 100 (very clean) to 0 (highly corrupt). Most African countries are ranked below 50, suggesting a high level of corruption in the continent, according to Transparency International's recent report. This suggests negative implications for the trust indices of the region. In the 2020 CPI ranking, 39 assessed Sub-Sahara Africans had an average score of 32, with 66 being the highest score for Seychelles and 12 lowest score for Sudan. The report further shows that more than two-thirds of the assessed. Transparency International is adjudged to be more reliable and efficient and covers more countries than other individual sources alone by Alvarez-Diaz et al. (2018).

H2: All things being equal, trust in insurance in Africa is expected to be low due to the high level of corruption.

Human Capital Development. Prior studies established a link between trust and human capital development. Delhey and Welzel (2012) document an enhanced outgroup trust in people extends beyond projection where human empowerment is introduced in society. Enhanced outgroup trust fosters overall trust in people, which will raise their trust in financial behavior, all things being equal. Following the tradition of previous studies, the study adopts the human development index (HDI) as a proxy for human capital development. HDI is expected to have a positive link with trust. HDI range is 0-1, and higher values are better.

H3: All things being equal, trust in insurance in Africa is expected to be high in a state of high human capital development.

Income inequality. Income inequality has a negative relationship with trust (Jordahl, 2007). Uslaner (2008, 2013) showed that high inequality causes low trust, though, the author's argument much lies on inequality as a connector of trust and corruption. "inequality depresses trust" (Uslaner, 2008). The author showed that the reciprocal cycle is channeled through inequality. Using an experimental design, Gallego (2016) shows that perceived income inequality has negative implications on the prosocial behavior of trust of others, especially among socially disadvantaged people (the poor). However, a negative link is expected between trust and inequality. Following the tradition of previous scholars, we used the GINI index, which is a World Bank estimate, as a proxy for inequality measures.

H4: All things being equal, trust in insurance in Africa is expected to be low due to high inequality.

Unemployment. Essentially, unemployment refers to the share of the labor force that is without work but available for and seeking employment. Previous studies found mixed results on the effect of unemployment on political trust. Whereas Kroknes et al. (2015) and Roth et al. (2011) document a negative link between unemployment and social trust, Bauer (2018), using micro-level survey data, could not uphold the position of the former scholars. This suggests a mixed finding in their association.

H5: All things being equal, trust in insurance in Africa is expected to be low due to unemployment.

Methodology

Data and data sources

Data for the study are drawn from different reliable sources as shown in Table 1. Analyses are in two phases – 'causality' analysis and 'association' analysis. The paper used the VAR Granger Causality test and co-integration analysis to investigate whether generalized trust leads to insurance market development or whether insurance market development leads to change in generalized trust in the African insurance market's context. Following that is the analysis of the influence of institutional and socioeconomic factors on trust in insurance using both OLS and a two-stage least squares

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procedure with instrumental variables (IV) models.

Generalized trust is measured using the World Values Survey (WVS) question: "*Generally speaking, would you say that when dealing with people, most people can be trusted?"* The answers are given on a scale from 1 to 3, which corresponds to "Most people can be trusted," "Can't be too careful," and "Depends."

WVS consists of nationally representative samples of residential adult populations, and the average sample size is 1,080 for Africa. Out of 17 African countries covered in at least one of the seven waves, 5 have at least three waves, with South Africa having the highest coverage in 6 waves. On the ground, to reduce missing data, we adopted those 5 countries comprising Egypt, Morocco, Nigeria, South Africa, and Zimbabwe (see: Appendix).

There was no direct question on trust in insurance services from the survey used. We adopted trust in others and trust in banks questions in measuring trust in insurance in this study. This is justified by Koh, Mitchell, and Fong (2019), who document that trust in financial representatives influences pension savings, investments, and insurance purchases. They showed that trust in financial representatives (bank financial advisors and insurance agents) stood at 64% in Singapore.

Traditionally, insurance market development is measured by insurance penetration, which is the percentage of written premiums to national GDP, or insurance density, which is the ratio of written premiums to the national population. However, the study used penetration because density is prone to measurement error (Park et al., 2002). We only use data on the socioeconomic and institutional variables for only the years that trust survey data are available. To this effect, the measurement time point of data for the countries of study is the years in which the WVS is fielded, namely: 1981, 1990, 1995, 1999, 2005, 2010, and 2017, respectively.

Table 1. Description, justification, and sources of variables used

Variable	Definition	Justification	Source
Trust (TRUST)	Generalized or social trust	Using trust in other people responses	WVS
Market Development indicator:			
Penetration (PEN)	Ratio of total premium to GDP	To gauge the market activities	Swiss Re Institute
Institutional Factor:			
Corruption (CPI)	Corruption perception index	To measure the institutional strength or weakness	TI
Socioeconomic factors:			
Human Capital Development (HDI)	Human Development Index	To measure average achievement in key dimensions of human development	UNHP
Inequality (INEQ)	GINI index	To measure the influence of income gap	WDI
Unemployment (UNEM)	Share of labour force that are unemployed	To gauge labour market dynamics	WDI
Control Variables:			
Region dummy	1 = West Africa, 2 = North Africa, 3 = South Africa	To gauge the effect of regional market development	Dummy

Notes: UNHDP = United Nations Human Development programme; WVS = World Values Survey; WDI = World Development Indicators; TI = Transparency International.

