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Trading In Stability

With a stunning twist of fate, companies that are looking for a refuge from the turmoil of recent years in developed markets are turning their attention to the continent that for much of the past century was considered suitable only for the bravest—or perhaps rashest—investors. Extractive businesses such as mining and oil and gas companies have been there for decades, for obvious reasons, but recent years have seen global consumer goods companies, banks and IT and telecoms companies also looking for opportunities in Africa. And opportunity is exactly what they are finding.

As they explore these hitherto underappreciated markets, they are discovering not only that the costs associated with setting up shop in Africa are often lower than they anticipate, but that the markets themselves are showing the sort of growth potential that is rarely seen elsewhere in the world.

At the same time, Africa is becoming a source of inspiration and innovation, particularly in the use of mobile technology. In West Africa, for example, cocoa farmers are using their mobile phones to share weather and pest alerts and to gather information that can dramatically increase their crop yields. Across sub-Saharan Africa, phone-based money management is becoming increasingly prevalent, particularly among those without bank accounts, upending traditional financial services models.

Although it is currently generating a great deal of interest and attracting a flood of investment, Africa still faces considerable challenges. Its infrastructure is woefully inadequate, even by the standards of developing markets. Many countries have neglected their education systems in recent years—meaning that even as investors eye Africa, they cannot find enough skilled or educated local people to help build the countries' economies. And although the continent is blessed with abundant natural resources, in many cases it lacks the expertise even to map those resources, let alone to take advantage of them.

One of the biggest issues Africa has to overcome is the perception that it is a dangerous, corrupt and difficult place to do business. There is no doubt that it is challenging, particularly for new entrants, but companies and investors are reporting that the risks of operating in Africa have been, in many instances, overstated. "The general perception of risk in Africa is changing," says Orli Arav, head of project finance at Frontier Markets Fund Managers. "But we've been there for a long time and never thought it was as risky as people thought."

Dan Keeler

Editor-at-large

Global Finance



VanNiekerk, Standard Chartered: There is fresh interest in investing in Africa

markets investment professional who splits her time between Lagos, Nigeria, and New York. “The lack of infrastructure, in particular power, makes many businesses here in Nigeria less competitive than their global peers in a wide range of sectors.” The difference in pure cost terms is substantial, but the social cost is far greater. Producing more power domestically would generate jobs and help diversify the economy while strengthening the case for improving other infrastructure, such as transportation and telecommunications systems.

In the Democratic Republic of Congo, power shortages are thwarting the government’s efforts to push its copper mining industry up the value chain. The government has repeatedly tried to force miners to stop exporting copper concentrate and instead export only finished copper, but many producers say they cannot process the ore in-country because they don’t have access to reliable electricity supplies.

Power shortages and interruptions also impose less-obvious costs on business because they make Africa a challenging place to live, raising costs for employing expatriates and locals alike and forcing people to spend a considerable amount of time dealing with energy shortages rather than being productive.

BREAKING OUT OF A VICIOUS CYCLE

There is no question that the lack of infrastructure across sub-Saharan Africa is



Arav, Frontier Markets: Infrastructure funding mechanisms have developed considerably

impeding the region’s development, but it is also inhibiting the flow of investment needed to fund the construction of infrastructure. Historically, Africa has looked to donors, predominantly from the West, to square the circle, but new models of infrastructure financing are now appearing that are helping channel private funds into much-needed projects in Africa.

The changes taking place are timely: As much of the world wakes up to Africa’s economic potential, there is no shortage of available funding, much of it coming from other emerging markets, such as Brazil and China. Just in the past year, for example, China pledged up to \$20 billion in funding for projects in Africa. Japan promised to stump up \$32 billion, and US president Barack Obama, at the conclusion of a three-nation trip to Africa, announced the Power Africa initiative, a multiyear plan backed by \$7 billion in US funding aimed at helping reduce the continent’s power infrastructure deficit. Private investors are keen to put money to work in Africa, too. With investment returns from other regions dwindling, Africa, with its rapid population growth, burgeoning economies and vast, untapped resources, is proving a tempting target.

A number of funds are working to harness that enthusiasm. The African Development Bank, which already has \$17 billion invested in infrastructure-related projects, recently launched its Africa50 fund with the hope of drawing

