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FINANCING PROJECTS AND DEALS IN AFRICA

By

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INTRODUCTION

Whilst dealing with the theme given to us, we need to think about a much more deeper consideration. To what end are we considering such funding and such programmes?

- Is it for the profit?
- Is it for the development of our societies?
- Is it for the enrichment of a few?
- Is it for a combination of all these?
- If so, what is the right balance?

Finding the right balance will be a challenge that we will have to contend with, for many generations to come. It is unfortunately, a challenge we cannot defer.

Thinking about the challenge of financing projects in Africa, we need to be conscious about the longer term objective and conditions under which we ought to be doing this. It ought not to be merely for the sake of financing. As we consider this, we also need to think about the source of this capital and prioritise these sources according to their respective long-term beneficial characteristics for the continent.

Foreign sources, whilst they are essential for closing a capital gap shortage, are not optimal for the long-term. In the long-term, the receiving economy experiences huge capital reversals, as maturing investments result in dividend outflows. This is a typical characterisation of South Africa's external account. In effect, this deprives the receiving economy of higher reinvested earnings, which would bring about multiplier effects in capital formation and growth.

This observation can be replicated at the continental level. How do we ensure long term optimal investing? How do we ensure sustained capital retention and increased reinvested earnings?

Domestic savings are and will always be superior. How do we increase reliance on savings from the continent? That is the key policy challenge and choice facing us on the continent.

Should this make us vulnerable? The answer is yes. Should it limit our choices? No.

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Foreign Direct Investment (FDI) has always been a significant source of external finance in developing countries. This continues to be the case. It has also become a mechanism of integrating into the global marketplace. FDI triggers:

- technology spill-overs;
- assists human capital formation;
- contributes to international trade;
- helps to create a more competitive business environment; and
- enhances enterprise development.

All of these contribute to higher economic growth, which is the most potent tool to deal with unemployment and poverty, over the medium to long-term. You may be asking the question, where is he going with this argument?

Given our socio-economic imbalances, this is the best remedy for Africa.

Africa has, until recently, been somewhat left out of this process for many reasons, including small market sizes, poor infrastructure, weak regulatory frameworks, debt problems and, in some cases, political instability. However, over the past decade, there has been considerable progress with economic and political reforms in several African economies. These developments mean that Africa now sits on the cusp of explosive economic development and growth.

However, long term success is a function of how ready we are. For FDI to contribute fully to economic and social progress in Africa, host-country governments need to create a policy environment that enables them to extract development returns on investment. That means, the absorptive capacity needs to be improved to maximize returns from foreign capital assistance. As the old adage goes, “luck favours those who are ready”.

Governments should thus develop a set of policies that are not only focused on investment promotion, but also address issues such as human capital and skills transfer, infrastructure and enterprise development. These are likely to increase FDI spill-over effects and contribute to diversifying the economic base of countries in the region. Progress will also be sped up as international investors realise that massive growth potential lies in Africa.

Not only that, governments need to develop the capacity to engage with partners to ensure that relationship with donors favour the host country, at best, or are at least equitable. Equal partnership is key, for going forward.

As we look to the future, the challenge is to find ways and means of harnessing more investment, both from the continent itself and from outside Africa. Collaborative investment efforts between companies, institutions and/or countries, will naturally aid the process. The business forum at hand is discussing this very topic and is a stepping stone in the process to bring alive and realise the opportunities that Africa presents.

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WHY PROMOTE ASIAN FDI IN AFRICA?

There are many positive attributes of the Asian economies that make a compelling case for partnership. These range from technological advancement, skills, capital surpluses and large and growing markets.

Asian countries have shown over the decades, since the Second World War, an admirable propensity to save, much more than many other regions of the World. Not only that, they have displayed an impressive ability to innovate and ground their leadership on technological advancement and by leapfrogging their peers and competitors. They have also demonstrated their ability to adapt different ideologies for their sustained development.

That is at the heart of a beneficial partnership with the continent.

Despite the current global economic malaise, prospects for most Asian economies still look very promising. The table below summarises the latest World Bank forecasts for growth in some of these economies:

	2012 (%)	2013 (%)
China	7.7	8.1
Indonesia	6.1	6.3
Malaysia	4.8	4.6
Philippines	5.0	5.0
Mongolia	11.8	16.2

Savings in Asian countries are also uncomparably high, implying that there is still great scope for productive investment outside of their borders. In exchange, Africa offers a wealth of natural resources and often very entrepreneurial people. Its often under-served markets provide investment opportunities for Asian and other firms. Increasing FDI into Africa also promotes trade by opening and expanding market opportunities.

Over the past two decades, FDI has become a vital source of economic development for the African continent, with funding increasing from approximately US$ 9 billion in 2000 to US$ 18 billion in 2004 and US$ 88 billion in 2008.

Although Asian investment in Africa often targets the energy sector, there are important investments in the telecommunication and real estate sectors (Table 1). New investors are also active in areas that are particularly important to Africa's developmental agenda, such as infrastructure and agriculture. The experience at the PIC indicates that we have barely touched the tip of the iceberg, in terms of investment in these areas.

