Hogan Lovells Africa Forum South Africa Report

The Hogan Lovells Africa Forum South Africa took place in Johannesburg on 7 October 2016 at the Hilton Hotel in Sandton.

Hogan Lovells

Welcome by Andrew Skipper and Lavery Modise

Andrew Skipper, a partner at Hogan Lovells and head of our Africa practice, welcomed the speakers and delegates. He said Hogan Lovells with its 6000 people in 50 global offices, of which the Johannesburg office is the fourth biggest, is committed to Africa. The firm has been working in most countries on the African continent for decades. Although we only have one office in Africa, we work closely with local law firms on the continent, whom we chose for being the best.

He singled out the practice areas in which the firm is leading on the continent as being mining and natural resources, banking and trade finance, anti-bribery and corruption, and dispute resolution.

Andrew emphasised the basic underlying principles of the firm - that we are here to serve and work as partners with our clients and our community. And that this was at no time more important than today, when the link between what is possible and what is right is a blurred line.

He said that there is no new normal anymore, we occupy a disrupted world were preconceptions are challenged daily, time honoured assumptions are simply rejected and the opportunities to disrupt for evil as well as good are equal. That the globalisation model is no longer accepted or trusted by many individuals, who don't trust big government, big business or big data and fear for their jobs, privacy and security.

Opportunities in Africa needed to be seen in the global and local context. And that there are massive opportunities, but there is also real risk. There are new technologies, trading arrangements and funding available, but also required are fair playing fields, local capacity building and transparency. He said that he found the entrepreneurial spirit and optimism in Africa compelling and that we, at Hogan Lovells, are committed to understanding and operating in Africa, investing in it, and that we are here to stay.

Then Lavery Modise, Chairman of Hogan Lovells (South Africa), addressed the delegates:

"After the dawn of democracy in 1994 our country was warmly welcomed by the nations of the world to become part of the global village. Business and investment opportunities opened up and our new government established trading links with USA, UK, China and elsewhere in world. Our Law Society followed suit by relaxing some of its rules and regulations to enable local firms to combine and do business with international law firms. Hogan Lovells (South Africa) benefited from this development.

"South Africa is generally regarded as the gateway into Africa, and it is therefore appropriate for today's event to be held on African soil. I want to remind South Africans that South Africa is actually part of the continent of Africa – we are Africans. I mention this because in everyday conversations some South Africans don't see themselves as part of Africa. To them Africa means the rest of Africa, to the exclusion of South Africa. South Africans have a lot to learn about the challenges and opportunities for doing business in Africa. Our distinguished speakers are going to navigate these issues with us and I hope by the end of today's proceedings we will have learnt some lessons about the challenges and opportunities of doing business in Africa.

"I think it is proper as a partner of the South African office that I should welcome you all to the Hogan Lovells Africa Forum South Africa 2016. A special word of welcome to our colleagues as well as our visitors from across the globe: We are truly and honestly humbled by your presence here and we hope that you'll enjoy your stay here as well as the forum."

Opening keynote address by Mr David Makhura, Premier of Gauteng Province, South Africa

The continent's growth was set to continue to remain strong, making Africa the "continent of the future".

Premier Makhura said that there was no better time to discuss Africa's prospects than now, at a time when major economies of the world were going through turmoil and grave uncertainty. Any business that was sleeping would miss that Africa – the 2nd fastest growing economy after Asia – was the place to be. The continent's growth was set to continue to remain strong, making Africa the "continent of the future". Yet challenges were still ahead. For any economy to grow, leadership was required from government and business. He emphasised that we needed to push ahead to build sound and enduring institutions and infrastructure; drive industrialisation and innovation; promote economic integration and greater levels of intra-Africa trade to ensure that growth was inclusive and shared among all citizens of the continent.

He said that the continent needed to focus on the integration of its economies and markets, bolstering regional trade and investment, expanding access to funding and regional markets, strengthening infrastructure development and encouraging innovation.

He believed that Gauteng, due to its strategic position, had a more constructive and direct role to play in shaping the continent's prospects. It had evolved into South Africa's economic engine, as well as Africa's financial, industrial and professional services hub and technological nerve centre. His ultimate goal was to strengthen reciprocal trade between Gauteng and all major economies on the continent, he said.

Panel 1: New horizons – How African businesses are transforming the continent and transcending borders

The panel was chaired by Carl Stein, a partner at Hogan Lovells. The panellists were Jonathan Kirby, Finance Director of SABMiller Africa; Dr Johan Van Zyl, Co-CEO of Africa Rainbow Capital (Pty) Ltd; Darryll Castle, CEO of PPC; and Damilola Adetunji, Partner at Odujinrin & Adefulu, Nigeria.

