STRACHAN PARTNERS

CHALLENGING RISK PERCEPTIONS IN AFRICA

It is easy to overestimate the characteristics and severity of risks when it pertains to an unfamiliar and a largely unchartered terrain. Africa is no exception to this in relation to international private capital flows – particularly when charting foreign direct investment opportunities. A common misconception is that Africa is a large singular entity - a giant country with uniformly applicable laws, cultures and conditions. On the contrary, Africa is a continent comprising of 54 countries and territories, with diverse and distinct socio-economic and political environments. Africa consists of sovereign states that range from countries that enjoy political stability, well-rounded economies and robust infrastructure, to countries that are politically unstable and destabilized by ethnic tension and clashes.

Undoubtedly, risk preferences play a key role in determining where to invest in Africa. A cursory glance at these perceived challenges begs the question, "Why bother investing in Africa?" A better question is "Why not Africa?"

Africa's governing structures range from free market democracies to autocratic dictatorships, and either side of the spectrum is susceptible to varying levels of political unrest, crime and widespread corruption. Allowing these risks to serve as a deterrent to doing business in Africa is a myopic view of an unfamiliar terrain.

Africa possesses a rapidly evolving landscape that lends to a myriad of opportunities for intrepid investors to achieve massive financial gain. Successful business ventures in Africa are largely dependent on the investors' palate and derring-do for varying levels of risks. The key to success is understanding the actual risks and learning how best to mitigate against them. This allows investors to navigate seemingly murky waters in the most effective and efficient manner that minimises the risks and maximises profits.

WHAT ARE THE REAL AND PERCEIVED RISKS OF DOING BUSINESS IN AFRICA?

Perceived Risks of Doing Business in Africa

Risk averse and conservative investors tend to view the most economic and structurally developed countries in Africa as the most attractive locations to launch an incursion into the African commercial space. However, these countries may lack coveted economic sectors. For instance, South Africa does not compare with Nigeria in terms of a burgeoning labour force, or a robust oil and gas sector.

Another risk factor considered in determining where in Africa to invest, is a country's or region's political climate. Each country in Africa has its own unique set of socio- political and economic pros and cons, which need to be carefully considered. The key is to take a molecular view of each country, or of the specific region of interest and discover its idiosyncrasies prior to deciding whether or not to pass on an investment opportunity. The Executive Secretary of the UN Economic Commission of Africa observed that risk perceptions, including concerns about the political, legal and regulatory environment are crucial to investment decisions .

The Secretary went further to stress that "Africa must begin to tell its own story", he pointed out that for every publicised negative media story about Africa, "be it a violent conflict, human rights infringement, shaky election process or instability, we can find the equivalent in developing Asia.[i] "

This highlights that a huge part of tackling the perceived risks of investing or doing business in Africa come down to the importance of letting Africa take charge of its own narrative. Relying solely on generic media coverage to make such a determination is a broad-brush approach of a uniquely nuanced and particularized field. Asia and other emerging and developing economies also have their fair share of "growing pains", yet they do not endure the closely scrutinized, demonized, sensationalized negative media associated with Africa. Africa needs to seize control of its own narrative and tackle negative perceptions about the continent.

This requires a concerted effort by the respective African governments to deemphasize the bad press by balancing it out with a more positive perspective. It is difficult to invite more players to the field if the players have a limited or negative perspective of the playing field. In terms of general awareness, Africa still remains a mystery to most of the Western world. The adherence to a single story of Africa being a war torn, poverty stricken, and disease-ridden place is a grossly shuttered view of a vibrant and dynamic continent.

Real Risks of Doing Business in Africa

The real risks of doing business in Africa can be traced to the following Financial, And Socio-Political Investment Challenges: [iii]

i. Limited public-sector capacities and capabilities to develop strategic forecast and development, policy uncertainty, weak regulatory environments and enforcement, and a dearth of skilled technical workers. The Economic Commission for Africa identified establishing an enabling environment, as well as tackling regulatory and institutional impediments as the most challenging stage of project preparation in various African countries.[iv]

ii. Limited financial markets, longer project gestation, and foreign exchange transaction issues, which make financing issues more complex. Africa needs to develop and modernize its basic infrastructures particularly by acquiring modern transportation systems and improving power generation.

