Drivers of Growth and Investment in Sub-Saharan Africa

An Oxford Analytica report produced for Hogan Lovells

Introduction

What is the nature, scale and direction of sub-Saharan Africa's current growth phenomenon? What political, economic, social and business factors are driving or constraining investment? In addressing these broader questions, this report focuses on trends in three key sectors (mining, power supply, and private equity), with some examples drawn from other sectors. It considers the principal African business destinations along with some smaller markets of special interest. The report's particular focus is on how issues of regulation and governance are key factors shaping investor experiences and business success across the region.

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Executive Summary

High average GDP growth rates across sub-Saharan Africa (SSA) will continue to attract investor interest, especially amid sluggish global growth. Yet averaged outlooks belie the considerable divergence evident between and within SSA's diverse countries and sub-regions, in terms of economic and developmental potential.

External drivers and capital remain significant in determining African growth. Among other things, this resource-rich region's residual structural reliance on raw commodities exports (and cyclical related dynamics) and on unpredictable portfolio capital flows means that its overall outlook is more contingent on shifting global economic conditions than most other developing regions.

This external exposure creates some significant vulnerabilities at the macro level. These persist alongside some enduring local-level constraints to more sustained, diversified and job-rich growth. In addition to perceived or objective political risk factors and regulatory problems, many settings suffer serious shortfalls of reliable electricity, and skills deficits. Most governments have failed to foster significant shifts in agricultural productivity (with all its potential flow-on effects).

Nevertheless, internal and intra-regional dynamics are also important positive drivers of growth. Viewed differently, power and transport infrastructure deficits can comprise "opportunities in disguise", with significant mega-project infrastructure investment already underway. The upside of complex and challenging environments can be considerable innovation, as well as high rewards and yields.

Moreover, young, fast-growing and under-served urbanizing populations in major markets are generating sustained home-grown demand for consumer products and services. SSA's manufacturing sector (largely undeveloped outside of South Africa) may also stand to gain as labor costs rise in Asia. A sometimes complex environment is raising the significance of firms capable of providing logistical, business, and professional services.

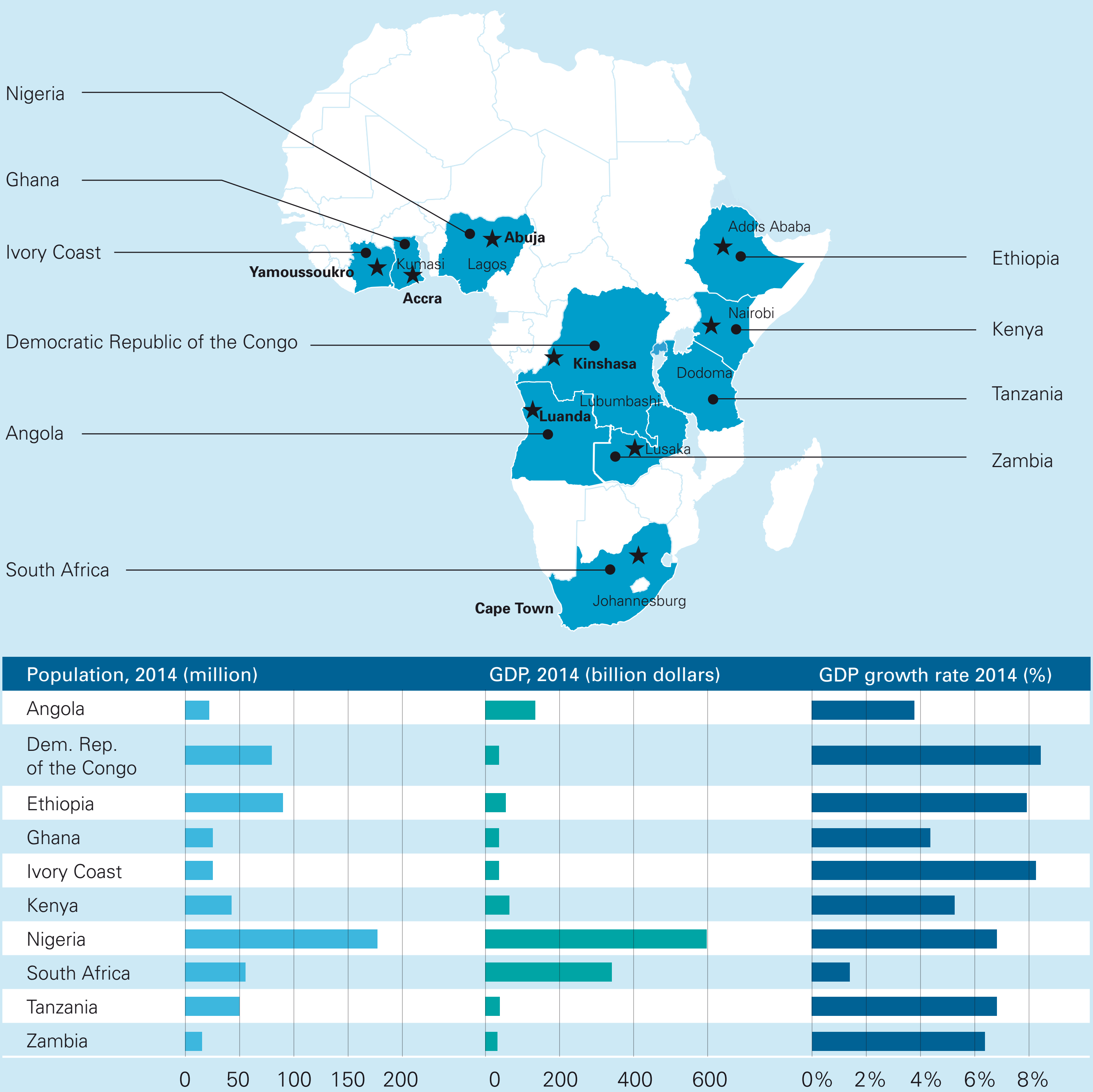
Recent experiences in parts of SSA show that regulatory reform can act as a catalyst for growth and investment. Particular scope exists for relatively small progress on investment climate reform to yield significant gains in investment attractiveness. Policy support for innovative public-private partnerships also holds promise. Further scope exists for greater sub-regional integration and regulatory harmonization to create consumer markets and infrastructure corridors of sufficient scale to attract sustained foreign and regional investment.

The region's diverging growth and governance experiences will continue to limit the utility of generalized descriptions of (or prescriptions for) the "Africa Rising" story. Still, the sustained interest in that story reflects the many investment opportunities that are available, or which will emerge. It also reflects recognition of the potential transformative gains that are possible, especially where policymakers are able to create the conditions for sustainable development of Africa's abundant natural and human capital.

Drivers of Growth and Investment in Sub-Saharan Africa

Three broad sets of conditions – around political economy, societal change, and commercial considerations – are tending to drive and shape investment trends in SSA. These conditioning factors are interlinked, and do vary considerably within the region's many different markets, as reflected in the source and scale of growth and investment in recent years.[1]

Graphic 1. Key investment destinations : population, GDP, growth rate



[1] All SSA trend analysis must depend on datasets that are sometimes unreliable and often incomplete.

[2] 10 key investment destinations, based on inward FDI flows in 2013

Political and Economic Environment

Two broad contrasting features mark the contemporary African growth phenomenon: an enduring external economic orientation and exposure (based on historical over-reliance on primary commodities exports and on foreign capital), alongside an emerging set of more internal or domestic growth dynamics not necessarily directly related to external factors. The pace and degree of this external-internal structural shift is one of many debates about "Africa Rising", a phenomenon that cannot be understood in isolation from political forces and their effect on policymaking and governance.

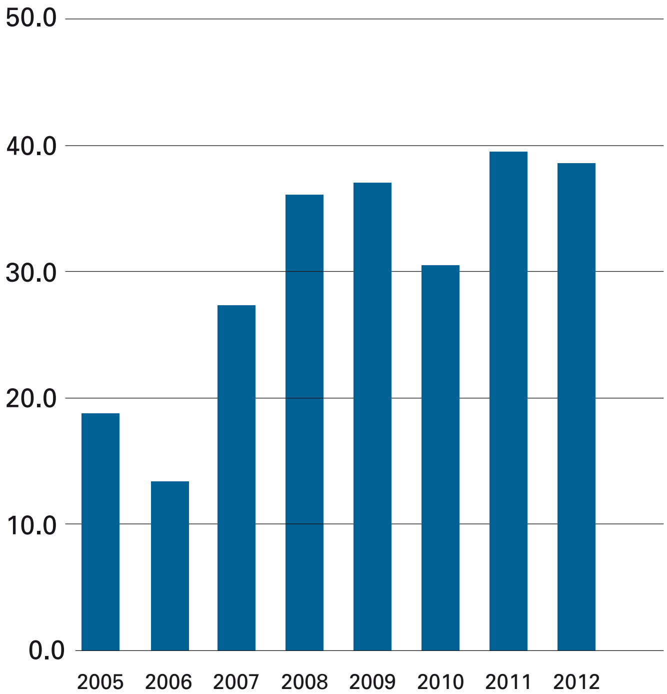
Economic: global integration and exposure

The SSA region has achieved sustained strong economic performance for over a decade but the essence of the Africa investment proposition remains its abundant future potential. This potential derives from that recent growth record and from clear, enduring and attractive fundamentals, especially around commodities supply and emerging consumer demand.

