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A widening cast

An increasing diversity of investor types signals the arrival of more sophisticated business strategies. Is Africa heading for mainstream status?

BY VICTORIA MAIGROT

Seven of the 10 fastest growing economies over the next five years will be in Africa, according to the International Monetary Fund; a figure which is starting to capture the attention of institutional investors at large.

"Africa contains a set of fundamentally fast-growing economies, and the easiest way to make sustainable returns is to invest in growth," says Andrew Brown, chief investment officer at US-based Emerging Capital Partners. Based on this thinking, investment strategies are moving beyond extractive models built around natural resources.

Today, an emerging middle class with increasing purchasing power, a growing service sector and vast agricultural potential provide investment opportunities to private and public equity fund managers alike.

"The best form of help for Africa is African countries helping themselves by trying to deliberately engage in trade with the rest of the world and with each other," says Jim O'Neill, chairman of Goldman Sachs Asset Management. For that progress to be achieved, hard infrastructure is necessary, ideally with countries also harmonising regulatory and pricing frameworks at a cross-border level.

"I am an optimist with the brakes on," says David Cowan, Africa economist at Citi, who predicts Africa's growth will remain around 5 percent until investment in infrastructure reaches 30 percent of GDP.

Nevertheless things are improving quickly, and savvy investors are keen not to be left behind. Public equity investors are aiming to tap Africa's macro trends, while maintaining diversified portfolios. Growing telecommunications, financial, digital, infrastructure and natural resource sectors have all provided opportunities, through companies that are conducting business on a regional and even pan-African scale.

However, lack of liquidity remains an issue. Liquidity levels on the Nigerian stock exchange, for instance, have actually decreased since the country's banking crisis in 2008.

Both Kenya and Nigeria have responded to this problem. Huge development programmes are taking place in both stock exchanges to enhance liquidity and governance. Stocks cannot be shorted on either exchange; a process where an equity is borrowed to be sold in order to benefit from future price depreciation. This leads to lower transaction volumes, and therefore lower liquidity.

Reforms also aim to encourage local companies in seeking domestic rather than foreign listings. For example in 2010 Aliko Dangote, owner of the Nigerian cement company Dangote Cement, listed $154m worth of shares on the local stock exchange. The company recently expressed the desire to float $3bn worth of stock on the London Stock Exchange, a bourse which international investors are more comfortable trading on. This is liquidity that the domestic exchange would rather keep at home and needs to work towards retaining in the future.

Nevertheless, the importance of liquidity should not be overstated. Investors with the right time horizon are able to buy and hold positions, and build up exposure to the market over time. Investors also receive compensation through a liquidity premium, but have to be particularly confident in their knowledge of African equities if they are planning to enter the market.

Politics in command

Perceptions of political risk, bribery and corruption remain the most significant barriers to investment in Africa. However improvements have been made both in terms of peaceful handovers of power, and fiscal and monetary reform.

"The long-term trend is one of maturing political development," says Kemal Ahmed, frontier markets portfolio manager at Investec Asset Management, despite events such as the recent coup d'états in Mali and Guinea-Bissau. The nine presidential elections scheduled for 2012 have the potential to consolidate stability or exacerbate political risk.

Infrastructure remains a central concern. Investment is essential to change Africa's economic geography and take as many companies as possible to a pan-African level. Yet only 8 percent of South Africa's GDP is spent on infrastructure, compared to 44 percent in China. World Bank data suggests that collectively, sub-Saharan African governments need to spend $93bn per year over the next decade for their infrastructure to match other emerging market regions.

Governments cannot afford the funding required to give an additional boost to growth, so the continent is looking to foreign direct investment. The prospect of overcoming bottlenecks in infrastructure presents scope for company growth, which interests fund managers given the largely untapped nature of African frontier markets.

Ian Carton, global head of cash equities at Standard Bank, has seen a significant rise in interest in Africa from his clients. "We are now increasingly seeing global portfolio managers attend [our conferences], in a bid to gain access to corporates and policymakers representing a theme that everyone is interested in," he says, noting that historically, delegates represented at the conferences were predominantly dedicated African portfolio managers.

$1,000bn

The amount McKinsey Global institute argued that Africa's GDP would grow to by 2020

Public equity aside, the Invest AD-Economist Intelligence Unit survey predicts a shift in focus from commodities towards private equity over the next three years by institutional investors. Perceived as a means of creating value in a broader and deeper way by its advocates, PE fund managers stress that the creation of value takes time within their asset class, but rewards are significant.

