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Africa: The next frontier for investors?

Africa's murky image deters some investors, but those already there say the prospects are bright and there is money to be made.

Wars, civil strife and corruption have given Africa a dubious reputation. But conditions are changing as countries become more democratic and implement much-needed reforms. For investors, those who know the continent say, despite vast gaps in infrastructure and widespread weaknesses in governance, regional cooperation between African states is strengthening, democracy is spreading and economic reforms are taking hold; Africa holds out a promise of strong growth.

"Africa is the last frontier," proclaims Mo Ibrahim, Chair of the Mo Ibrahim Foundation and chairman of Satya Capital, an investment firm that focuses on Africa. The continent has huge resources, he says. "If you really want to make money you have to be there."

After growth averaging close to six percent in many African countries last year, the continent as a whole is expected to see its GDP expand by more than five percent this year. Seven African countries, including Ethiopia, Mozambique, and Nigeria, are forecast to be among the world's ten fastest-growing economies over the five-year period to 2015. Last year, according to Ernst & Young, the number of foreign direct investment (FDI) projects in Africa rose by 27 percent.

But Africa could be doing even better. Though it accounts for one seventh of the world's population, the continent attracted only 2.8 percent of total FDI by value in 2011, down for the third year running, according to figures published by United Nations Conference on Trade and Development (UNCTAD). The turmoil of the "Arab Spring" in northern Africa was mainly to blame. But there were other problems. In sub-Saharan Africa, civil war in Mali; fighting between Sudan and South Sudan; persistent instability in the Republic of Guinea Bissau; and lawlessness in Somalia all reinforce Africa's negative image. In its 2012 Africa attractiveness survey, Ernst & Young hailed the progress made by many African economies but warned "Africa is still viewed as unstable, corrupt and generally riskier than other regions."

"The facts tell a different story – one of reform, progress and growth," the consultancy firm asserted. But the negative "perception gap" between Africa's image and reality has become the continent's number one challenge, it affirmed.

Negative image misplaced

Ibrahim agrees. The continent's negative image is misplaced and unfair, he says. To illustrate the point, he recalls the problems he had some years ago raising funding for an African mobile telephone company that he operated. After lengthy negotiations, the banks he had been talking to agreed on a loan well below what he had been asking for. Soon afterwards, he sold the company to a Kuwaiti investor, and "the guys who gave me only US$90 million lent them US$2.4 billion." The security was the same, he points out. The bankers just preferred lending to a Kuwaiti rather than an African name.

Such misapprehensions are leading many people to overlook the opportunities that Africa offers, the Sudanese-born entrepreneur insists in an interview with INSEAD Knowledge at the INSEAD Africa Business Conference in June. "We really have to be reasonable in analysing the situation in Africa," he insists. "There is a big gap between perceptions about Africa and reality."

Africa's population is smaller than India's, he points out, but its total GDP is bigger. "Many countries in Africa are ahead of China and India in governance and the rule of law (and) there are a lot of wonderful stories. A lot of African countries are really moving forward."

While much of northern Africa remains problematic, the overall trend in sub-Saharan Africa is positive. According to UNCTAD, FDI inflows to sub-Saharan Africa rose from US$29.5 billion in 2010 to US$36.9 billion in 2011, a level close to their peak in 2008 of US$37.3 billion. Intra-African investment is also rising. In 2011, according to Ernst & Young, investment from one African country to another accounted for 17 percent of all new FDI projects in the continent.

At any one time, concedes Ibrahim, "There are problems in three or four countries." Overall, however, he insists that Africa is an excellent place to do business. "Wherever there is a gap between perception and reality, there is a wonderful business opportunity."

Since 2007, his Mo Ibrahim Foundation, has worked to encourage reform and promote awareness of Africa's new realities. His foundation was created following the 2005 sale of Celtel International for £3.4 billion, an African mobile phone operator that he had founded a few years earlier. Its annual Index of African Governance ranks the performance of African countries in areas ranging from civil rights to health. It offers a US$5 million annual prize for Achievement in African Leadership, plus an annual stipend of US$200,000 to former African leaders who have promoted good governance, with a view to allowing them to continue playing a role in public life once they have left office.

Progress underway

Other speakers at the Africa conference also emphasised the strong progress that is under way. "There is a very positive trajectory," Simon Harford, co-head of African investment for private equity investor Actis, told INSEAD Knowledge. "Politically, a lot more countries are moving to democracy and the political outlook is more predictable and stable. Economically, a lot more countries are stabilising their macro-economics."