It is sometimes overlooked that in the two decades before 2000, SSA's share of imports and exports in the world economy steadily declined, from around 5% to around 2%. Very low domestic savings and shallow markets, as well as an over-reliance on capital-intensive primary sectors such as mining, perpetuated a deep structural dependence on foreign direct investment (FDI), typically from a handful of Western countries and companies. This is certainly not the case today, following greater integration and partial transformation of SSA into a global economy that, with the rise of the BRICS and others, is itself far more diverse:

- On the back of the post-2002 oil-price rises and commodities boom, SSA average GDP growth accelerated, holding at between 4% and 6% for over a decade now. Today nine of the 20 fastest-growing economies globally are in SSA. Perceptions and momentum matter, too, and successive surveys of investors, corporate executives, and consumers speak to strong levels of confidence, optimism, and intent in relation at least to SSA's main economies.
- Between 2006 and 2013 inward FDI in SSA grew at an annualized rate of 15%, although the upward momentum has slowed somewhat in more recent years (Graphic 2). Inward FDI at 44 billion dollars in 2013 is about six times the FDI flow at the start of the 2000s. Some estimates suggest that this flow is equivalent to levels of FDI flowing into China over the same post-2000 period, when measured by relative GDP.
- While part of Africa's deepening capital pool is contingent on the vagaries of portfolio inflows and outflows, the FDI figures speak to a more profound phenomenon. Sustained external interest in the region is not simply a function of following a simplistic growth or yield narrative at a time of softness in developing world economies. Investors are drawn not just to the region's significant energy and mineral reserves or agribusiness potential, but to fundamental deficits in its main economies: in a context of growing infrastructure investment, there is considerable value to be found simply in meeting pent-up demand from SSA's under-serviced, fast-growing, increasingly urban consumer base.

Graphic 2. Total net inward FDI in SSA, 2005-2013 (billion dollars)



Source: Oxford Analytica and UNCTAD

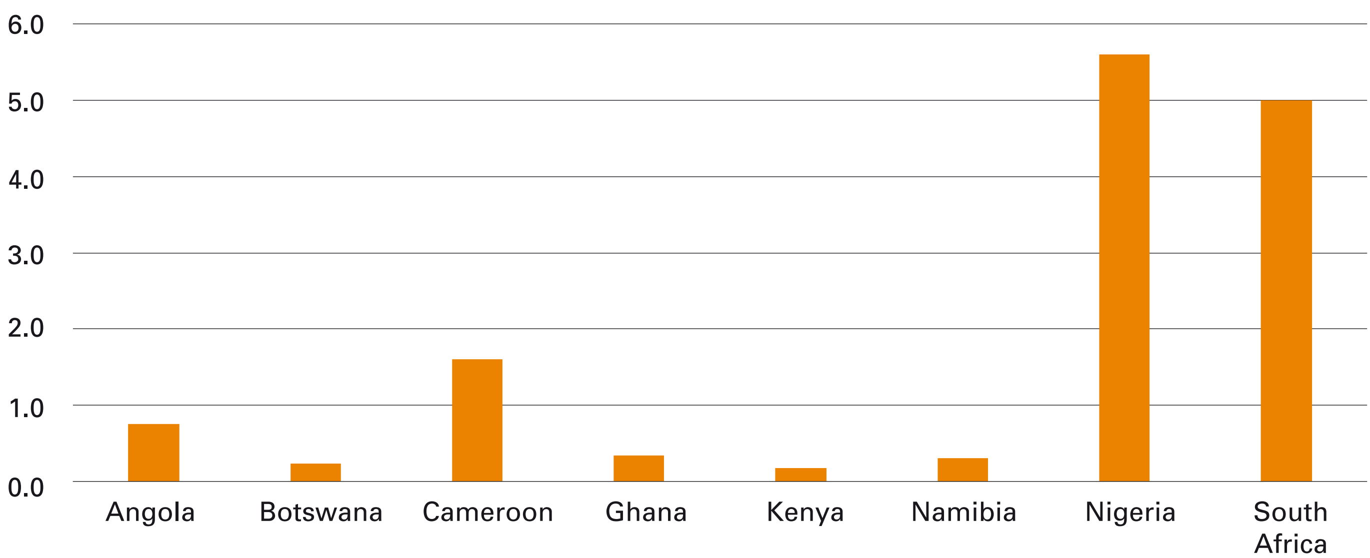
The region is far more economically and financially integrated today than a decade ago, a relative fact that continues to sustain its broadly positive economic trajectory. Commodity prices are unlikely to reach pre-2014 highs, putting sustained pressure on SSA's growth path whatever the dynamism of internal secular demand. Yet the overall outlook suggests continued foreign interest and involvement, domestic public and private sector infrastructure investment, sustained consumer demand, and relief from high oil prices for many economies.

On the other hand, greater global financial and import-export integration, and link to the China growth path, also create vulnerabilities for SSA economies, relatively few of which drive the core data that underpins the overall "Africa Rising" story:

- FDI flows, at 6% of global totals, are still half those of Latin America (11%) and a fraction of developing Asia's share (27%). FDI into SSA is still concentrated in a few mainly resource-rich economies; the top 10 SSA countries account for over 83% of FDI, with the remaining 37 countries receiving less than 17%. The four most sizeable economies (Nigeria, South Africa, Angola and Kenya) account for 70% of SSA's GDP, with M&A activity largely concentrated in largest economies (Graphic 3).
- The composition of China's growth will become less commodities-intensive, as the emphasis turns towards domestic consumption and services, over fixed infrastructure investment. This will probably see a net decrease in demand for SSA's resources, particularly from countries like Congo-DRC and Zambia. This is significant since SSA has not experienced an agricultural revolution and manufacturing (despite some promising signs in some places) has generally experienced decades of decline and comprises only about 12% of GDP, below half its share in developing Asia.

The diversity of SSA economies is illustrated by the differential impact of the recent global oil-price drop. This has left leading oil-producing states such as Angola and Nigeria highly exposed in their fiscal and foreign exchange outlooks, but cheaper fuel imports have given something of an inflation-easing growth boost to Kenya, South Africa and others. The effect is complex since Nigeria imports most of its fuel products, and relies decreasingly on its oil sector to drive the economy – pointing to the significance of local demand and non-oil growth dynamics in the overall contemporary Africa economic story.

Graphic 3. Top 10* countries by total M&A activity, all sectors, 2014 (billion dollars)



UNCTAD 2014; UNECA 2014; WEF 2014.

**Based on completed deals. DRC (85.2 million dollars) and Mauritius (54.8 million dollars) are excluded due to size. Source: Oxford Analytica and Bloomberg*

Economic: local momentum and outlook

SSA's growth story is not confined to the extractive industries and related external demand. One clear trend underpinning investor interest is a rapidly expanding, internally driven service economy, with local demand, companies, and the need for capital driving and shaping SSA's growth path:

- Consumer-facing and services sectors, especially banking and telecommunications, are growing fast; the construction sector is booming and infrastructure investment growth is higher than the global growth average (although well below what is needed to bridge the financing gap). While not all SSA economies are undergoing rapid growth, in most of them there is significant achievable economic growth space resulting from decades of under-investment, low productivity, or protectionism, and poor service delivery.
- Today 30 of the largest 50 companies operating in SSA are non-extractive firms. While foreign capital still tends to fund mining and energy investment, domestic and regional capital is increasingly behind growth in other sectors. Larger economies such as Kenya and Ghana are marked by high credit extension growth (24% and 31%, year-on-year, respectively).
- On most analysis, the extractive sector (especially oil) accounted for about 30% of the 2000s (and since) GDP growth across SSA, the rest a consequence of internal demand and domestic reform in non-oil and non-mining sectors. On recent data, services and manufacturing make up 54% and 34% of M&A activity across SSA, with the primary sector accounting for only 13%. Non-resource sector growth rates now regularly exceed overall GDP growth rates in a number of SSA economies. Among the three largest economies in SSA by GDP, levels of economic diversification vary. Angola, for example, is heavily reliant on its oil industry both in terms of contribution to GDP and exports, while Nigeria's domestic economy is relatively diversified despite its reliance on oil exports for government revenues and foreign exchange. Meanwhile, South Africa's mature mining sector has not impeded the emergence of a service-led economy (Graphic 4).

Graphic 4. Economic snapshot of Angola, Nigeria and South Africa, 2013

	Angola	Nigeria	South Africa
GDP (billions dollars)	124.2	522.6	350.6
Agriculture (% of GDP)	10.2%	30.9%	2.6%
Industry*	61.4%	43.0%	29.0%
Services	28.4%	26.0%	68.4%
Total exports (billions dollars)	69.7	104.9	109.7
Fuel and mining products (% total exports)	96.4%	94.7%	33.3%
Commercial services	1.3%	1.8%	12.6%

[4] World Bank

- For example, Ghana became an oil exporter in 2010, but by 2012 its services sector was growing at double the rate (10%) of its minerals sector, with some sub-sectors (telecoms and financial services) experiencing growth rates above 20%. In Nigeria, non-oil GDP growth by 2013 was nearly 8% (with some sectors such as construction and transport growing at over 15%), driving overall GDP growth of above 6% despite contraction in the oil and gas sector's output. Tanzania, a mining jurisdiction, has found that recent growth in sectors such as retail (16%) and transport (16%) is double the overall rate of GDP growth.
- Likewise, banking sector growth exceeds GDP growth in the main SSA markets (outside South Africa), on the back of a growing domestic capital base of the new "middle" or "consumer" classes and those previously unbanked. Along (and sometimes coupled with) the telecoms sector in particular, the financial and insurance services sectors have shown considerable innovation in products and services, with flow-on effects for other parts of the economy – and with some potential for these insights to be applied in more developed markets.
- Along with local stimulants for growth are regional ones. While performance varies considerably across sub-regions, there is broadly a political effort underway to boost regional economic and trade integration. This holds considerable promise for creating more attractive markets of scale and cost efficiencies. At present, less than 15% (by value) of SSA exports go to other African countries, compared to 30% in Latin America, 50% in Asia, and 70% in the EU. Regional reforms will take time, but the potential opening up of sub-regional markets in SSA holds considerable promise for longer-term investors.
- Investors will still face volatility, disruption, and delays. The sharp decline in Nigerian equities in 2014 is one testament to this, while the resilience of equities in Kenya and South Africa over that time speaks, again, to the lack of uniformity in SSA markets.

