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Investing in Africa: More Than Meets the Eye

By Jeffrey R. Krilla, Thomas W. Laryea, and Peter G. Feldman

International businesses and investors are focusing unprecedented attention on Africa. The continent is increasingly seen as presenting opportunities for commercial transactions that benefit the investor, local counterparts, and the wider economies of recipient countries. To be successful in such investment strategies, it is important to leverage the positive factors drawing firms to the continent and to engage the requisite legal and policy expertise to guide sound business decisions.

Africa Is Bigger Than We Think

Popular depictions of the global map significantly shrink the relative size of the African continent. With a land mass of nearly 12 million square miles, the continent of Africa would easily contain the United States, China, Japan, Russia, and Europe. Africa is much bigger than we have been made to think. The optical distortion entailed in the “standard” shrinking of Africa should not limit our perspective. The vastness of the continent—with the tremendous diversity in language, culture, economies—presents both challenges and opportunities for investors navigating for business prospects.

Positive Trends

Investment decisions in Africa are appropriately informed by the growing size of markets on the continent, promising macroeconomic conditions, abundant natural resources

and human capital, and positive trends enhancing the legal and institutional frameworks for doing business.

Macroeconomics

Despite the external shocks arising from the 2008 global crisis, Africa as a whole has been relatively resilient. African economies were bolstered by improvements in monetary and fiscal policies that had been made over the years, which gave room to engage in countercyclical measures. Over the past decade, six of the ten fastest-growing countries in the world were in sub-Saharan Africa. The fastest-growing economy in the world in 2011 was Ghana, which registered an approximately thirteen-percent increase. Granted, these growth figures come from a relatively low base, but they reflect significant relative data for companies looking for new markets in which to grow in light of the low growth trend in advanced economies. While much global attention has been fixed on the high growth rates in China, 10 African countries have per-capita GDPs exceeding that of China. Along with the rise of a middle class across the continent, Africa’s combined consumer spending is also strengthening, from \$860 billion in 2008 to a projected \$1.4 trillion in 2020. The burgeoning middle class, with its discretionary spending power, will boost consumer demand across a wide range of goods, services, and technologies.

Natural Resources and Human Capital

The continent’s natural resources have been a source of attraction for investors over the centuries, but it is worth noting that from 2000 to 2008 natural resources directly accounted for only 24 percent of Africa’s GDP growth. Africa has approximately half of the world’s gold deposits, 10 percent of its oil reserves, and a third of its diamonds, copper, platinum, and “rare earth” minerals—many of which are critical to the functionality of smart-phones, tablet computers, and flat-screen TVs. Sixty percent of the world’s uncultivated arable land is in Africa, which of course provides a key input for the development of agribusiness (although maximizing potential in the agribusiness sector would depend on improvements in infrastructure elements such as power, irrigation, and transportation). The human capital on the continent also bears emphasis. By 2040, Africa will be home to one in five of the planet’s young people and will have the world’s largest working-age population: some 1.1 billion people. The long-standing “brain-drain” that has depleted needed human capital on the continent is thankfully a reversing trend, buoyed by a returning diaspora and

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the infusion of expatriates who are internationalizing many of the growing business centers on the continent.

Investment Flows

Recent investment flows into Africa are another indicator of the continent's increasingly attractive economic profile. In 2011, private equity firms raised \$1.5 billion for projects on the continent. China alone is expected to invest more than \$100 billion in Africa in 2012, more than double the \$46 billion invested by India. Overall foreign investment in Africa has grown more than sixfold in the last decade. One enduring question is whether U.S. investment will catch up in the upcoming years.

While a role remains for multilateral and bilateral government financing (in some instances on concessional terms), private capital flows through foreign direct investment, portfolio investments into private equities and government securities, and remittances have become the main source of external financing for many African countries. Nonetheless, an undeniable role remains for the public sector to spur sustained investment by the private sector. Tools at the disposal of the public sector for these purposes include providing catalytic financing, enhancing risk mitigation mechanisms, reforming legal and institutional frameworks, and assisting with the implementation of best practices and local know-how. Looking ahead, there is a concern that the continuing threat to financial markets arising from unresolved debt problems in advanced economies may encourage risk aversion (including fear of the unfamiliar) and compromise private capital flows to Africa in the near term.