"The continent is really moving very fast," echoed Luc Rigouzzo, executive president and managing partner of Amethis Finance, a Paris-based Investment Advisory firm focused on Africa. From having been an exporter of raw materials and an importer of finished products, he said, Africa is now witnessing the growth of an indigenous manufacturing sector. Local and regional markets are developing to serve an emerging class of urban consumers. "Today, the main African market is Africans themselves. The people who are getting rich in Africa are Africans serving Africa."

Hurdles

To be sure, there are still many hurdles. Power shortages are a major bottleneck, and transport and communications infrastructures are sorely inadequate. According to KPMG, Africa needs to invest between US$90 billion and US$100 billion annually – more than double its current US$45 billion expenditure – to improve roads, railways, ports and other infrastructures and build hospitals and schools.

The continent's underdeveloped financial sector and the difficulties faced by firms in accessing finance are another major bottleneck. According to the African Development Bank, only one in five small and medium-sized enterprises (SMEs) in Africa has a line of credit from a financial institution. Even large companies find it hard to get financing beyond five years from sources other than development finance institutions.

Institutions like the International Finance Corporation, part of the World Bank Group, are doing their best to help resolve the problem. "What we try to do is provide the liquidity to the local banks for them to be able to on-lend," says IFC director Imoni Akpofure. "But you can't force the local banks to lend longer term unless they feel comfortable, and it is much easier for a bank to lend to the government than to a company where you have to do analysis."

Development is also having a negative effect on Africa's wildlife, potentially one of its strongest assets. According to a report by the World Wildlife Fund (WWF) and the African Development Bank, Africa has suffered a decline of nearly 40 percent in biodiversity in the last four decades. This trend risks being exacerbated by the rise of intensive farming, including through so-called "land grabs" – investments by foreign governments and corporations in large tracts of land bought or leased at cheap prices from African governments in order to produce food for export.

Land grabs

The government of Ethiopia has leased vast areas of land for negligible prices to companies like Bangalore-based Karuturi Global and Saudi Sheikh Mohammed Al Amoudi's Saudi Star corporation, in an operation that it says is designed to promote technology transfer. Western investors have also got in on the act, and similar deals have been signed in other African countries, from Ghana to Tanzania. Such investments are leading to the displacement of hundreds of thousands of people, and violent protests against them are already taking place in Ethiopia and other countries.

Though "agriculture is the future of Africa", such deals are definitely not in the interests of Africans, says Ibrahim. "Foreign countries come to Africa and through some dubious and often secret deals, non-transparent deals which (are) not published, they grab millions of acres and then they start kicking peasants out to produce 'food security'. Food for security for whom? What about our own people?"

Even in economic terms, adds Rigouzzo, at a time when demand for food is growing within Africa, such operations do not make sense. "There's a big paradox here," he observes. "It's probably the first time in history that African agriculture has a good future because there is a big market in African cities. But it's now, when African produce can serve African markets that you have a lot of people coming in from outside." As awareness of their downside rises, he and others believe, such investments are likely to run into trouble. "People investing in land grabbing are making a big mistake," Rigouzzo says.

Despite such dark spots, nonetheless, there are many positive aspects. Regional economic integration is being fostered through such bodies as the East African Community, the 15-nation Economic Community of West African States, or ECOWAS, and similar initiatives elsewhere in Africa. As an example of such cooperation, Akfopure cites the West African Power Pool that is working under the auspices of ECOWAS to develop a reliable power grid and a common market for electricity in the region. "This is a good example that is being replicated in other places."

For hard-nosed investors, problem areas of today such as power and financial services are the potential profit centres of tomorrow. Both are among the sectors attracting investment from firms like Actis and Amethis.

Young workforce

Above all, however, Africa's most appealing feature for many investors is its youthful population, with all the growth that this implies for sales of consumer products and services.

With "more than 50 percent of the population under the age of 18," says Anat Bar-Gera (MBA '87D) chair of high-speed broadband provider 4G Africa, which operates in Cameroon and plans to expand into other countries soon, "Africa has a fantastic demography." Africa's young generation, she says, are "the natural up-takers" of the services her company provides.

Over the next few decades, says Rigouzzo, Africa can look forward to a "demographic dividend" in growth similar to that enjoyed by China and India in recent years. "Even with all its problems," he asserts, "I am absolutely confident that the continent in 20 years will be the next growth frontier of the planet."

Mo Ibrahim was keynote the speaker at the Africa Rising Business Conference, which was held at INSEAD Fontainebleau on 15 June 2012

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