One manifestation of investor interest in SSA's growth has been the demand for sovereign bonds issued by a growing number of African economies. In just the last two years, a handful of SSA countries have issued 22 billion dollars in "eurobond" debt, double the whole previous decade's total and equivalent to over 12% of FDI in the same period (Graphic 5).
The resulting funds, it is hoped, will help sustain locally-driven growth and deepen its structural underpinnings in particular by enabling governments to address growth-constraining bottlenecks around infrastructure. Most SSA governments have been running expansive fiscal policies for this reason – largely with the encouragement of the IMF and other institutions.

Graphic 5. Composition of order book for government bonds

	No. of investors	U.S.	UK	EUROPE	ASIA	OTHER
Ghana (August 2013)	158	60%	21%	15%	2%	2%
Namibia (October 2011)	160	25%	40%	30%	5%	
Senegal (May 2011)	125	30%	37%	29%	4%	

[5] Countries such as Kenya, Tanzania, and Mozambique which receive shorter-term benefits from lower oil prices might also lose out on a longer-term view if lower energy prices result in investors suspending or canceling the development of major new oil and gas resources.

Yet the new debt profile creates new contingent liabilities worth noting, also increasingly highlighted by the IMF. These debts are from on commercial markets and so are not fully analogous to the debt burden for which many SSA countries obtained relief a decade ago, freeing up their growth outlook at that time:

- Emerging SSA economies are borrowing in dollars, but could face soaring repayment costs. Scenarios include a rising dollar as U.S. interest rates rise, and asset re-pricing in developed markets partly reflecting U.S. monetary policy shifts. It is hard to escape the sense that some of the interest in SSA debt markets is only relative to low yields obtainable in developed markets. That situation may well change over the medium term, and SSA's evolving, opening economies have quite rapidly become far more reliant on short-term bond and equity inflows than they were when this decade started.
- Local currencies in some places face significant pressures or at least volatility, especially if the commodities softness continues. Ghana, a "darling" of investor and bond-buyer sentiment and which became an oil producer in 2010, has had to seek IMF assistance in recent months. It is fighting 14% inflation, a growing deficit, and a bloated new public sector, a large dollarized import bill for its expansion activities, and a one-third depreciation in its currency.
- While each SSA government has different features, serious questions remain about the capacity of these relatively small emerging economies to absorb new funds and to utilize them efficiently and effectively in ways that will result in growth-supporting changes. Their ability to discharge these debts will partly turn on SSA bureaucracies that have a patchy record of planning and delivery, and little experience in supporting significant public-private partnerships. Scope exists in many SSA economies for raising domestic tax revenues (and/or expanding the tax base), but accompanied with the significant challenge of penetrating largely informal economies, and at the risk of dampening the consumer spending that is fueling much of the growth.

Although some debt factors are hard to know (such as the burden of concessional loans received from China), most SSA countries' debt-to-GDP ratio is currently considered manageable (at about 33% of GDP overall), at least relative to the rich world. However, most governments have been operating fiscal expansion polices and without the policy buffers that helped them ride out the 2008-09 shock and downturn. For instance, oil giant Nigeria has squandered the high – oil-price era, committing negligible funds to contingency funds or its new sovereign wealth fund. Meanwhile, although portfolio capital outflows can be tracked it is difficult to quantify just how much of SSA's wealth is lost through tax avoidance schemes and illicit outflows, especially from oil-rich states.

Political: governance, democracy, stability
Since the 2000s, there has been a broad trend of both consolidation of democratic institutions and expectations, and progress on improving the technical governance capacity of the bureaucracies of major SSA economies. This has happened in parallel to greater foreign and local investment and continues to attract and reassure it.

Around the time that the oil and other commodities booms started to energize African GDP growth in 2002, something else was underway in political systems across SSA:

- Coming after South Africa's 1994 transition and Nigeria's 1999 emergence from military to democratic rule, the early 2000s saw peace deals reached in chronically war-torn settings from Angola to the Congo and in long-troubled West African settings such as Sierra Leone and Liberia; political stability also came at this time to places that had experienced considerable turmoil, such as Ethiopia, Rwanda, and Uganda. While several parts of SSA remain conflict-affected and insecure (or face emerging risks), on balance the continent is far more stable today than 20 years ago.
- Likewise, in terms of more representative and responsive governments, while there have been some notable outliers, occasional disruptions or reversals and some recent stagnation, broadly speaking the region has experienced a democratization trend. Nigeria has just experienced its first peaceful post-election transfer of power to an opposition party; in fast-growing economies such as Ghana, Zambia, Senegal, and Sierra Leone, incumbents have (in some cases successively) accepted electoral defeats and power has changed hands without violence; with some notable exceptions, media freedom has expanded and political debate is vibrant in most settings; in general, Africans' expectations about compliance with

democratic norms continue to grow. Despite many problems, this has fostered on aggregate greater peaceful political pluralism than at any time in the post-colonial period.

- This political context is significant for related trends in the overall governance of SSA polities and economies. By analogy to the economic growth story, the combination of external support and internal demand has seen a pattern of institutional strengthening in key public-sector areas. Among these are central banks, which in recent years have shown and enjoyed greater policy independence or at least technical capacity and competence. In places such as Nigeria, confidence in central banks has been a key plank of the investment and growth story. Institutional consolidation and the rise of a class of technocratic governors and administrators is not confined to economic regulators but can be seen in other sectors, from elections administration to civil aviation.
- It is true that along with residual deep problems of public-sector incapacity, inefficiency and corruption, significant political or stability risks and challenges remain in much of SSA. This is so even if investors are far better now at discerning particular risks rather than seeing SSA as uniformly vulnerable to insecurity or misrule. The long-term investment outlook in SSA must inevitably factor in the potential for downside political and social scenarios, for instance, wherever one can foresee a difficult combination of low political legitimacy or responsiveness, inequality and/or resource scarcity, and high youth unemployment.

Within policy circles in major SSA capitals, there is a shared focus on a daunting range of economic and developmental challenges that high GDP growth alone will not resolve, and in many cases only exacerbates. These debates are current within investor circles too, as firms find that their lists of longer-term threats and opportunities to market growth and business continuity contain very similar sustainable development problem-sets to those facing public authorities (Graphic 6).

The issues preoccupying SSA policymakers include how to achieve more inclusive, job-rich growth; narrowing physical infrastructure deficits, especially in electricity provision; expanding the quality and quantity of healthcare and education systems; diversifying sources of economic growth and revenue away from extractive industries, and deriving more local value-add from those industries; formalizing a greater proportion of business activity; addressing stubborn poverty and rising income inequality; managing the nexus of climate change, scarcity of natural resources, urbanization, and population growth; building human capital resources; and building public-sector governance capacity, including around taxation.

Graphic 6. Corruption, and human development and income inequality, for selected countries (relative rankings), 2013

Corruption*		HDI		Income Inequality	
1	Ghana	1	South Africa	1	Ghana
2	South Africa	2	Ghana	2	Zambia
3	Zambia	3	Zambia	3	Kenya
4	Ethiopia	4	Kenya	4	Tanzania
5	Ivory Coast	5	Angola	5	Ethiopia
6	Tanzania	6	Nigeria	6	Nigeria
7	Nigeria	7	Tanzania	7	Angola
8	Kenya	8	Ivory Coast	8	Ivory Coast
9	DRC	9	Ethiopia	9	DRC
10	Angola	10	DRC	N/A	South Africa

*Corruption data is for 2014; **1 = best; 10 = worst*

Sources: Transparency International, UNDP, World Bank

Social Environment

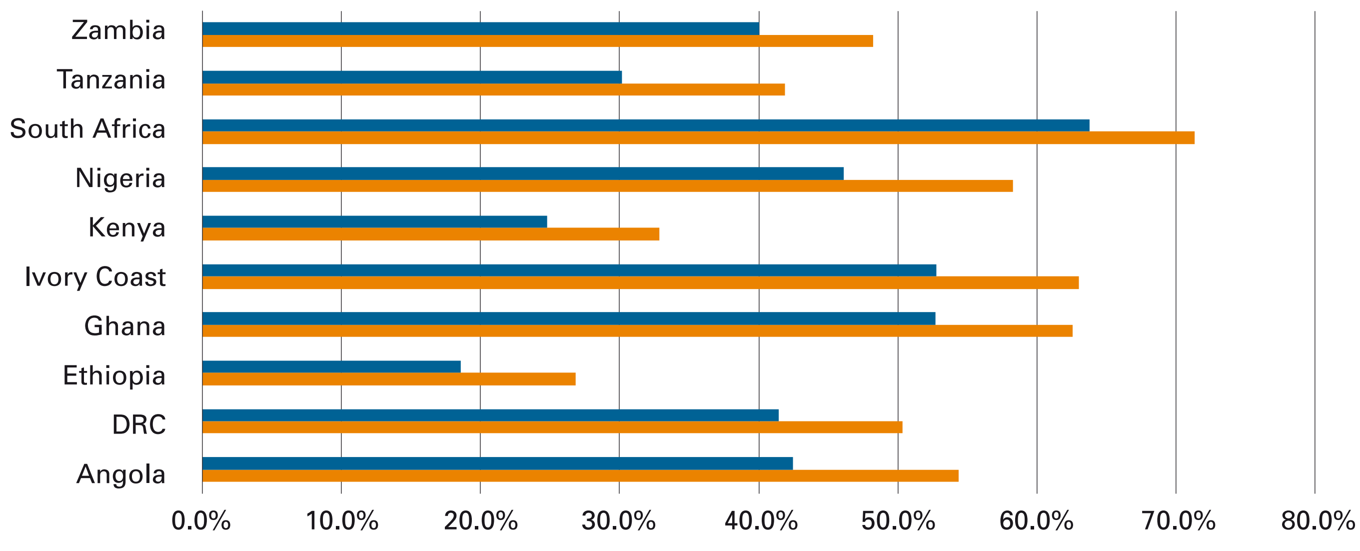
For better or worse over the medium and longer terms, both political and economic trends in SSA are strongly shaped by the region's most notable social phenomenon: its large, young, and fast-growing population and the rapid expansion of its major cities.