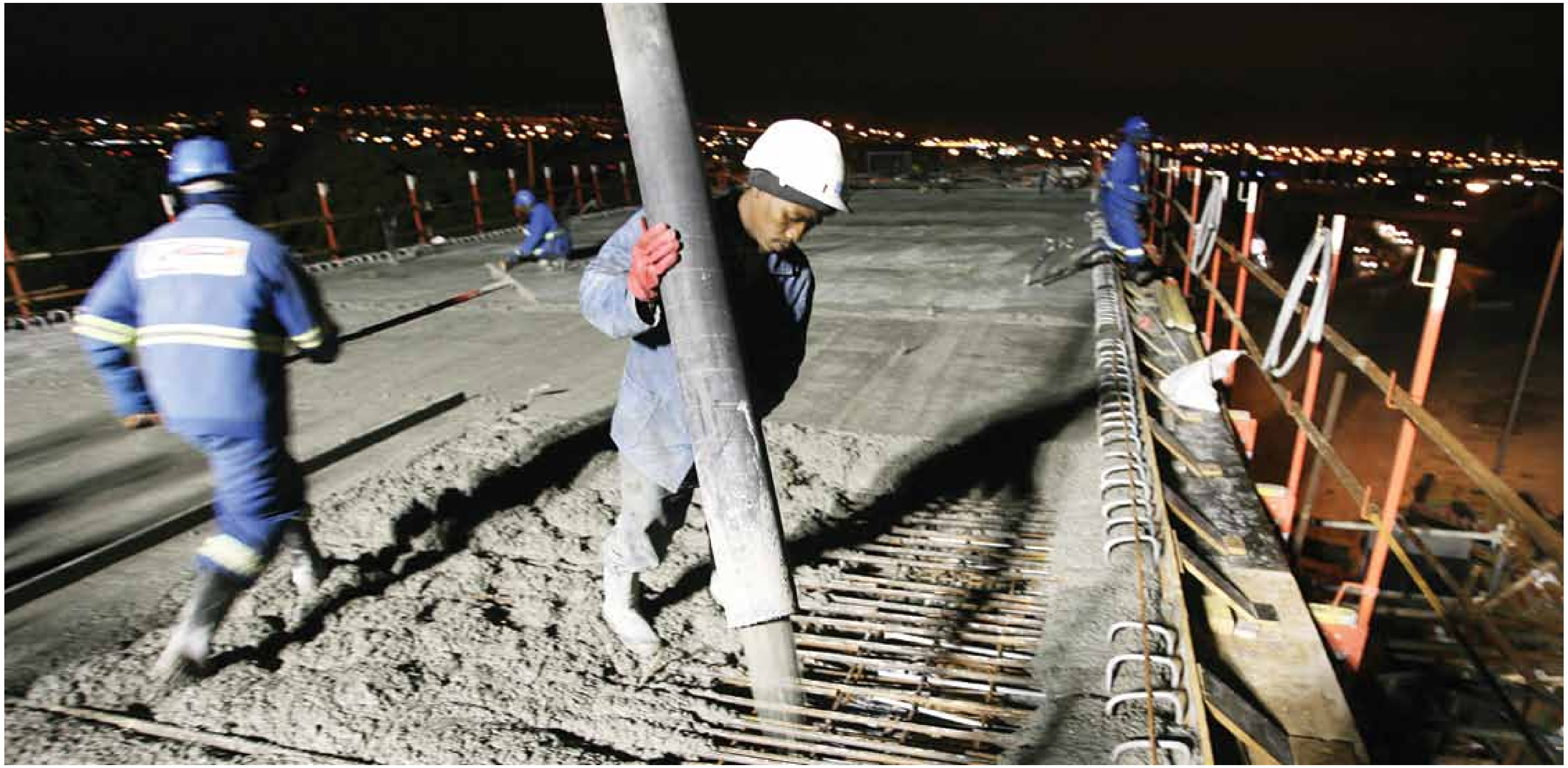
The entry of big players such as the Carlyle Group, which plans to raise $500m for a new Africa focused fund, is expected to encourage other big institutions to enter the market. As indicated in a statement, Carlyle highlighted "the potential to double this amount through co-investment with other Carlyle global funds," taking the fund to a total of $1bn.

The African Development Bank recognises the fund's significance, and has pledged $50m to Carlyle, which is in turn eyeing opportunities in Kenya, Tanzania, Botswana and Ghana. Whilst contributions from development finance institutions including AfDB are welcome, more reliable flows of private investment make them less necessary than in the past.