Ameliorating these areas will create a sizeable positive ripple effect throughout Africa's various economies and in turn lead to a surge in foreign direct investment from private investors scouring the globe for large projects with attractive returns[v]. It is important to note that many countries in Africa have identified these issues and have enacted legislation to attempt to ameliorate these challenges and address these deficiencies.

AFRICA: THE NEW FRONTIER

Africa is a huge market opportunity. It is one of the fastest growing regions globally with huge infrastructural needs[vi]. It has about 52 cities with a population of one million or more and currently has very low intra-regional trade[vii]. Africa also possess the youngest population globally - youths aged 15 –24 accounts for 20% (226 million) of the continent's population[viii].

An estimated ten million youths enter the labour market annually and this figure is expected to increase to 50% of the urban population by 2030[ix]. Africa is experiencing rapid growth, as developing economies are anticipated to grow at 4.1% a rate far faster than advanced economies[x].Africa is home to six of the top 13 fastest growing countries in the world[xi]. Ethiopia is the fastest growing economy of 2017 according to the World Bank's Global Economic Prospects[xii]. Ethiopia's GDP was forecast to grow by 8.3% in 2017, in contrast the global growth is projected to be only 2.7%[xiii]. It's accelerated GDP growth is due to the Ethiopian government's spending on infrastructure[xiv]. Africa has the highest percentage, 60%, of the world's uncultivated arable land[xv]. It also has an abundance of natural resources, minerals, oil, gas, and precious stones and metals[xvi].

i Risk Perceptions Hurting investments in Africa https://www.uneca.org/stories/risk-perceptions-hurting-investments-africa
ii Risk Perceptions Hurting investments in Africa https://www.uneca.org/stories/risk-perceptions-hurting-investments-africa
iii Infrastructure Financing in sub-Saharan Africa Best Practices from Ten Years in the Field – The Boston Consulting Group and the Africa Finance Corporation BCG-Report-Africa-May -2017
iv Risk Perceptions Hurting investments in Africa https://www.uneca.org/stories/risk-perceptions-hurting-investments-africa
v Unlocking Nigeria's Potential – The Path to Well Being The Boston Consulting Group BCG April 2016
vi Infrastructure Financing in sub-Saharan Africa Best Practices from Ten Years in the Field – The Boston Consulting Group and the Africa Finance Corporation BCG-Report-Africa-May -2017
vii Infrastructure Financing in sub-Saharan Africa Best Practices from Ten Years in the Field – The Boston Consulting Group and the Africa Finance Corporation BCG-Report-Africa-May -2017
viii http://theconversation.com/africas-youth-and-abundant-arable-land-are-a-potential-winning-combination-48855
ix Infrastructure Financing in sub-Saharan Africa Best Practices from Ten Years in the Field – The Boston Consulting Group and the Africa Finance Corporation BCG-Report-Africa-May -2017
x https://www.weforum.org/agenda/2017/06/these-are-the-world-s-fastest-growing-economies-in-2017-2/
xi http://www.businessinsider.com/world-bank-fast-growing-global-economies-2015-6?IR=T#1-ethiopia-13
xii https://www.weforum.org/agenda/2017/06/these-are-the-world-s-fastest-growing-economies-in-2017-2/
xiii https://www.weforum.org/agenda/2017/06/these-are-the-world-s-fastest-growing-economies-in-2017-2/
xiv https://www.weforum.org/agenda/2017/06/these-are-the-world-s-fastest-growing-economies-in-2017-2/
xv http://theconversation.com/africas-youth-and-abundant-arable-land-are-a-potential-winning-combination-48855
xvi Business in Africa: The Risks, Rewards and Challenges https://leaglobal.com/thought_leadership/LEA%20AfricaWhitepaperFINAL.pdf

THE REWARDS OF INVESTING IN AFRICA.

Africa currently has nearly a billion people on its continent by 2030 it will have the world's largest and youngest labour force[xvii]. Africa is forecasted to have close to 3 billion people or 30% of the world's population by 2063.[xviii] This explosive growth creates a myriad of business opportunities for the intrepid investor. Africa has collectively one of the world's highest unemployment rates, this creates a perfect opportunity for workforce development.[xix]

Improved employment opportunities for lower income earning members of society has created a thriving consumer group of people who are now capable of affording what were previously inaccessible or unaffordable goods[xx]. This creates an opportunity for businesses to target a growing set of consumers. For instance, cell phones and their associated services represent an exploding market among lower income earners. This is due to the fact that phones are a modern convenience and a status symbol.