Demographics and urban growth

There already exist considerable investment opportunities simply to meet pent-up existing demand for goods and services in major SSA cities. Seen against the backdrop of the profound unfolding socio-economic phenomenon of rapid urban population growth, there is little wonder that demographic factors underpin much of the investment interest in the longer-term African growth story:

- Population data in the region is patchy, but the current total of around 1 billion people is growing at around 2.5% annually. Fertility rates are more than double the global average.
- Some of SSA's most important or of-interest economies – including Nigeria, Kenya, Ethiopia, Tanzania, and Congo-DRC – feature in the top 10 fastest-growing countries by population. On current trends, over the next 15 years to 2030 there are some predictions that the population of SSA will nearly double.
- Much, if not most, of this population growth will be concentrated in urban centres. In 2010 the UN estimated that by 2020 major centers such as Lagos, Kinshasa, Dar es Salaam, and Nairobi will have doubled in population size from their 2005 levels; the combined economic output of many of SSA's major cities will probably double by 2025. By 2030, the urban population is forecast to account for over 50% of the population in Angola, Congo-DRC, Ghana, Ivory Coast, Kenya, Nigeria, and South Africa. The expansion of the urban environment is set to transform infrastructure needs and consumption patterns (Graphic 7).

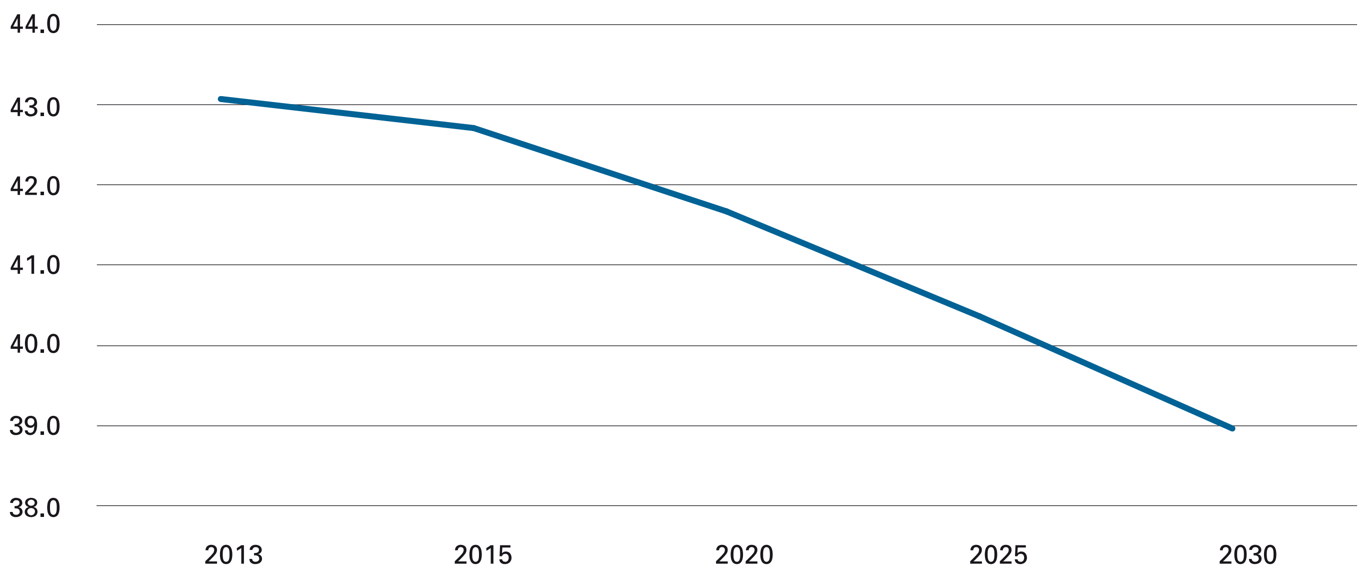
Graphic 7. Urban population in selected countries, percentage of population, 2013-2030



Source: World Bank

- Moreover, the demographic profile of SSA countries reveals a massive youth bulge: in many major countries, over 40% of the population is under the age of 15. As labor costs rise elsewhere in the developing world (from China to Mexico), this has given rise to speculation that SSA could attract manufacturing investment aimed at supplying both local and global markets.
- More generally, speculation exists over whether (and which) SSA countries might enjoy a potential "demographic dividend" with transformative economic consequences. With SSA fertility rates in (slow) decline, there is some scope for anticipating a shift whereby the worker-dependent ratio eases, boosting per-capita income and freeing up savings or disposable income in a way that can drive significant market development. Over the next 15 years, youth as a percentage of the overall population is expected to trend downward at a rate of 0.6% per annum (Graphic 8).
- The need to educate, treat, electrify, feed, service, supply, tax, connect, and transport SSA's urban populations creates significant commercial opportunities. These gaps will often arise because of poor-capacity local governments.

Graphic 8. Youth 0-14 years as percentage of population in SSA, 2013-2030



Source: World Bank

Yet alongside upside scenarios of dynamic new consumer classes and competitive labor pools are more alarming ones in which mass urban under-development constrains or, at worst, unravels economic growth, social cohesion, and political stability. SSA hosts only 13% of developing-country urban-dwellers, but 25% of slum-dwellers; about 60% of urbanized SSA people live in "slum" conditions (compared to the 33% developing-world average). Investors with long-term plans need to assess which countries have the ability, especially in terms of institutional capacity and urban planning, to harness rapid urban population growth in ways that make an overall "demographic dividend" possible or likely.

Consumption, spending, and demand

Whatever the fate of Africa's mega-cities, and however one chooses to define the "middle class", there is little doubt that SSA offers global firms in the consumer goods, financial services, health, education, real estate, and other sectors a customer base that is growing fast in terms of size, spending power, and aspiration:

- From 2005-2015, consumer spending has grown at nearly three times the rate of average SSA GDP growth, with significant numbers (if not a significant proportion) of citizens moving into "disposal income" brackets.
- On one estimate, Nigeria's "consumer class" doubled its spending power during the 2000s. More broadly, consumer spending has been boosted across many SSA countries in recent years by greater public-sector hiring and wage growth, dynamism in the informal sector, some small-business growth and private-sector hiring, some welfare and cash-transfer schemes, and remittances from abroad (which are reaching about 30 billion dollars annually).
- Many consumer-goods, construction, services, and other firms will organize their SSA strategies around groups of cities, not whole countries. By virtue of their very under-development, SSA cities will continue to fuel innovations and "leapfrogs" of potential global application. The SSA experiences (and earnings growth) of firms such as SAB Miller and Diageo (beverages), MTN (telecoms), Nestle (foodstuffs), and Unilever (household goods) tell an unequivocal story of success in both penetrating and helping to develop African consumer markets.
- It is nevertheless possible to exaggerate the consumer story in SSA, despite its future potential: most existing consumers have low spending power (even this creates a market for low-value, high-volume goods); less than half of SSA's economies combine GDP of over 10 billion dollars with a consumer base of over 10 million people; urban poverty and inequality levels remain high and most people earn precarious incomes in the informal economy.

Despite the opportunities, business conditions are not easy: retail infrastructure is undeveloped, consumer data is very scarce, and the informal sector easily dominates trade volumes. There is a premium on firms being able to find and create value by adapting to conditions in Africa's cities, and respond to local consumer preferences. The longer-term opportunities will tend to turn on the degree of policy responsiveness and government capacity to unlock bottlenecks to urban growth and support skilled, healthy, secure, and mobile populations. This will vary greatly across and within different countries in SSA.

Business Environment

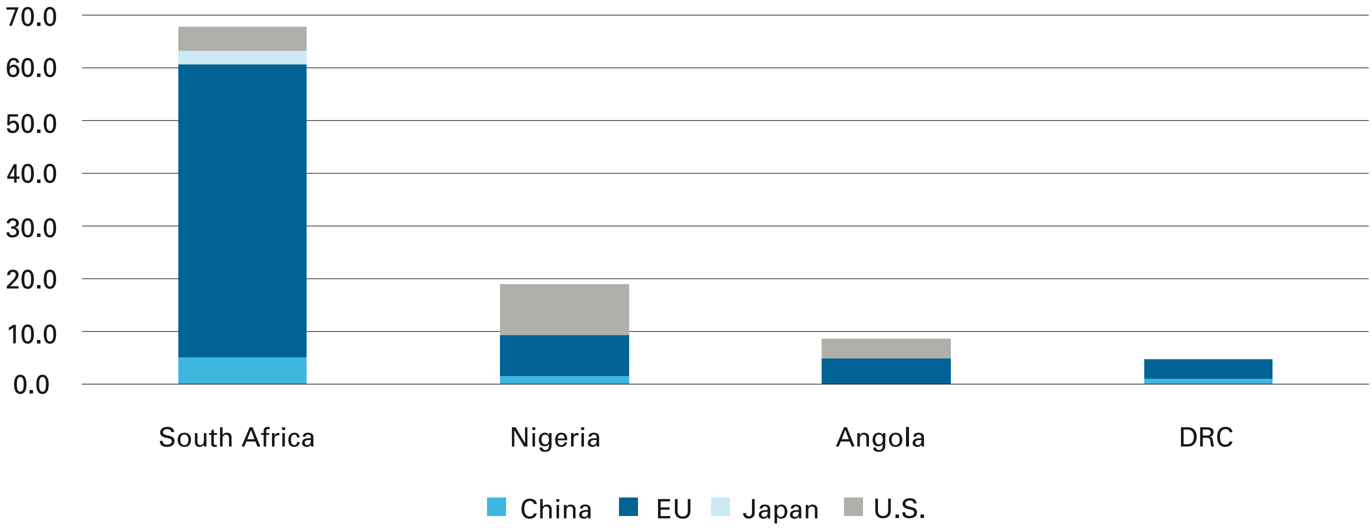
The combination of external interest and local potential points to a third broad factor shaping the SSA growth story: the policy and regulatory environment for doing business. A snapshot of current trends in the region would reveal two things. First is the considerable distance still to be traveled in improving legal and regulatory frameworks, amid serious productivity and competitiveness problems, governance concerns, and in the context of political and capacity constraints on reform.