The session focused on how African businesses are transforming the continent and transcending borders. Jonathan Kirby provided interesting background into his experience at SABMiller. When Jonathan joined, SABMiller was only present in three African countries and today commands a presence in over 40 African countries. One of the key elements, which he and the other panellists raised, is that of local partnership and the need to partner with local corporates and local employment to grow and expand a successful business in Africa in order to leave an imprint on the continent. One of the key points, also raised by Dr Johan Van Zyl and Darryll Castle, and one which constitutes a challenge to transformation and investment into Africa, is that many European countries as well as America often focus on Africa as a continent rather than focusing on the different African countries, which have vastly different economies with varying levels of development. The panellists remarked that all African countries are, to an extent, painted with the same brush and there is a lack of distinction. Skills shortage was also identified as a major challenge faced by corporates, DFIs, financial institutions and other key investment and development players in the market.

Another major issue that came to the forefront in this and the other sessions is the lack of foreign currency, especially the limited supply of dollars in Nigeria, which poses a direct challenge to funding and investment in the country. The lack of forex in the country is also impacting the business environment for fast-moving consumer goods, with many local businesses having to close down. Damilola Adetunji highlighted that Nigeria has been experiencing great difficulty as a result of the plunge in crude prices, which have fallen more than 50% over the past two years. Crude oil is one of the biggest exports of Nigeria. The continued weakening of the naira has also sent foreign investors fleeing. Damilola mentioned that the government was set on change and is doing more to expand in the agricultural industry to ensure exports of Nigeria are diversified to not only include crude oil. Mozambique, although an energy resource country, was also recognised as a jurisdiction in which it is difficult to do business due to the ongoing conflict resulting from the civil war and the lack of certainty surrounding legislation in the country.

Panel 2: A new age of funding. The rise of alternative investments and co-investing in Africa

The panel was chaired by Lodewyk Meyer, a partner at Hogan Lovells. The panellists were Olivier Buyoya, Regional Trade Lead Sub-Saharan Africa at IFC; Jean Craven, Joint Chief Investment Officer at Barak Fund Management, and Frances Geldenhuys, Executive, Structured Trade & Diversified Lending, Africa at Standard Bank.

The panel discussion focused on the rise of alternative investments in Africa and its gradual move into the mainstream financial industry, garnering greater attention and acceptance from both regulators and investors. Alternative investments include private equity, hedge funds, managed futures, real estate, commodities and derivatives contracts. If there was one key message from this session, it was the importance of partnerships in the wake of regulatory reform. In order for alternative investors to be successful in Africa, they need to collaborate, rather than compete with the traditional commercial banks and development finance institutions (to which we will refer collectively as “banks”).

Regulation

Arguably, one of the biggest changes to occur in the financial system since the global financial crisis is increased regulation. Capital and liquidity requirements as part of the Basel III directive have disincentivised banks from holding too many alternative “riskier” assets on their books and encouraged a deleveraging exercise by the banks, with many “riskier” assets being sold off. Despite this, investors still have the need for these more flexible and short-term investments and funding, which provides an opportunity for alternative financiers to step in.

But why is this? Well, not only are banks required to hold more Core Tier 1 capital against their risk weighted assets (RWAs) than before (from 2% to 7%), but now their RWAs will be calculated differently too, with sharp increases in RWAs from trading activities, that is the “riskier” investments, up 23% or more in some instances. If the earnings from such activities cannot be passed on to underlying clients then banks’ capital strategies will naturally have to become more focused around lower risk assets that are less volatile and provide more stable returns for demanding shareholders.

In any case, we can expect to see the more complex derivatives, trading and similar “riskier” business activities reduce in banks as the new rules come into place and take their toll on the profitability and returns of banks engaging in such transactions. This lack of liquidity in the respective markets caused by the absence of the banks will undoubtedly be filled by the alternative financiers who are more nimble and can fulfil on such demands more easily and under less scrutiny.

Co-investing

An alternative structure could take the form of co-investing, whereby banks form relationships alongside alternative investment companies to gain exposure to “riskier” asset types, but without having to directly hold the asset on their balance sheet. The co-investing model provides an avenue for institutions that would like to be more actively involved in the perceived “riskier” deals, but do not want to fully insource investing in such asset class. The model offers several advantages relative to the

traditional and direct investing models, for example co-investing is an efficient way to reduce the average cost of investing as the bank is not typically charged management or performance fees. Plus, the additional capacity provided by co-investing enables the bank to make larger transactions available to clients without having to invest in the fund directly and place an asset on its book that would be too large to cater for their usual transactions.

In contrast to direct investing, co-investing allows institutions to outsource the more difficult and complex investment tasks, for example sourcing, closing, and executing deals and managing and operating assets during the ownership phase, while capturing some of the upside in the form of lower fees and exposure to performance of "riskier" assets without such stringent capital constraints. Maintaining a passive minority stake also allows banks to avoid many of the internal and external political considerations associated with direct investments. However, the added costs of conducting diligence on an investment and managing the additional counterparty risk could mean that co-investing may only make sense when deploying large sums of capital.