FDI PREDICTIONS

$150bn

New FDI projects in Africa are forecast to reach $150bn by 2015, creating 350,000 jobs per year



QUICK STATS

$93 billion

The amount World Bank officials estimate sub-Saharan Africa needs to spend on infrastructure

$500 million

The amount Carlyle Group plan to raise for a new Africa fund

Source: Carlyle Group

The long haul

Henry Obi, chief operating officer at Helios Investment Partners, stresses that PE fosters economic growth in the long-term. He draws on the example of Equity Bank Kenya, whose customer base has increased from 1.8 million to 7.15 million after PE investment.

Mr Obi argues that the bank has earned profits from "bottom of the pyramid customers", and is growing so rapidly that it has started regional expansion. "This increases the tax base of the country and eventually the region as a whole, through corporate tax and income tax from the bank's employees," he says.

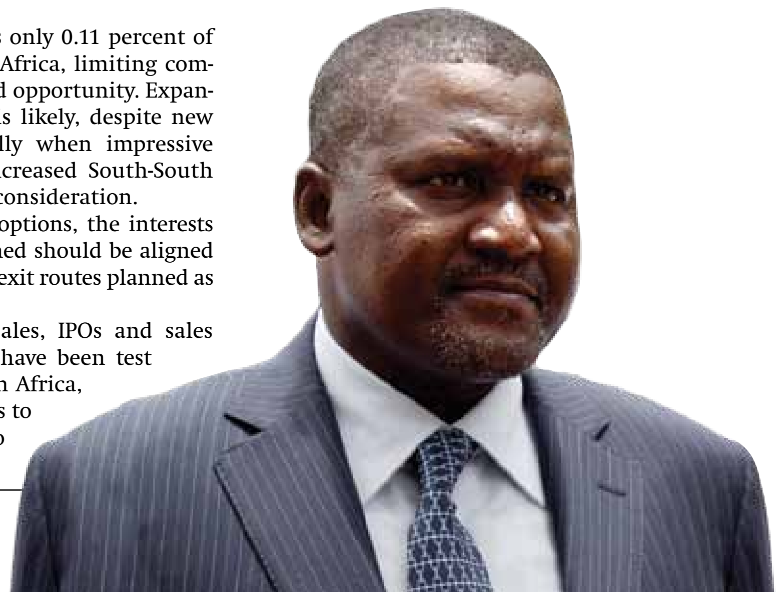
The long-term vision aligns the incentives between financiers and the private sector to achieve mutually beneficial goals, says Geetha Tharmaratnam, principal, investments and head of environment, social and governance, at Aureos Advisers Ltd.

PE helps give a company access to capital, contacts and help with management, making it more operationally efficient and providing access to new markets. Ultimately, if they fail to add value to a company, PE fund managers restrict exit options that are already narrow, since strategic players will only buy at a premium in the knowledge they are investing in long-term growth.

PE penetration is only 0.11 percent of GDP in sub-Saharan Africa, limiting competition for deals and opportunity. Expansion of the market is likely, despite new regulations, especially when impressive growth rates and increased South-South deals are taken into consideration.

In terms of exit options, the interests of all parties concerned should be aligned from the outset, and exit routes planned as early as possible.

Whereas trade sales, IPOs and sales to private investors have been test driven by PE funds in Africa, the main challenge is to maximise portfolio returns. IPOs, for example, are proving tricky given the illiquid nature of stock exchanges. This is predicted to improve over time. African governments and businesses understand that in order to attract investment, standards must get better as the market attracts more players.



ABOVE: Constructing a bridge in Johannesburg, South Africa
LEFT: Aliko Dangote, owner of the Nigerian company Dangote Cement

PHOTOS: GETTY IMAGES

Going forward, the African population is estimated to increase from 1bn to 2bn by 2050, providing a vast consumer base and young work force. "The regional approach is more likely to reap benefits in the short- to medium-term," says Shanta Devarajan, chief economist for Africa at the World Bank.

With this in mind, winners in both the private and public equity space will be companies and investors that target sectors that are able to expand to a pan-African level. But macroeconomic harmonisation will require widespread cooperation between African states and this is likely to take time.

"We have seen African clients be the first to take steps to invest on a pan-African basis which is a good indicator," says Chris Derksen, head of frontier markets at Investec Asset Management. Already, over 60 percent of the largest listed South African corporates plan to expand through Africa, attracting deals such as Walmart's 51 percent takeover of the South African retailer Massmart.

Once more widespread levels of infrastructure are achieved for the operation of pan-African business, Africa can start to look towards global markets, catalysing growth.