The second, contrasting trend is the reformist energy being directed (at least in some countries) at creating a more attractive and manageable operating environment, including through efforts towards regional integration to create consumer markets of scale. Last year's World Bank "Doing Business" report suggested that in the last decade business environment reforms took place at a rate three times faster than in OECD countries; it showed that SSA countries (all from East and West Africa) made up half of the top 20 most-improved countries in the world for the previous five years in terms of pro-business regulatory reform.

Diversification of sectors and actors
The map of doing business in SSA has been changing fairly rapidly, as some of the following trends show:

- Where once many SSA governments displayed ambivalence towards the private sector, in most settings a new era of pragmatism prevails. There is stronger interest in dialogue with business and investors, responsiveness to their concerns, and growing interest in public-private partnerships to meet social needs while furthering commercial opportunities.
- Partly to foster growth and partly for revenue-raising reasons, governments are putting considerable effort into formalizing parts of the economy dominated by informal-sector traders and providers, from retail to transport. In many settings, formal-sector firms are learning to leverage the informal-sector by making their products and services available through street-level and hand-held (mobile technology) platforms.
- There is greater diversity of players in African business, even if regional business is dominated by Nigerian, South African, and increasingly Kenyan firms and businesspeople. In poorer countries, donors and international organizations have "discovered" the SME sector and are working to improve financing and advice to local firms, boosting potential options, targets, and partners for foreign investors in the process.
- While rhetoric is not always matched with action, historically oil-dependent economies such as Nigeria are devoting greater attention to diversifying sources of growth in neglected sectors, in particular agriculture and agri-processing. The latent productivity gains to be had in these sectors are themselves a significant investment opportunity.

Graphic 9. Top 4 recipients of FDI, 2001-2012



Source: UNCTAD

In parallel to diversity of growth sources is the greater diversity of investment and export partners now available to SSA. BRIC countries received only 9% of SSA's exports in 2000 (and less than 5% in the 1990s), but now account for around 40% of these, a share which is rising. The impact and interest of China's state-owned and private firms is well known, but Brazilian and Indian firms and investors are also highly active on the continent. From an investment perspective, over the last 10 years China has emerged as a crucial regional investment partner in addition to traditional partners from the EU, Japan, and United States (Graphic 9).

- The new map of business players goes well beyond the BRIC countries. Turkey and the Gulf countries are increasingly important players, especially in East Africa, and in niche sectors within sectors such as construction and agribusiness. The new SSA business map sees, for instance, Filipino energy firms bidding for Nigerian utilities, Malaysian firms developing palm-oil plantations in West Africa, and small Australian and Canadian mining services firms exploring around the continent. In addition to direct investment, money from the Gulf and other less traditional SSA sources is an important element of new portfolio and private capital flows.

From Africa's perspective (and whatever the net impact on Africa's economies of the rise and entry of China), this diversity of business and investment partners is overwhelmingly a positive development. Meanwhile, it is easy to overlook the enduring significance of trade and investment relations, for many SSA economies, with the EU, United States, Japan, and South Korea. Indeed, by number of new projects (if not value of deals) the UK and United States remain the leading source of direct investment in SSA, followed in third place by South Africa.

Regulation and governance

One appealing characteristic of SSA economies, from a long-term investor perspective, is that fairly dramatic improvements in the business and investment climate are possible with relatively few reforms. This is not to gloss over the very significant hurdles that exist, across much of SSA, to more clear, transparent, and efficient business and investment administration. It is merely to observe that many SSA countries' objective (and perceived) investment attractiveness could improve fairly rapidly where political, policy, and commercial alignment exists for necessary reforms to the entry, operating, and profit repatriation environments. The overall trend is one of reforms to the "ease-of-doing-business" climate, as the World Bank's most recent "Doing Business" report makes clear:

- Some 35 of 47 SSA economies implemented at least one relevant ease-of-doing-business reform in 2013-14, a total of 75 reform "actions."
- Rwanda is the world leader in overall business climate reforms in the last decade (on page 20), and in 2013-14 implemented the largest number of reforms in the region, followed by Mauritius and Sierra Leone.
- SSA also accounted for five out of the top 10 improvers worldwide in 2014 (that is, economies making the biggest improvement in business regulation).
- A number of SSA economies rank in the top half of global ease-of-doing business, with finance and tax gateway Mauritius highest at 28th globally, followed by South Africa (43rd) and Rwanda (46th).
- This reform trend is eroding SSA's dire pre-2000s dispensation whereby in 1997, for instance, the net "costs of regulation" in some indicative SSA markets were estimated at between 86% and 99% (Tanzania and Nigeria respectively, as a percent of GDP per capita) compared to 10% to 17% (Malaysia and Thailand).

Despite this positive trend, larger SSA economies are still relatively difficult places to do business. While Ghana ranks in the middle globally (70th), Kenya is well below average at 136th, while Nigeria, SSA's largest economy, scores poorly at 170th and Angola is almost at the bottom of global rankings (181st). Investor experiences can vary considerably by sector within these rankings. Moreover, they are not necessarily good guides to whether substantive improvement has occurred, and can or will occur, in any one place. The fact remains that 14 of the 20 least competitive economies worldwide are in SSA, and while some may hold niche opportunities their outlook cannot necessarily be transformed by local regulatory reforms even if these were achievable. Investors will continue to need expert insights into the governance of particular sectors in particular settings, a reflection of SSA's diversity and its complexity.

The agricultural sector, which employs and supports most Africans, is in many respects the "missing piece" of the region's growth path. Its transformation potential is heavily contingent on very difficult, time-consuming regulatory reforms with deeply political implications. SSA has up to a fifth of the world's arable land, but produces less than a tenth of world agricultural output. Agricultural growth is about 3% annually, held back by infrastructure deficits, chronic under-investment, and poor linkages of SSA's predominantly small-scale farmers into significant value-chains. However, complex or legacy regulatory and socio-political issues are also a major constraint and agribusiness investors require considerable advice and support.

Spotlight – Business climate reform: **Rwanda’s regulatory revolution**

Rwanda’s story of investment and business climate reforms, especially since the mid-2000s, constitute an outstanding SSA example of the possibility, and impact, of concerted and strategic regulatory and institutional reform.

Small, landlocked and historically associated with serious political risk, Rwanda struggled to attract foreign investment or to foster local business growth. However, its success at ease-of-doing-business reforms has had dual reinforcing effects, not only making the business climate easier but (all-importantly) changing perceptions about the country and generating momentum and interest in investor circles.

In the World Bank "Doing Business" rankings in 2010, Rwanda was the standout performer, rising 76 places globally (from 67 to 143, of 183 countries). This is the fastest-ever leap by any country. Overall from 2005-2015, Rwanda is the most-improved performer on the rankings worldwide. By 2015, it ranked 46th globally. The country also now ranks 65th globally (after Portugal) on the Heritage Foundation’s "Economic Freedom" index, 4th in SSA and above average globally. It regularly features positively in EY’s annual ‘Africa Attractiveness’ survey.

With the help of the World Bank group, and overseen by the Rwanda Development Board, the country has reformed across the board, for example revising construction permit processes (2008 and since), establishing special fast-track commercial courts (2009), enacting minority investor protections (2010), and easing the cost, hassle, and delay of new-business registration.

The government focused on creating an environment for private-sector enterprise and investment reception, preparing commercial legal frameworks (a new or revised company law, secured transactions law, insolvency law, and labor law) and reforming the financing sector (including minimal capital adequacy ratios), business entry and operations, tax, trade logistics, and public-private partnership frameworks. It has set up "one-stop" centers for business interface with administrative and regulatory agencies. It cut the time to register a business from 16 days to two days; property registration times fell to two months (from over a year), with a huge cut in business and property registration costs. It has instituted strong anti-corruption laws that are enforced.

The country’s GDP has grown at above 7% annually, on average, since the mid-2000s, and nearly doubled to 7 billion dollars in 2012, from 3.7 billion in just 2007; GDP-per-capita remains low (600 dollars) but is rising quickly. FDI in-flows in 2014 of about 110 million dollars were down from 150 million in 2013 but still 10 times the volumes of a decade earlier (2004).

Rwanda’s example is proving highly influential on its peers, especially in East Africa, with many seeking to attempt similar reforms. However, most peers will struggle to replicate the Rwandan story: this is partly due to incapacity and partly due to complexity (Rwanda’s was a small, undeveloped, post-conflict economy); it is also partly because few SSA governments have the overwhelming political dominance that Rwanda’s ruling party has, and which helps account for its ability to "get things done". Indeed the country ranks near the bottom in democracy indices (such as *The Economist* and Freedom House rankings). Moreover, Rwanda still ranks poorly (164th globally) on trading across borders, something that is somewhat out of its hands, but common to many SSA economies despite efforts at regional integration. A small domestic market, it suffers too from high transport costs and lack of skilled labor.

The upshot is that Rwanda’s reform story is remarkable, and offers a glimpse of how much slack exists for pro-business reforms in many SSA countries. However, its progress is not necessarily replicable by others – and investors need to look beyond ranking metrics to explore the reality of doing business in Rwanda, as in any SSA country.