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Empirical model and analysis

We first addressed the question of whether trust in insurance causes insurance market development or whether insurance market development leads to causes trust in insurance using Granger Causality in the VAR test using the models in equations (1) and (2).

$$TRUST_t = \beta_1(PEN)_{t-i} + \beta_2(TRUST)_{t-j} + U_{1,t} \quad [1]$$

$$PEN_t = \beta_3(PEN)_{t-i} + \beta_4(TRUST)_{t-j} + U_{2,t} \quad [2]$$

Where TRUST = Generalised trust; PEN = insurance penetration, which proxy insurance market development; β = coefficients; t = time; t-j = the lag period and $U_{1,t,}$ and $U_{2,t}$ = error terms. Unrestricted VAR estimation was used in selecting the optimal lag of (1) based on AIC (Akaike information criterion).

For the analysis of the influence of institutional and socioeconomic factors on market development, we use equation (3).

$$TRUST_{t,1981-2017} = X_{i,t-1}\alpha + \beta(PEN)_{i,t-1} + \delta_{i,t} \quad [3]$$

Where X is a vector of socio-economic and institutional variables, which include CPI = Corruption; HDI = Human capital development; UNEM = Unemployment, and INEQ = Inequality. PEN = insurance penetration, and $\delta_{i,t}$ = error term. Following Kasmaoui et al. (2018) and Zak and Knack (2001), Eq. [3] is estimated using Two-Stage Least Squares (2SLS) model.

Results and discussion

Pre-estimation Tests

Table 2 presents the summary descriptive statistics and correction matrix of the variables of study in Part A and Part B, respectively. The average (mean), median, and standard deviation of the level data are within the acceptable thresholds, though the gap between the maximum and minimum values seems wide. From Part B, UNEM has a high correlation with PEN at 80.3% and INEQ at 79.2%. By this, UNEM is eliminated from estimation analysis because of the possible effect of such on the validity and reliability of the results of the regression.

Table 2. Summary of descriptive statistics and correlation matrix

Part A: Descriptive statistics

	Mean	Max	Min	Std. Dev.	Obs
TRUST	5.55	29.1	0.4	7.327562	20
PEN	3.544118	13.5	0.3	4.144159	20
CPI	10.675	43	1.6	13.73493	20
HDI	0.549333	0.7	0.37	0.093474	20
INEQ	57.645	301	30.2	58.45399	20
UNEM	11.82067	30.2	3.56	8.939427	20

Part B: Correlation Matrix

	TRUST	PEN	CPI	HDI	INEQ	UNEM
TRUST	1	0.163	-0.143	0.274	-0.005	0.169
PEN	0.163	1	-0.134	0.229	0.161	0.803
CPI	-0.143	-0.134	1	0.503	-0.221	0.057
HDI	0.274	0.229	0.503	1	-0.065	0.416
INEQ	-0.005	0.161	-0.221	-0.065	1	0.792
UNEM	0.169	0.803	0.057	0.416	0.792	1

Estimation Results

The study investigated the causal link between generalized trust in insurance and IMD as well as the impact of socioeconomic and institutional environment on trust in insurance. A unidirectional causal relationship is found from trust to the market development and not otherwise, as shown in Table 3.

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Table 3: Pairwise Granger Causality Tests

Null Hypothesis:	Obs	F-Statistic	Prob.
PEN does not Granger Cause TRUST	13	1.02785	0.3346
TRUST does not Granger Cause PEN	13	5.26668	0.0446*

* No causality null hypothesis is rejected at the 5% level of significance

From the result, insurance market development does not Granger cause trust in insurance. Rather, trust in insurance leads to insurance market development. The result concurs with the survey report on the African emerging market by Deloitte (2019), in which they found that trust drives Africa's insurance market. The result upheld hypothesis [H1a]. This is not surprising because trust influences investment (Zak & Knack, 2001).

Table 4. Presentation of the regression results of Eq. [3]

	Dependent Variable is (TRUST)		
Coefficients	**Variable**	**OLS**	**2SLS**
β_0	Intercept	-21.19 (5.19)***	-21.19 (5.19)***
β_1	CPI	-0.049 (0.08)	-0.049 (0.08)
β_2	HDI	18.80 (8.87)*	18.80 (8.87)*
β_3	INEQ	0.32(0.05)***	0.32(0.05)***
N		*13*	*13*
Adj. R^2		0.80	0.80
S.E. of Reg.		2.03	2.03
D-W stat		2.42	2.42
Mean dep. Var		3.50	3.50
S.D. dep. Var		4.63	4.63

Notes: (i) This table presents regression results
(ii) Absolute figures are the coefficient estimates, while standard errors are in parenthesis
(iii) ***, **, and * indicate statistically significant at 1 percent, 5 percent, and 10 percent levels (two-tailed test), respectively.