Selected 10 Asian greenfield FDI projects in Africa, 2002 – 2006 (US$, millions)

Value	Company	Source Country	Industry	Year	Destination Country
6000	ONGC	India	Energy	2006	Nigeria
4300	Petro Vietnam	Viet Nam	Energy	2006	Algeria
3600	Pertamina	Indonesia	Energy	2005	Libya
1500	Huawei Technologies	China	Telecom	2006	Ethiopia
1300	Marvis	Singapore	Energy	2006	Gabon
1000	Petronas	Malaysia	Energy	2005	Sudan
1000	CNCP	China	Energy	2003	Sudan
413	RanHill	Malaysia	Real Estate	2006	Libya
400	Global Formwork	Malaysia	Real Estate	2005	Nigeria
392	BHEL	India	Energy	2006	Sudan

Source: FDI in Africa, Policy brief no. 4 – October 2010

TRADE AND ECONOMIC TIES BETWEEN AFRICA AND ASIA

During the last fifteen years, trade flows between Africa and Asia have rapidly increased (both ways). The high growth of Africa's trade with Asia is largely driven by exports from China and India, the two dynamic economies not only in Asia but also in global terms. Africa's exports to Asia are largely driven by increasing demand in Asia for natural resources and other primary commodities coming from growing industrial sectors.

While China and India are the two drivers of the recent growth in Africa-Asia commercial relations, other Asian developing countries are also important players. Africa's exports to five

ASEAN countries (Indonesia, Malaysia, Philippines, Singapore, and Thailand) together have expanded by 65% during the last five years.

Establishing new trade relations with Asia is an effective way for African exporters of food and other agricultural commodities to expand. Asia's developing countries continue to grow in relatively rapid terms to increase their purchasing power. Building new trade with such countries can help African exporters overcome the constraint of low income elasticity. Low income elasticity is often considered the main reason for the stagnant demand for the primary commodities exported by African countries. Given the low income elasticity of food demand, expanding trade with the partners in Asia will have more significant consequences than expanding sales within existing saturated markets such as Europe (Africa-Asia Trade and Investment, 2008)

South African *de facto* economic and financial integration with sub-Saharan Africa region coupled with FDI has and is gaining continuing traction for development on the Continent. Progress in multilateral trading arrangements has continued, with the emphasis on removing nontariff barriers to trade, including red tape and addressing infrastructure shortfalls. In the South African Customs Union (SACU), further integration continues along the five priority areas highlighted in the 2010 summit. SACU countries are working toward promoting industrial development among SACU members, improving trade facilitation, developing common SACU institutions, and engaging in joint trade negotiations with third parties (IMF Country Report 2012: 30)

Between 2003 and 2009, Nigeria was a top destination for Chinese FDI on the continent, second to South Africa. While initially driven by its vast demand for energy resources, China's involvement in Nigeria has since expanded far beyond oil. China's public and private companies are making forays into Nigeria's manufacturing and information and communication technologies sectors. They are developing two special economic zones within Nigeria and are building new roads, railways and airports across the country.

By 2010, Nigeria had become China's fourth biggest African trading partner, and the second largest Chinese export destination on the continent. Trade between the two countries accounted for nearly one third of the trade between China and the whole of West Africa (West African Challenges: 2011)

CHINESE INVESTMENT IN AFRICA

In July 2012 Chinese President Hu Jintao opened the fifth China-Africa Cooperation Forum with the announcement that China will offer an additional US$20bn in loans to Africa over the next three years. This is double the amount that was offered at the 2009 forum (www.howwemadeitinafrica.com). Since the mid-1990s, China has been targeting developing (rather than developed) countries for its investment projects. African governments generally welcome Chinese FDI which provides capital that Africa needs, especially in the light of decreasing FDI from industrialised countries since the advent of the financial crisis in 2007.

Statistics show that Chinese investment in Africa has being growing steadily. Chinese firms have invested in various sectors in Africa, including resources, transport, agriculture and trade. Chinese firms have also recently increased their investments in construction, largely through infrastructure development projects. China has also invested in energy security in order to support its long term growth. As oil is a major import for China, it has been investing in refinery projects across the African continent.

PIC'S EXPERIENCE IN AFRICA & CHALLENGES

The Public Investment Corporation (PIC), under the mandate of our major client, has allocated a significant amount of capital to be invested in the rest of Africa, namely 5% of total assets under management. This translates to a minimum of R50 billion. We have only in the last two years or so accelerated our pace of investment into the rest of the African Continent. We are learning as we go and at the same time building relationships across the Continent and across a host of different sectors, all of which provide a return opportunity to the savvy investor.

Our engagements thus far have been extremely diverse and have taken us to countries such as Tanzania, Nigeria, Mozambique and Zambia. In one investment, through Ecobank, we straddle at least 32 African economies. Of course there are both challenges and rewards to investing into new African territories, but all investing holds both threat and opportunity and it is up to us as asset managers, to discern the good from the bad.