Sectoral Trends

It is possible to identify one or more key trends that are likely to significantly shape the medium-term path of business and investment in three selected sectors: mining, power, and private equity. These trends and sectors are important in their own right, but also illustrate some wider patterns of potential relevance across other sectors, from agribusiness to manufacturing to financial services.

Mining

State intervention to leverage mining investment in support of wider development

Significant mineral endowments have long been a hallmark of SSA's overall economic stature. The "Africa Rising" story may increasingly be focused on urban consumer dynamics and related sectors, but for many investors the African proposition is heavily related to natural resources. Much of the foreign investment and interest has been – and remains – around oil and gas, but mining (and related activity and infrastructures) is a significant sector in many SSA countries, many of whose potential reserves are untapped or not yet explored.

The principal mining sub-sectors across SSA are undergoing a shift in the context of the global price and demand outlook. Considering the main fiscal, regulatory, and other trends in recent years and their likely trajectory, investors must typically accommodate state intervention around major projects: states are increasingly resorting to legislative and other regulatory or policy tools in an attempt to leverage mineral wealth for local job creation and business growth, by engineering "backward linkages" from major projects into the domestic economy.

Scale: Although the commodities "super-cycle" has tapered off, it helped drive high GDP and export revenue growth in many minerals-rich SSA economies:

- By the end of the 2000s, global minerals production values were four times what they were in 2002. Most existing SSA producing countries benefited, attracting significant capital investment and exploration, while major projects transformed the macroeconomic outlook of small countries such as Sierra Leone and Guinea. Over the decade after 2002, SSA came to account for 15% of global capital expenditure in mining, up from less than 5% in the 1990s.
- Cyclical commodity trends do not overshadow SSA's inherent attractiveness as a mining destination in the future. The region is largely "under-mined" and certainly under-explored: despite holding over a third of global solid mineral reserves, it contributes only 6-8% of global production. Many SSA countries are high-potential, low-production mining venues.
- SSA accounts for half of the world's list of countries heavily reliant on producing non-fuel minerals, while half of SSA countries rely on minerals for over 70% of export earnings. Mining comprises 78% of DRC's exports, 65% of Guinea's, 40% of Tanzania's, and 25% of Ghana's. This creates obvious vulnerabilities, but also opportunities for policy interventions to more creatively link mining activities to other local economic sectors.

Power, transport infrastructure, and skills deficits will continue to constrain the attractiveness and productivity of operations in many parts of SSA. Yet mine-to-port corridors and other mining-related needs can themselves be good business for construction firms and service providers, while also having significant effects for other sectors and users.

Implications: The mining sector and its commodity-specific sub-sectors display considerable diversity, but a number of broad trends can be discerned in SSA mining as it consolidates in the context of shifting Chinese and global demand dynamics:

- Having seen significant growth in the last decade, the sector will consolidate and cost-cut internally, a pattern not limited to SSA. Major mining houses will continue to scale back capital expenditure, and marginal, incomplete, or scheduled projects will remain at risk of suspension or cancellation. This is especially so, at present, in relation to many iron ore, thermal coal, bauxite, and gold projects.
- Given their social, environmental and revenue-transparency footprint, major mining ventures in SSA will face an increasingly demanding and diffused regulatory landscape in home and host jurisdictions, along with pressure from financiers, insurers, and others to exercise greater scrutiny over their bidding and contracting processes, general operations, and mine-site exits or suspensions.

- The "resource nationalism" trend observable through the 2000s has weakened as demand and prices have cooled. The phenomenon saw states in SSA and globally, often facing populist pressure, attempt to revise mining taxes, royalties, and other fiscal arrangements, demand extra development spending, or legislate for compulsory state equity stakes (among other things) in new projects. There is some "lag" effect where firms with sunk investments still face this sort of assertiveness from host governments. Some SSA mining countries have, more pragmatically, negotiated sliding fiscal scales capable of adjusting more smoothly, and fairly, to volatility and price cycles.
- Governments in SSA, encouraged by donors, are becoming more attentive to, and fluent in, applying interventionist policies around creating backward or upstream links (see "spotlight trend" box, on page 23) and forward or downstream links, the latter including beneficiation schemes intended to reduce raw commodities exports and develop domestic value-adding processing and refining capabilities. SSA countries generally have a weak record in implementing efficient, competitive industrial policy of this sort.

Mining and related sub-sectors will remain important both to Africa-oriented investor queries and portfolios, and to the national economies of some prominent SSA economies from South Africa to Ghana. This is true even though 2013 marked the first year in which mining and metals no longer featured in the top 10 sectors for new FDI projects (by number) in SSA.

Spotlight – Leveraging investment for wider growth: **local content regulation trends**

Most extractive industry investment in SSA in the last decade has not been particularly job-rich, nor directly boosted local smaller enterprises. Mining can dominate FDI, exports, and state revenues in some countries without contributing greatly to employment or even share of GDP. On one estimate, local firms account for less than 10% of all extractive-sector supply contracts. Most mining ventures have significant ongoing operating expenditures, over many years, which could be directed to local workers and suppliers, even spawning an industrial base and diversifying the national economy. Amid popular pressure and with the support of international organizations and donors, policymakers have sought to encourage greater procurement and hiring from local sources. Indeed, many have introduced mandatory legislation to this effect, often directly citing the lead shown by their peers. Major SSA extractive industry investment destinations have introduced various policy or regulatory moves to promote local procurement and hiring:

Nigeria: the Local Content Development Act ("Nigerian Content Act") of 2010 is a prime example of this legislative trend. Intended to create non-oil productivity on the back of the oil and gas sector, among other things it requires foreign firms in the hydrocarbons sector to meet high targets for construction and materials procurement, transport, and other services.

Ghana: 2013 saw the passage of Ghana's equivalent "Local Content and Participation" regulations. The targets are ambitious: firms must outsource 50% of all goods and services contracts to Ghanaian firms within five years, and 90% of these by 2023. Equal bids with higher local content value must be preferred, and firms are obliged to submit their local content strategy for review, and to publicize it.

Mozambique: under popular pressure to demonstrate tangible benefits from extensive new coal-mining investment since the 2000s, the 2011 "Mega-projects Law" set the trend now manifested under the revised petroleum regulations and the new Mining Law (August 2014). This requires foreign investors in the mining sector to prefer local goods and services to the extent that these are of comparable quality, quantity, and availability of supply; it also proscribes a (rather vague) requirement to use locals as sub-contractors or employees of sub-contractors and provide employment and training for local citizens.

In all cases, legislators and policymakers have been driven not only by the economic case for leveraging extractive industries to develop other parts of the economy, but by political pressures – amid high youth unemployment in particular – to demonstrate local benefits from increased FDI into high-profile minerals sectors. In this sense the regulatory trend can be seen as a manifestation of "resource nationalism" although it is strongly encouraged by the African Development Bank and others. It is a key aspect of the African Union's 2008 "African Mining Vision" policy guidance framework.

There is generally a high risk of contracting firms that are not competitive on price, timeframes or quality, and some scope for rent-seeking and corrupt practices. Investors in settings such as Ghana note that timelines and targets, while legislated and mandatory, are highly unrealistic given underdeveloped local service-provision, manufacturing, and labor pools. If local companies were already competitive, local content policies would not be required. One concern is that mandatory local content regulations lead to forms of protectionism rather than stimulate greater local competitiveness. Excessive faith may be placed in these laws, creating some potential political risk of sharp tightening of rules when governments face local pressures for job creation and wealth distribution: local content policies have applied in Angola for many years now, but despite the government having more capacity than most to enforce these (should it choose to), the policies have had limited impact on job creation and non-oil diversification. Investors will find that enforcement of targets varies by country and over time. Local capacity to supply larger-scale projects will take time to develop. In theory, as local suppliers and skills-providers become more competitive, this will benefit mining firms who will see these issues as creating value and reducing supply-chain risk, rather than as compliance matters. Governments across SSA meantime face a delicate balance: providing a supportive environment for smaller African businesses without undermining project competitiveness and the ability to attract foreign investment. African regulators will continue to pursue this balancing act, against a backdrop of popular impatience and pressure from elites for "easy" business opportunities.

Energy

Regulatory frameworks for private financing of electricity supply – and public tariffs

With its major river systems, gas reserves, solar exposure, and other resources, the SSA region is not short of power-generation potential. Nor is there any shortage of future demand, given the region's growing urban population, as well as its envisaged transport systems, factories, mines, and farms. However, the region is notoriously short of installed electricity generation and distribution capacity. For example, Spain alone has a greater installed generation capacity than the whole of SSA.

Alongside other stark figures on this most vital of SSA economic growth bottlenecks are some positive trends in terms of investment. These include international initiatives around power and growing interest in public-private partnerships in this sector. The regulatory frameworks required to attract sustained investment in power supply – including by establishing a viable tariffed consumer base – form the intangible or "soft" infrastructure without which physical energy infrastructure will not materialize.

Scale: When placed against data on the region's notable generation and distribution deficits, levels of current and future demand suggest a significant investment gap:

- Despite its resources, the region's "energy poverty" is striking. Some 68% of people in SSA have no access to electricity (over double the 24% figure for developing countries globally); for example, over 90% of people in Ethiopia, among the most populous African countries, rely on biomass (wood, etc.) for cooking.
- Only seven of Africa's 54 countries have an electrification rate over 50%. Thus with less than 15% of the world's population, Africa accounts for 50% of those globally without access to electricity. Partly due to population growth, the proportion of those in developing SSA without access to electricity is set to worsen before 2025 but improve thereafter, whereas in developing Asia the share of those without access will halve, on current trends, by 2030. In the mid-2000s, while average GDP in SSA was growing at nearly 5%, electricity generation was growing at close to 1%.
- "Access" tells only part of the story, since reliability and volumes of power are poor and highly variable. Most of the 30% of SSA people who have access to electricity rely on fuel generators, not grid energy. Moreover, power in most of SSA costs 4 to 5 times the average global price of grid electricity, severely constraining economic growth and investment attractiveness. Existing generation capacity is often under-used due to under-investment or poor management, and significant losses and inefficiencies exist in transmission and distribution.
- Outside South Africa, average electricity consumption is currently very low. The whole of SSA consumes less electricity than Brazil, and less than a quarter of Brazil's consumption per capita. However, low consumption rates mostly reflect supply constraints, not soft demand.
- These deficits create huge direct investment opportunities in addition to the general economic boost that will come with narrowing the energy deficit. There is demand for electricity, and the prevalence of generator power shows that paying buyers, both business and household, certainly exist. A 2015 McKinsey scenario projected that power consumption in Africa will have increased four-fold by 2040, to equal today's total consumption of India and Latin America combined.