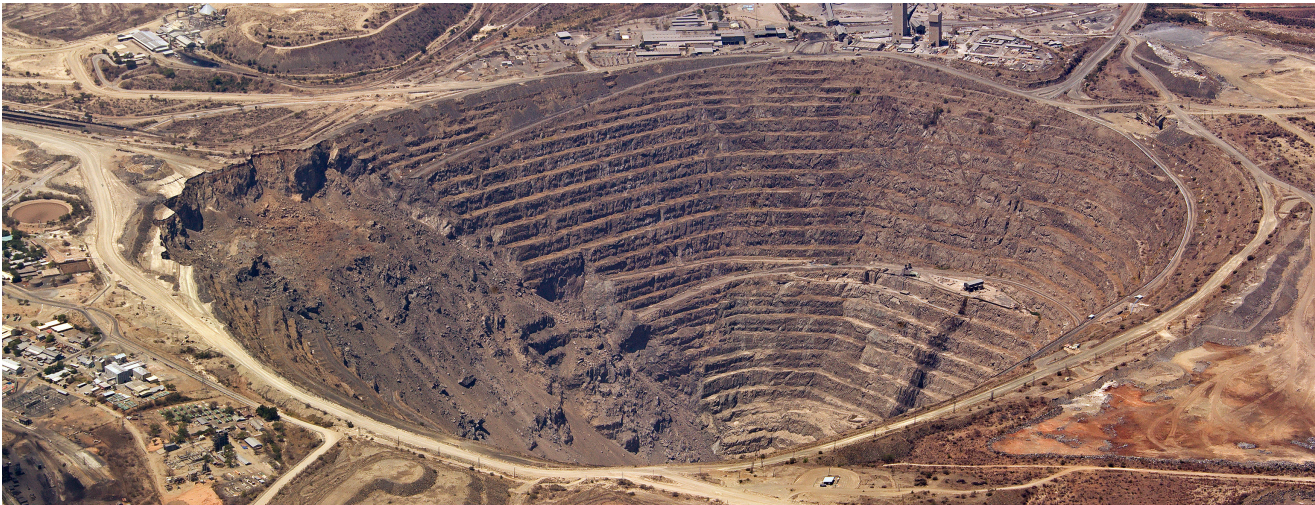
up to \$50 billion from private investors, sovereign wealth funds and, significantly, African savings and pension funds. Private investors are also the targets of a swath of recently launched, Africa-focused private equity funds—including one from Brazilian investment bank BTG Pactual, which aims to reach \$1 billion.

Having access to funding is only half the battle, however. “The capital is available to fund infrastructure projects in Africa—there is no shortage of investors,” notes Emile Du Toit, South Africa-based head of the Pan African Infrastructure Development Fund (PAIDF) and head of infrastructure investments at Harith Fund Managers. But, he cautions, “there are not enough well-crafted projects that are investable.” There are two key problems, according to Du Toit. “In perceived high-risk areas like Africa, you have to go the project finance route for infrastructure, and you have to have strong government support. Many governments in Africa are not strong enough from a financial or regulatory standpoint, and project finance takes too long for most private-sector players.”

“The lack of infrastructure makes many businesses here in Nigeria less competitive.”

— *Nnena Nkongho, emerging markets investment professional*

Funds such as the PAIDF attempt to address these problems by devising agreements tailored to potential investors’ risk tolerance and using a creative mix of dollar and local-currency structures. Two key factors are helping to support such efforts, says Orli Arav, head of project finance at Frontier Markets Fund Managers, which manages the \$753 million Emerging Africa Infrastructure Fund: “A number of successful projects backed by private equity



have shown that companies can be comfortable with the risk," she says. The second key factor is that investors are receiving lower returns elsewhere, so the yield from a sub-Saharan African power project, for example, can suddenly look exceedingly attractive to a long-term investor.

Arav, whose fund tends to be involved in arranging or participating in financing for African infrastructure projects, says

"In perceived high-risk areas like Africa, you have to go the project finance route for infrastructure and you have to have strong government support."

— *Emile Du Toit, Harith Fund Managers*

funding structures have developed considerably recently, but she still sees scope for innovation. One of the key issues, she notes, is that developers need to ensure there is an exit strategy. "Currently the exits are very limited," she says. "We are seeing some progress in that the new players might decide to buy some of the assets during development, but it's not enough. What could sharply change the pace of development is to have a market where you can sell projects later on. That will

only happen when you have a lot of big players looking to buy assets."

LOOKING BEYOND LOCAL

One of the commercial banks that committed financing to Obama's Power Africa initiative is Standard Chartered, which pledged to fund more than \$2 billion in energy projects. The bank's director of project and export finance for Africa, Neil VanNiekerk, says he is optimistic about changes taking place in the infrastructure funding space that are encouraging local banks to become more involved. "Different structures appearing now, including some that incorporate a soft-currency element, are encouraging local banks to participate. That is proving important in concession-based projects in the power and infrastructure space

particularly, because the income the projects generate is almost certainly in local currency." Some of the new structures are also enabling domestic banks to take part in longer-term financings by including shorter-tenor, local-currency tranches that can be partially refinanced.

Dubai-based VanNiekerk is also seeing fresh interest in investing in Africa, particularly from private equity funds and asset managers, and believes the Power Africa initiative will bring new players into the

market. "They are sitting on a lot of capital, and there is a strong chance they will start directing it into Africa," he asserts.

Changes in the way infrastructure development plans are being implemented may also enhance their effectiveness. Adonis Seka, Central Africa cluster head for Ecobank Capital—the investment banking arm of Ecobank Group, involved in infrastructure financing across Africa—says many countries in Africa are taking a more regional approach. "When you build roads, for example, it's not just about getting the network set up in this country, it's about connecting with the border countries and improving economic and social activities across the entire region," he explains. "It's about opening up trade to make sure you expand exports and the movement of goods regionally."

There is clearly a long way to go to bring Africa's infrastructure up to even a basic standard, but there is a high degree of optimism around recent developments. "The catalysts for a sustained productivity boost and a structural transformation of African economies are starting to fall into place," says Razia Khan, head of regional research Africa at Standard Chartered. Du Toit sums up the change in mood: "Suddenly there is more momentum. You can get meetings in a week or two, rather than a month—it's top of mind." If the momentum is sustained, perhaps Obama's hope that all Africans will have access to electricity by 2030 will be realized. ■