Trust in Insurance and Corruption. The results in Table 4 show that trust in insurance has a negative relationship with corruption though not significant. The result concurs with the prior studies that found a negative and reciprocal relationship between trust and corruption (Uslaner, 2008, 2013; Kubbe, 2013). This upheld the hypothesis that, *All things being equal, trust in insurance in Africa is expected to be low due to the high level of corruption.* This is so because the level of corruption on all fronts in Africa is high.

Trust in insurance and Human capital development. As expected, trust in insurance has a positive and significant link with human capital development in Africa. This result agrees with Delhey and Welzel (2012) and with our hypothesis that, *All things being equal, trust in insurance in Africa is expected to be high in a state of high human capital development.* This is so because education, for example, empowers and enhances the income of the citizenry, which is expected to increase demand for insurance, both life and property insurance.

*Trust in Insurance and Inequality***.** Trust in insurance and income inequality has a positive and significant relationship from the result of the regression against the findings of prior studies. We had expected that *All things being equal, trust in insurance to be low due to high inequality in the continent.* This result has to be interpreted with some caution. The reason could be the demographic advantage that the African insurance market is enjoying given its

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large youthful population, who are potential consumers of insurance products such as life insurance for young couples, for example.

Robustness tests. For the robustness check, the effect of regional economic development was gauged using dummy variables. Lebedyev (2011) documents that regional effect affects trust in the banking industry. The regions were dummied as follows: West African country = 1, South African country = 2, and North African country = 3. The essence of this is to gauge the sub-regional effect based on their economic prosperity on trust. The northern African region is deemed the most populous among the regions contributing up to one-third of Africa's GDP. The result, which is not reported here, does not significantly change the finding. Again, the results of both the OLS and 2SLS are consistently the same, as shown in Table 4.

Conclusion and policy implications

Africa's emerging insurance market has growth potential, but there is suspicion of mistrust in the market, which attenuates a low consumption rate. This study explored the causal association between trust and insurance market development on the one hand and the influence of socioeconomic and institutional factors on trust in insurance on the other hand.

A causal link from trust to market was established, and the market activities are driven by trust in insurance in Africa. The findings contribute to new knowledge and a deeper understanding of trust in financial institutions. The outcome of this study is strategic to regulators and policymakers because of the contributions and feedback effects of the insurance industry on the entire economy. Again, knowledge of the link between trust and IMD in Africa's insurance market has a significant contribution to the extant literature on trust in the insurance debate and the determinants of corporate market development in the financial service industry.

The main policy implication of the findings is that policymakers should adopt a regulatory framework that will enhance trust in insurance and, in turn, foster market development and increase insurance uptake. By this, assets will be preserved, and resources will be mobilized to actualize finance for economic development in Africa.

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APPENDIX - Part A: Number of times individual African countries were involved in WVS

Country	W1 (1981-1984)	W2 (1990-1994)	W3 (1995-1999)	W4 (2000-2004)	W5 2005-2009)	W6 (2010-2014)	W7 (2017-2
Algeria	-	-	-	yes	-	yes	-
Egypt	-	-	-	yes	-	yes	yes
Ethiopia	-	-	-	-	Yes	-	yes
Brukina Faso	-	-	-	-	Yes	-	-
Ghana	-	-	-	-	Yes	yes	-
Libya	-	-	-	-	-	yes	-
Mali	-	-	-	-	Yes	-	-
Morocco	-	-	-	yes	Yes	yes	-
Nigeria	-	yes	yes	yes	Yes	yes	-
Rwanda	-	-	-	-	Yes	yes	yes
South Africa	Yes	yes	yes	yes	-	yes	-
Tanzania	-	-	-	yes	-	-	-
Trinidad & Tobego	-	-	-	-	Yes	yes	-
Tunisia	-	-	-	-	-	yes	yes
Uganda	-	-	-	yes	-	-	-
Zambia	-	-	-	-	Yes	-	-
Zimbabwe	-	-	-	yes	-	yes	yes
Total (N)	**1,596**	**3,514**	**4,675**	**13,437**	**13,710**	**17,870**	**6,(**
No. Countries covered	1	2	2	8	9	11	5

Part B: List of African countries surveyed in each wave

Wave	W1	W2	W3	W4	W5	W6	W7
Countries surveyed	South Africa 1982	Nigeria 1990, South Africa 1990	Nigeria 1995, South Africa 1996	Algeria 2002, Egypt 2001, Morocco 2001, Nigeria 2000, South Africa 2001, Tanzania 2001, Uganda 2001, Zimbabwe 2001	Burkina Faso 2007, Egypt 2008, Ethiopia 2007, Ghana 2007, Mali 2007, Morocco 2007, Rwanda 2007, South Africa 2006, Trinidad and Tobago 2006, Zambia 2007	Algeria 2014, Egypt 2013, Ghana 2012, Libya 2014, Morocco 2011, Nigeria 2012, Rwanda 2012, South Africa 2013, Trinidad and Tobago 2010, Tunisia 2013, Zimbabwe 2012	Egypt 2018, Ethiopia 2020, Nigeria 2018, Tunisia 2019, Zimbabwe 2020
Total	1	2	2	8	9	11	5