Arguably the region's main overall developmental challenge is finding ways to incentivize and reassure serious energy investors who find the basic demand profile compelling. The current focus on power in SSA reflects the positive coincidence of potential for clear investment opportunities and huge developmental impact.

Implications: In this context, a number of major trends are worth noting:

- At the international level, initiatives such as the UN "Sustainable Energy for All" and U.S. President Obama administration's "Power Africa" scheme are both raising awareness of needs and opportunities, and catalyzing commitments of investment and technical assistance. Chinese and other sources of significant capital are focusing on the power story, while global utilities management firms are finding opportunities to revive and manage state-owned assets. In particular, schemes such as Power Africa are helping reduce risks by offering new models for de-risking power projects with state-backed guarantees.
- At the regional level, considerable scope exists to explore savings in building costs (with some added but lesser transmission costs) by fostering regional integration of electricity markets and supply. The existing regional "power pools" provide some basis for this, although considerable political will, trust, and financial regulatory expertise will be required to create transparent, investable regional power markets of any scale.
- At the national level, many major SSA countries are under growing popular pressure – not just economic incentive or business demand – to improve electricity supply services in urban areas. They are putting emphasis on regulatory reforms to create financially viable power sectors that are transparent to investors, where tariffs reflect the true cost of power (even if some state subsidies are applied), and where clear and stable regulatory frameworks allow private investors to plan ahead and allocate risks. In particular, there are concerted efforts at legal reforms to enable public-private partnerships in major energy projects, and purchasing agreements to accommodate independent power producers (IPPs).
- The region's tough operating environment continues to help spur innovation for example in renewables-based mini-grids and off-grid systems. Weak revenue collection capacity – a major inhibitor of private-sector interest in the sector – is being addressed through the growth of pre-paid user systems modeled on mobile phone pre-paid "air-time" and indeed transacted on mobile platforms, creating a pool of households offering investors steady demand.
- The clear existence of pent-up local demand will continue to generate foreign investor interest in particular in renewable sources, especially solar (across SSA), gas-fired power (across SSA), hydropower (West, East and Central Africa), geothermal (East Africa), and wind power. At present other SSA countries trail South Africa in creating a clear regulatory environment and incentives for IPPs and investment in renewables, with a solid tariff base.
- The scale of investment needed to revive existing power generation, transmission, and distribution is daunting. It far exceeds even the accelerated public and private investment now going into powering Africa's future. SSA accounts for 65% of the investment needed to meet the "Energy for All" framework targets. For McKinsey's 2040 scenario, over 800 billion dollars in investment is needed, even considering efficiency gains and cost savings as new renewable and other technologies accelerate in coming years. The policy emphasis on generation – which is more attractive to private investors – creates a risk of under-investment in transmission and distribution.

Notably, more positive scenarios for SSA power, according to the OECD and International Energy Agency, are "fragile" ones. They are vulnerable to various contingencies, in particular, the "failure to implement policy actions". While the demand profile speaks for itself in terms of investment opportunity and developmental implications, the significance of institutional policy, planning, and regulatory capacity cannot be understated if SSA is to realize this potential. This reinforces the primacy of ensuring that the "soft" infrastructure of investor-friendly regulatory frameworks is reformed, if the "hard" physical infrastructure is ever to be realized. Nigeria's recent history of privatization efforts in the power sector are a testament to this fact.

Spotlight – Regulating pent-up demand: **Nigeria's electricity privatization**

Nigeria's recent experience in partially privatizing many state generation and distribution assets illustrates the importance of regulatory and institutional reform in scaling-up investment attractiveness in SSA.

Rich in oil and gas but significantly under-industrialized, Africa's largest economy has long been held back by very serious shortcomings in available, reliable, and cheap electricity. Its installed generation capacity is no more than 7,000 MW – less than Serbia's generation capacity in what is Africa's most populous country. Up to 40% of this is typically considered off-line due to chronic under-investment, mismanagement, and other problems, including in transmission and distribution networks. Of those homes and businesses that do enjoy access to electricity (between 40% and 48%), the vast majority rely on imported diesel generators and fuel.

Before 2010 successive governments had promised to transform this situation, without much success and in the face, among other factors, of stiff resistance from those with vested interests in the status quo. From 2011, President Goodluck Jonathan made privatization and recapitalization of state-owned assets a key explicit political and policy objective. His administration sought to increase power production to 40,000 MW by 2020, a highly ambitious target.

To the surprise of many sceptical observers, in August 2013 the federal government completed "Phase 1" of its plan, when various consortiums completed the purchase of 60% of the assets of the state-owned Power Holding Company. These comprised six generation and 11 distribution assets, sold to consortiums, many of which saw elite Nigerian businesspeople partner with foreign firms, including Siemens and GE. The government established and underwrote a "bulk trading" entity to buy power from private generators for resale to distributors (until the latter improve their revenue-collection capacity). Some assets, notably the Transmission Company of Nigeria, remain in state hands but with private-sector managers.

The relative success of "Phase 1", a major undertaking, illustrates the significance of regulatory opacity and complexity and weakness in inhibiting investment in SSA, as well as the breakthroughs possible when political will and public-sector capacity are able to deliver a commercially satisfactory regulatory framework. The main challenge for Nigeria was to convince foreign capital to commit to the sector notwithstanding the obvious pent-up demand for cheaper, reliable power. The 2013 sale completion was the culmination of time invested, especially by the Public Enterprises Ministry, in rationalizing and making transparent key regulatory issues around tariffs and pricing and off-take agreements.

The privatization process – and the power sector generally – still face significant challenges, especially in sourcing the long-term financing, as well as technical and managerial skills, needed to revive and sustain Nigeria's grid network. Nigeria is nowhere near its 2015 target of 20,000 MW. The relative success of power reforms does not necessarily mean that long-awaited oil-sector reforms will succeed. Nevertheless, the sector stands as a testament to what is feasible given the combination of clear, underlying demand, serious private-sector interest, and concerted regulatory reform in the SSA power sector.

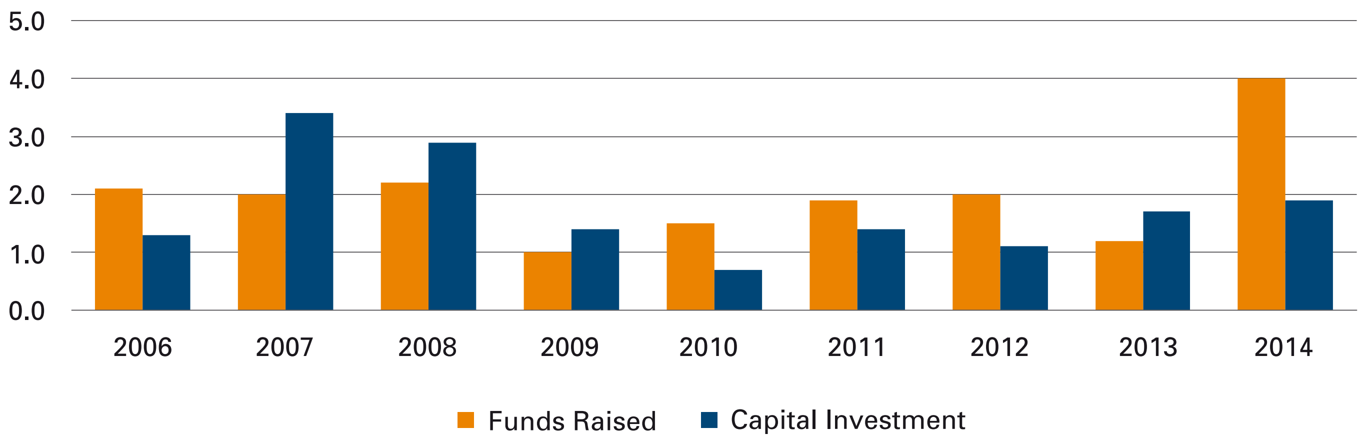
Private Equity

Unlocking capital amid a still-evolving financial regulatory landscape

Africa still accounts for a very small proportion of private equity (PE) transactions globally, but this share has grown fast. Moreover, in a region marked by such a gap between economic promise and capital availability, the particular hands-on qualities of PE investment give this investment class some potential to catalyze business growth in key areas. This impact may have potential galvanizing, "crowding-in" and confidence-boosting effects well beyond individual projects and investments.

Despite burgeoning activity in PE activity across SSA, challenges remain especially around finding investable targets for the growing body of interested PE investors, while some regulatory and other issues affect the prospects for most SSA economies to be able to attract capital and systematically offer viable "exit" avenues for PE investors (Graphic 10).