The future

There is clearly pressure on banks to reduce costs and fees while also maintaining a healthy level of shareholder returns. The flexibility of the partnership and notable upside in the form of reduced fees, exposure to "riskier" assets that clients demand to have and the improved returns/profitability from the full risk of such activities effectively sitting off balance sheet all provide ample rationale for banks with an appetite for these types of investments to form more co-investing partnerships with alternative financiers going forward.

Interview: Corporate Social Responsibility

To break with the formalities of panel discussions and to demonstrate our firm's commitment to corporate social responsibility initiatives Sue Stevenson from Barefoot College and Rand Merchant Bank's Yvette Nowell were interviewed by journalist Peter Ndoro. As well as affording both Sue and Yvette an opportunity to talk passionately about the work their organisations do in this space, Peter asked them about the responsibility companies have to society and the importance of CSR in business.

The consensus was that the best way to help people is to educate them, give communities the tools to lift themselves economically, transfer technology to them and let them run their own projects. In doing all this, it's important to partner with organisations, communities and government to give communities what they actually require.

Panel 3: Solving the infrastructure conundrum – lessons from China

The panel was chaired by Warren Beech, a partner at Hogan Lovells. The panellists were Claude Baissac, CEO of Eunomix; Ernie Lai King, tax and Asia practitioner at Hogan Lovells; Dr Quanlei Lui, Senior Executive Vice President at the Bank of China; Erwin Pon, Business Development Director: East and South East Asia at RMB; and Professor Baojin Zhao, a geologist at Unisa and Advisian/WorleyParsons Group.

Warren Beech posed the question to the panel, "Is China good for Africa, what lessons can be learnt from China and can the level of infrastructure development achieved by the Chinese be achieved in Africa during our lifetime?"

Claude Baissac recorded his concern that the previous "boom", which occurred in the infrastructure sector in Africa and lasted for 10 to 12 years, did not create the job opportunities that had been anticipated. He had conducted extensive research on this issue and concluded that from 1970 to 1990 there was no correlation between imports of mineral products by China from Africa, and the manufacturing value added during this time declined over the years. However, the mineral resources rent trend had increased over the same period. His view was that China's involvement in the Africa infrastructure has only benefited the elite of Africa and the perceived economic stimulation, as a result of its involvement, has been artificial. In response to the question whether or not Africa could achieve what China had in our lifetime (20–30 years), he said that the capacity of local governments to fund the level of infrastructure development that is required was doubtful. He believed that change could be achieved in our lifetime, but expressed his reservations in respect of its sustainability.

Professor Baojin Zhao had the view that there is a lack of expertise in respect of ore deposits in Africa and that the Chinese have the necessary expertise to assist Africa with this problem. He pointed out that the typical problems faced by Africa in relation to mining projects are the lack of infrastructure and the accompanying social issues. There was a long working history between China and Africa, and that Africa and China can learn much from each other, both culturally and socially, and that China is accordingly still of great value and "good" for Africa.

Dr Quanlei Liu pointed out that the Chinese influence in Africa is well recognised. From a banking perspective, the tax reforms serve as an incentive to encourage local government to build and invest in infrastructure. He said an important lesson that can be learnt from China is that it had not only engaged in one part of the infrastructure development process, but also participated in the planning, design, building, equipment, manufacturing and training processes. The Chinese government also recognises the importance of introducing private foreign capital to achieve this objective.

Warren then asked whether or not Africa can achieve the same level of infrastructure development as the Chinese were able to do, in our lifetime. According to Prof Zhao during 1949-1976 the infrastructure in China was very bad and many people were suffering in the country. The situation was very similar or worse to the current situation in Zimbabwe. Similar to many African countries roads, railways and electricity supply were very bad. After 1978 the Chinese economy opened up and started booming, bringing much foreign investment to China. China brought

in the necessary technical expertise and support from elsewhere in the world in instances when it was not available locally and that this is a great lesson for Africa to learn from China.

Erwin Pon expressed the view that the onus to develop African infrastructure must also be on the African governments that interact with China and rules of engagement must be set from the outset. If African governments decide that somebody else is needed to invest in their railways etc a certain level of "quid pro quo" is required. He pointed out that the Chinese economy is rapidly slowing down. Mining and iron ore companies in China are shutting down due to overcapacity. As a result, private enterprises in China are not being awarded contracts, as the government is awarding them to state-owned enterprises. Private enterprises are therefore looking elsewhere for other opportunities. But he did not believe that China is in a crisis and that the current situation can be turned around. The Chinese government is much more cautious to invest in Africa, because the success of the funding has not been as great as they had initially hoped and the level of corruption that exists when interacting with African governments is also a hindrance. As a result of this, the Chinese government has had to implement a number of anti-corruption policies.