Additionally, the middle class which has traditionally been a small percentage of the African population is growing due to job creation and greater access to luxury goods, that demographic has the potential to exponentially explode in ways similar to the U.S or Europe in the early to mid-20th century. The upper class in Africa also represents a thriving consumer base. Wealthier citizens have the taste for and the ability to pay for a vast array of luxury goods and services, which provide the greatest convenience or serve as an indicator of status and wealth.

Intergovernmental organizations such as the United Nations Economic Commission for Africa are taking steps to partner with the private sector in order to encourage growth in Africa[xxi]. There are many gaps in the African market, ranging from the provision of goods and services, to the execution and implementation of public infrastructure projects. African governments recognize the gaps particularly in terms of infrastructure, but they lack the financial resources and technical know-how to close the gap alone. Africa needs to mobilize an influx of private capital and expertise.

While there is a smorgasbord of problems that Africa needs to solve, these problems create an opportunity for the intrepid investor to infiltrate the African market in its nascence and get a foothold before the population explosion, which will lead to an exponential growth of consumers with increased purchasing power. International private capital – especially foreign direct investment has much to gain from broadening its investment into Africa.[xxii]

PROSPECTS OF DOING BUSINESS IN AFRICA

Private investors must understand the challenges that are unique and distinct to investment in Africa, and must develop the patience, resilience, and risk appetite that the African environment demands. They should also understand that most successful investors possess an enterprising approach and engage fully with projects - from visualization of the concept to its inception up until execution.[xxiii]

The following are four key attributes that the Boston Consulting Group has identified as crucial considerations for investing in Africa:[xxiv]

a. Calibrated expectations and a prepared outlook on the reality of investing in an African environment. Particularly, an appropriate level of risk tolerance, a persistent and undeterred mindset towards a successful outcome.

b. Acquiring a deep-seated understanding of the regions, target market, as well as local dynamics. African countries have discrete differences in their legal and regulatory atmospheres, varying levels of political stability, distinct cultures, languages, and natural resources to name a few. Particularly, utilizing a law firm with commensurate understanding of the inn workings of the local dynamics is vital.

c. An enterprising architectural perspective versus a disengaged investor only outlook. A hands-on "helicopter parent" approach is in some cases necessary regarding investments.

d. Mindfulness of community engagement as an essential priority, not an added-on benefit.

While successful projects in Africa are more likely to generate a higher return on investment than in any other continent Africa also has unique challenges that require investors to adapt to in order to be successful. Challenges can and should be managed and adequately prepared for to ensure that the probability of success is certain and the rewards are maximized.

Kanyinsola Olufon is a Junior Associate in the firm and is a member of the firm's Corporate and Commercial Department. For more information regarding this article, contact the author:
E: kanyinsola.olufon@strachanpartners.com
T: +234 (1) 2700722

xvii Infrastructure Financing in sub-Saharan Africa Best Practices from Ten Years in the Field – The Boston Consulting Group and the Africa Finance Corporation BCG-Report-Africa-May -2017
xviii Risk Perceptions Hurting investments in Africa https://www.uneca.org/stories/risk-perceptions-hurting-investments-africa
xix Business in Africa: The Risks, Rewards and Challenges https://leaglobal.com/thought_leadership/LEA%20AfricaWhitepaperFINAL.pdf
xx Business in Africa: The Risks, Rewards and Challenges https://leaglobal.com/thought_leadership/LEA%20AfricaWhitepaperFINAL.pdf
xxi ECA to partner with private sector in effort to spur growth in Africa https://www.uneca.org/stories/eca-partner-private-sector-effort-spur-growth-africa-says-songwe
xxii Infrastructure Financing in sub-Saharan Africa Best Practices from Ten Years in the Field – The Boston Consulting Group and the Africa Finance Corporation BCG-Report-Africa-May -2017
xxiii nfrastructure Financing in sub-Saharan Africa Best Practices from Ten Years in the Field – The Boston Consulting Group and the Africa Finance Corporation BCG-Report-Africa-May -2017
xxiv Infrastructure Financing in sub-Saharan Africa Best Practices from Ten Years in the Field – The Boston Consulting Group and the Africa Finance Corporation BCG-Report-Africa-May -2017