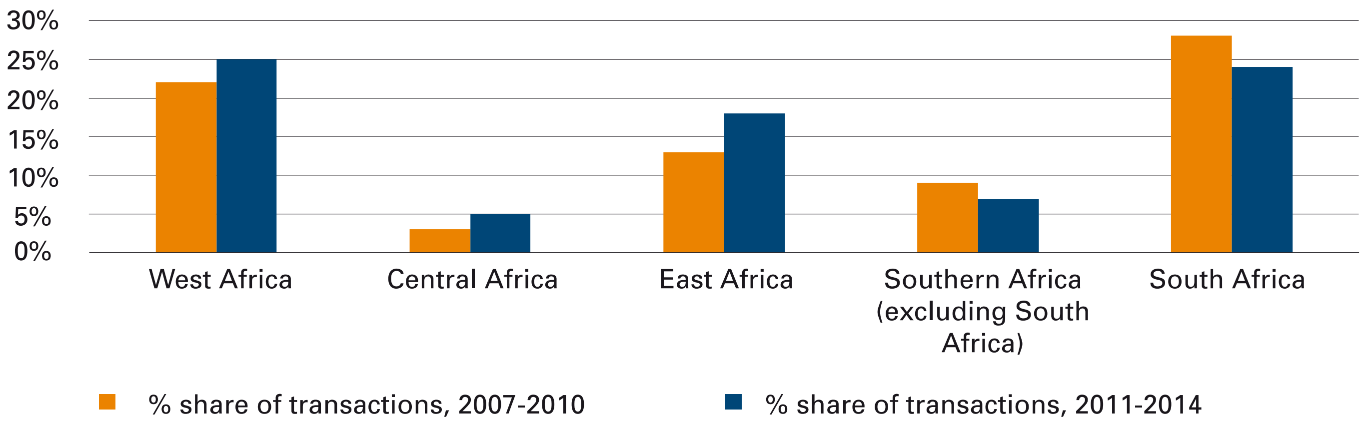
Graphic 10. SSA fundraising and investment, 2006-2014 (billion dollars)



Scale: The African PE space is still emerging, although it is evolving fairly rapidly:

- PE activity is very small in global terms, and low relative to other emerging market regions. For example, in 2012, total Africa-oriented funds raised amounted to between 1.1 and 1.4 billion dollars (having peaked at 2.2 billion in 2008) but this is small compared to the 206 billion dollars raised globally in 2012 in the PE space. Fund-raising increased in 2013, and 2014 saw over 4 billion dollars raised for Africa PE funds for the first time.
- Of the 330 billion dollars raised globally for PE funds in 2013, just over 10% was for emerging markets, but only about 3% (1.2 billion dollars) was earmarked for SSA deals. Still, the Emerging Markets PE Association (EMPEA) suggests that this figure is quickly reaching 10%. Deal-flow continues to rise, with 2014 seeing over 8 billion dollars' worth of transactions, the second-highest on record.
- PE deals comprise only a small proportion of foreign investment into SSA; the region's average ratio of PE investments to GDP is probably about 0.09% (compared to 0.86% in the US, on 2012 figures). PE investments are still no more than 10% of all acquisition deals in the region. Most capital is raised by a remarkably small set of PE firms.
- Public development finance institutions (DFIs) have comprised the overwhelming majority of private equity for African deals. However, global PE funds such as Carlisle, KKR and Blackstone are growing their Africa presence and portfolios, alongside South African funds and others with an Africa investment orientation, such as Abraaj and Helios. Moreover, some deals involve DFIs together with general partner PE funds.
- PE deals have generally been confined to the established SSA markets. Until fairly recently (2011) about 70% of reported deals (by value) targeted only three economies (Nigeria, Kenya, South Africa). Some estimate that by 2014 Nigeria had become the target for over 50% of all SSA-related deals, eclipsing South Africa, which in the last decade had accounted for about half of all deals (by value and volume; Graphic 11).

Graphic 11. Proportion of PE transactions in SSA by region, 2007-2014



- Deals have focused on extractives and energy, telecoms and consumer-facing sectors (especially fast-moving consumer goods), with some infrastructure projects, agribusiness, private healthcare, real estate, and financial services. Many observers see significant unrealized potential especially in smaller deals and SMEs, and there has been evolution of specialized SSA funds, such as those devoted only to renewable energy or real estate, and country-specific SSA funds.

Little reliable analysis has been produced on the relative significance or impact of PE-sourced financing on major African investment themes such as power or transport infrastructure.

Implications: PE firms could play an increasingly significant role in financing investment in SSA, for instance enabling successful "home-grown" firms and brands from established African business hubs to expand across their sub-region. The prospects for PE investment in the region are in general directly related to the evolution of the formal financial sector in countries (other than South Africa) whose domestic financial markets and policy frameworks on foreign investment and foreign currency management are still emerging.

In this way, the outlook for PE is closely related to key challenges of regulation and governance, both in terms of national jurisdictions and regional integration (where the targets are firms intending to expand their regional footprint). The field is marked by an ongoing debate:

- Some argue that conventional PE models are unsuited to SSA conditions, given the paucity of entry and exit opportunities, the relatively high cost of due diligence, and challenges around managing portfolio companies in practice.
- For others, the argument is that the less-developed nature of SSA's corporate and regulatory environment will not impede greater PE investment, but will trigger innovation and experimentation with other ways of "doing" PE investments and exits.

While political risk perceptions remain a constraint, and capital flows may shift in the future, the main problem for PE investors in Africa has not been raising funds. Low interest rates in the developed world and the preparedness of global investors to devote relatively small sums to be part of the African growth story make raising money relatively easy. Instead, PE investors' main problem in Africa has been the related problems of finding "bankable" African projects, and finding viable "exits" from their investments, mainly through the avenue of public listing. Many PE observers point to the inability of SSA-focused fund managers to absorb the capital now being committed to PE funds. They question whether enough investable African companies exist in economies that are mostly comprised of the informal sector. Other issues include lack of good data and local firms' poor financial record-keeping, inflation of asset prices due to competition among PE general partners ("over-crowding" or the over-supply of SSA-related PE funds, with insufficient managerial capacity in addition).

The "exits" problem is a function of the relatively undeveloped nature of local capital markets in most places beyond South Africa:

- In those places, fairly immature or shallow local financial markets compound other problems, including complex, uncertain or weakly-administered regulatory frameworks around foreign exchange and capital repatriation and taxation.
- Successful exits through listings are fairly rare outside South Africa, extending the length of time that PE managers hold assets in the region, and leaving management buy-backs, trade or secondary sales to funds as the exit options.

Yet there have been some recent successes, such as the IPO of Umeme, a Ugandan electricity distribution company acquired by Actis, the PE fund. Moreover, anecdotal evidence suggests that SSA countries other than South Africa are achieving a greater proportion of the region's successful exits, with some estimating that over 7 billion dollars in successful PE exits took place in Africa in 2014. SSA's stock exchanges will need to develop and deepen further to allow PE exits through listings, and this will take time.

While PE displays different characteristics to other investment classes, in many ways it is subject to the same factors and forces that shape other investor experiences. For instance, the appetite for African PE fund-raising is only partly absolute in nature, and partly related to the relative softness in economic performance in the developed world. Likewise, while particular PE investors may have varying experiences, the nub of PE investing is that it is not better than the underlying portfolio companies, and the partners' ability to influence change within these.

Thus the overall prospects for PE activity to make a significant impact on SSA investment are partly contingent on further development of legal and regulatory frameworks for inward investment, listing, foreign currency regulation, and general business and corporate activity. This suggests that PE activity into (and from within) Africa will remain heavily concentrated in Nigeria, South Africa, and Kenya, and only tend to affect other markets to the extent that PE investment in firms with regional operations enables expansion of those operations.

Spotlight – Regulatory reform and private equity: **the African pensions story**

Regulatory moves have occurred in major SSA markets to allow greater investment in alternative asset classes, such as PE, by SSA pension funds. This trend illustrates the wider scope for targeted reforms to substantially scale-up the value proposition of SSA investing.

Outside of South Africa, which has around 200 billion dollars in managed pensions, SSA pension funds are very small by global standards. Nigeria has under 30 billion dollars in pension funds, and under 0.3% of these assets are invested in PE (compared to nearly 10% in the United States). Kenya's pension pot amounts to less than 9 billion dollars.

Whatever their scale by global standards, these funds are important in the scheme of SSA's capital shortages. Around 30 billion of the 380 billion dollars of SSA pension fund assets under management are available for PE investment. This amount is triple the 10 billion in PE raised since 2009 for African opportunities. PE investments are often marked by longer investment horizons, something that makes them suitable for pension fund investors. The value of both Kenyan and Nigerian pension funds has been growing at over 20% year-on-year in recent times.

Regulators in SSA have proven fairly responsive to pressure to reform statutory limits on the proportion of pension funds that can be devoted to PE:

Nigeria: before 2010, regulations prohibited pension funds investing in non-listed securities. Since then, reforms have enabled up to 5% of assets to be allocated to PE funds. However, any PE fund recipient must be one deploying 75% of its assets inside Nigeria, reducing the pool of candidate funds.

South Africa: after 2011, Regulation 28 of the Pension Funds Act in its revised version raised the cap on pension funds investing in unlisted funds or entities from 2.5% (non-South Africa targets) and 5% (South Africa targets), to 10%. The country's Government Employee's Pension Fund is among the largest in the world.

Kenya: regulators have faced calls to revise statutory upper-limit restrictions (and a need for regulatory approval) on pension funds investing a greater proportion of funds in asset classes such as PE. Funds can invest in PE through provision for investment in "other assets" but only to 10% of the pension fund, with prior approval. The country's Retirement Benefits Authority reviewed the issue in 2012, but changes have not yet been gazetted.

Other SSA countries, including Ghana, have also reviewed their pensions-to-PE policies. However, regulatory reforms are not necessarily the whole story. Firstly, PE funds for Africa are not struggling to raise capital, but to invest it and secure exits. Secondly, most African pension funds invest well below even their previously-low allowed PE limits. This suggests that other issues, including reluctance about the asset class among pension fund trustees, are holding back the potential leveraging of Africa's pensions in support of investment in local businesses, helping catalyze or "crowd-in" foreign institutional and other investment.

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