Ernie Lai King said we have seen what China's capabilities and limitations are and its growth potential. He said that Senegal was an example of the most expensive Special Economic Zone (SEZ) in the world, and that it is questionable who got the bulk of the money from the transactions. He contemplated that this could perhaps be an example of China's involvement in Africa that has not been positive. China does not come to Africa to resolve its political and social problems, which is in accordance with its strict no-interference policy. China's main objective is to do business. It has not adopted the stance that some other countries had that "Africa is to be pitied". Africa and China have many historical similarities, such as poverty and lack of infrastructure. China was also the recipient of global aid but did not depend on it solely. The potential that remains to be unlocked in Africa is huge and that the way to unlock it is to align the objective of the countries as well as the available skill. A "win-win" situation needs to be achieved when China does business with Africa, and that Africa needs to be looked at as a long-term investment where proper skill transfers take place. Africa has the responsibility to negotiate with China, as the Chinese will come here and conduct their business in the environment in which they find themselves.

Warren Beech summarised the panel's joint conclusion as being that Africa has a high-risk, high return investment potential, but that African countries need to negotiate their position better. The same level of infrastructure development can be achieved in our lifetime, provided that individual governments do their part to ensure the sustainability of the investment in Africa by the Chinese.

Panel 4: Leaping ahead? How technology is transforming Africa

The panel was chaired by Andrew Skipper, a partner at Hogan Lovells. The panellists were Gaurav Bhandari, Senior Associate at DV Kapila & Co Advocates; Tielman Botha, Digital Lead at PwC South Africa; Aynon Doyle, Head of Policy Analysis & Research, Regulatory Affairs at MultiChoice South Africa; Grant Marais, CEO at VAST Networks; and Michael Roberts, CEO at Khonology.

Tielman Botha gave a brief insight into his extensive experience in Africa including South Africa. He provided a brief and easily understandable description of blockchain and why it has become important especially in respect of financial transactions.

Grant Marais gave insight in terms of bringing fibre-like dependability and connectivity to mobile users in Africa. He spoke to the widespread adoption of mobile technology in Africa and how the technology is allowing Africa to leapfrog issues that have ordinarily plagued Africa such as legacy infrastructure. Broad based connectivity will lead to Africa's success.

Guarav Bhandari explained the explosion of mobile payment systems in Kenya and highlighted the fact that MPesa operated successfully in part because of the keen interest and participation of the regulator in Kenya. He indicated that Africa needed its own agenda and needed bespoke solutions. Africa could not implement the solutions of other regions and expect the same/similar success in that Africa is, indeed different from international counterparts with a new set of challenges.

Aynon Doyle touched on the regulators' inability at the moment to rise to the level required to address technological developments in Africa. He questioned whether the strategy and approach of the South African government was correct and contrasted it against the rest of the world's approach, which has basically allowed communications technology to evolve and take a reactive approach in terms of guiding their development.

Michael Roberts had a positive view about the future of Africa and indicated that innovators were going to create interesting technology for application in Africa that would allow it to leapfrog ahead despite traditional limitations such as a lack of infrastructure. He indicated that innovators were encountering difficulties in that regulators were not sufficiently mature to understand the path technology was taking and he believed innovators would have to engage with regulators and assist them to understand the technology and conscientise them to appropriate regulatory standards in order for new technology to be successful.

The panellists fielded interesting questions from the audience including the protection of Africa workforces in light of technological advances. They were of the opinion that stakeholders should embrace technological advances in that employment opportunities would remain available, however it would be new types of opportunities/ employment to suit the new technological landscapes and challenges.

Closing keynote address by Judge Jody Kollapen, Judge of the North Gauteng High Court of South Africa

Judge Kollapen said that times may be turbulent but it was a wonderful time for South Africa because democracy was taking place - everything was happening within the framework of the constitution.

Maybe businesses prefer less turbulence and a more stable environment. Such as a clear policy framework, strong institutions that can enforce the law impartially, where the law is clear, predictable and enacted as a result of a participatory process. Over the past 22 years South Africa has managed to establish that. Prior to 1994 the law was largely seen as a tool of social destruction. Post-1994 the law became a tool of social transformation, where all can live and fulfil their potential in a society where democracy, human rights and social justice are advanced.

The rule of law has been an important feature, where accountability to the supreme law – the constitution – has been entrenched. Where the rule of law is strong, people in business can feel confident about investing. South Africa has the best legal training in the world, the legal profession enjoys a reputation of excellence and the courts have distinguished themselves to act without fear, favour or prejudice.

He said, "I can assure you, the rule of law is in a good place in South Africa. Institutionally we're doing well in terms of using the law to transform our society and creating an enabling environment for business."

The forum was closed by Susan Bright, Regional Managing Partner for UK and Africa at Hogan Lovells

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