As example of opportunity, both East and West Africa are rich with prospects for investment flows. The discovery of rich natural gas in Tanzania has led to an inflow of foreign investment attempting to gain a foothold in the country through infrastructure development. Countries such as China, Japan, India and Canada have taken bold steps in terms of investing into the Continent.

Education in most African countries is still an area requiring great attention. Often countries are faced with people who lack necessary skills to support the high growth prospects these countries may present. This is especially acute in the mining and engineering sectors. This has often resulted in a large inflow of expatriate skills in order to support the initial stages of business development. While most businesses attempt to promote transfer of skills to locals, base education to enable the effective absorption of these skills still needs to strengthen, and following that, sound tertiary education which can build further ability for full skills transfer in more technical industries.

Unfortunately, cases of corruption both in the private and public sectors in some countries still present a challenge to overcome. Though not unique to any region of the World, participants in Africa need to do the right thing, conduct business openly, honestly and with integrity. These actions by investors, coupled with a strong political will to do and enforce the same, will mean a stronger base from which opportunities can be fully realised and benefits passed on to those who ultimately deserve them.

The lack of road, rail and port infrastructure in many African countries makes logistics in respect of the transport of raw material and finished goods difficult. It is one thing producing an excellent product, and another to economically and timeously get that product to market. There are currently plans to improve road, rail and port systems in some countries (like South Africa), while even that challenge has meant business opportunity for others. Some private players in a number of African countries make excellent money as they find innovative solutions to minimise logistics costs, or take advantage of the fact that goods cannot be imported into a certain region cheaply enough given the lack of infrastructure.

Further constraints, in admittedly a fast changing landscape, has been the lack of internet connectivity and access. This has been massively affected too by the cell phone revolution, which in many countries has even led to a banking revolution where cell phones can be used to effect money transfers.

Sometimes, a shortage of energy infrastructure leads to a restriction of possible mining and smelting activity (this South Africa can attest to). In this constraint however, once again lies opportunity for other companies to come in and provide the necessary infrastructure, energy required and growth.

Issues such as taxation agreements between counties, or a punitive tax or tariff regime within a specific country can act as a deterrent. At other times, the opportunity might be seen as so promising that a number of possible investors in effect chase the same opportunity (thereby bidding up its price). Opportunities for beneficiation and value-add to raw natural resource extraction are still growing.

On the consumer side, a number of retailers (most notably South African-based ones, such as Wallmart through Massmart, Shoprite, Mr Price) have all recognised the latent but growing consumer power within Africa. Clearly, their and other corporate successes are integrally tied to infrastructure and logistics of getting their goods to where they need to be. However, the success stories are growing.[1]

There are still many millions of unbanked people in Africa. This implies a further lack of access to financial services and once again points to the possibility of an awakening consumer, especially as investment into the African continent rises and disposable incomes increase. Urbanisation, is also still occurring in Africa at the most rapid pace in the World. This points not only to the increased burden that is being placed on existing infrastructure in urban areas, but also the possibility of an urban consumer, if given the right enabling conditions.

Our own PIC investments into companies such as EcoBank, and Tanga Cement which operates out of Tanzania, are recognition of the growing opportunities in Africa and the confidence we have in Africa's future. The message is that of course the challenges are there, but so are the opportunities. Sage investors do their homework, they realise that one cannot delink development, social and financial return. There is also certainly scope for collaboration of investment effort and for co-investments in each-others regions, above import-export trade between ourselves. World growth needs the types of opportunities I have presented, but above all so do our people.

What are the risks?

As we increase ties with the Asian economies, it is important that we manage the rapid growing dependency on the Asian economies for Africa's wellbeing and future. It is simply unhealthy and unsustainable for the entire African economy, of more than 50 countries, to be dependent on a single country, namely China.

It will be essential that this risk is not allowed to go unchecked. Further, we need to be able to wean ourselves of this lifeline, should the need arise, with minimal negative impact on the continent's livelihood.

Other challenges that need to be considered on the Continent include:

- Lack of preparedness on the part of host governments, which leads to unequal partnerships.
- A continent that does not display a coordinated developmental programme.
- Regulatory fragmentation.
- Collaboration between different entities who may have different mandates/objectives/principles, and risk appetites.

[1] Examples: Mr Price is expanding into the rest of Africa, and has recently opened its first store in Nigeria, with another in Ghana being planned for 2012. Standard Bank now has a relatively well established and growing footprint in Africa. PPC cement has announced that it plans expanding into the contient and Shoprite has also begun the expansion process.

- "Dollarisation" which is inherently destabilisating.
- Lack of co-ordination amongst governments, DFI's and others to make a case for a collective and single African economic unit.
- Creditworthiness of counterparties.

These are just some of the challenges that the African economy, needs to deal with, collaboratively and yet decisively.

I thank you.