Legal and Institutional Reforms

Recent years have also witnessed notable enhancement in the legal regimes and institutions facilitating foreign investment. These developments include generally better public governance, although several notable exceptions remain. Measured by the World Bank's Ease of Doing Business Index, which tracks factors for starting a business such as dealing with construction permits, getting electricity, registering property, obtaining credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency, notable progress has been achieved in many countries in Africa.

Increased regional integration through international legal and economic cooperation has served to deepen markets by harmonizing relevant legal regimes and reducing trade barriers within the regional territories. Among the regional groupings leading this integration are the Common Market for Eastern and Southern Africa ("COMESA"), the Economic Community of Central African States ("ECCAS"), the Economic Community of West African States ("ECOWAS"), and the Southern African Development Community ("SADC"). In this context, a number of individual African countries have pushed ahead with

adaptations to their legal and regulatory regimes to facilitate increased investment flows, including the creation of "free zones" in which ordinary customs and tariffs do not apply. For example:

- Tanzania has established "Special Economic Zones" and "Economic Development Zones" in which companies enjoy a liberal regulatory environment as well as a host of incentives intended to spur production, promote exports, and generate employment. Such incentives currently can include an exemption from corporate taxes for an initial period of 10 years, an exemption from various taxes on capital expenditures for machinery and equipment, and an exemption from various shipment requirements or trade duties. Tanzania has also established the Tanzania Investment Centre, a "one-stop shop" that provides administrative assistance, ensures investor protections, and offers various investment incentives, such as a Certificate of Incentives that gives qualified foreign investors preferential treatment in the acquisition of land, as well as automatic approval for five work permits for expatriate employment. Notably, the Certificate of Investment also gives foreign investors the right to transfer outside of Tanzania 100 percent of their foreign exchange, profits, and capital.
- Kenya, for its part, has also undertaken to provide special incentives to help attract international investment. Kenya has established "Export Processing Zones," within which qualified companies can engage in certain manufacturing, commercial activities, or services. Among the benefits of operating in such a zone are exemptions from certain excise duties and an exemption from the payment of income tax for the first 10 years from the date of the first sale by an enterprise. Companies located in Export Processing Zones are also exempt from the payment of withholding tax on dividends and other payments to nonresidents during the period that the company is exempt from income tax. Additionally, qualified foreign investors in Kenya may be eligible to receive an investment certificate that entitles the investor to three entry permits for management staff and three entry permits for owners, shareholders, or partners.

Notwithstanding these positive trends, the extraordinary legal and regulatory diversity in Africa, both across and within countries, presents complexity to the would-be investor. The degree of government involvement in the business environment, while generally pervasive, varies in terms of legislation, regulation, administrative oversight, government market participation, and, in some instances, government interference. Part of the planning phase of any successful investment strategy involves obtaining the

necessary advice on the legal landscape and government factors that inform the viability of proposed investments.

Tips for Success

Against the backdrop of promising market conditions and economic indicators, markets within Africa have become an increasingly attractive destination for foreign investment and business expansion. While, as a general matter, the business climate for such investment has improved in recent years, complexities and unevenness remain. Given this diversity both across the continent as well as within certain countries, a focused analysis is critical to identifying business opportunities and addressing potential obstacles.

Companies considering investment in Africa should take into account several key factors.

Africa is not one market.

Africa consists of 54 sovereign states. While many jurisdictions or regions share common characteristics, there are substantial variations between and among the various legal, regulatory, governmental, social, and economic environments of each country. Understanding these differences can help international investors gain insight into a wider range of opportunities, as well as avoid common pitfalls.

Public-private partnership in the broad sense is key.

The private sector on the continent and foreign private investors are increasingly the main drivers of engagement and economic growth in Africa. For a private investor, often a key differentiator between success and failure is the capacity to leverage appropriate support of the public sector while maintaining a commercial orientation in investment decisions.

Sustainable investment strategy requires international and local partnerships.

Slash-and-burn approaches to investment are short-sighted. Cultivating relationships with local counterparts—suppliers, customers, employees, communities, and the public sector—will tend to increase the size of the pie for all and produce more sustainable investment returns over time.

Sophisticated legal advice is necessary.

To optimize success, investors need lawyers who understand both the legal and the strategic dimensions of investing in Africa. Advising on transactions or disputes with respect to African investment requires a deep understanding of the intersection of law and regulations combined with international and domestic expertise and credibility. ♦