Lex Mundi World Ready

A report from The Lawyer Research Service and Lex Mundi

Africa – the great opportunity

African countries offer enormous potential for overseas investors, but there are also some serious challenges to overcome

About the research
This article summarises the discussions at Lex Mundi's Emerging Africa Conference in Cape Town in March 2016. For more information on the conference, please contact Eric Staal, director of business development at Lex Mundi, at estaal@lexmundi.com.

Africa is rapidly becoming the global economic growth engine. Half of the world's 25 fastest-growing nations are in Africa and almost 40 per cent of the continent will achieve GDP growth of more than 5 per cent in 2016. The population is set to grow by 50 per cent to 1.5bn by 2030, and by 2040, Africa's working-age population will rise to 1.1bn from about 500m today – greater than the working-age populations of China and India combined.

A burgeoning middle class is also catalysing growth across a range of sectors, including financial services, telecommunications, retail, residential and transportation.

These developments have caught the attention of international investors and multinational companies, many of which are rushing for alternative investment opportunities in response to diminishing growth prospects in BRIC (Brazil, Russia, India and China) and other emerging markets.

But despite the enormous potential, there are serious challenges to investing in Africa. Businesses are vulnerable to risks ranging from commodity price fluctuations and exchange rate volatility to weak regulatory institutions and emerging security threats. This creates misconceptions about doing business in Africa.

Perhaps the most obvious misconception is the belief that the difficulties of doing business are uniform across the continent. In the words of Dr Donald Kaberuka, former president of the African Development Bank and senior representative for the African Union's Commission for Peace Fund, "Africa is a complex mosaic which is very often misunderstood".

Another misconception is that the risk environment is more challenging than in other emerging economies in Latin America or Asia. In fact, studies by the World Bank indicate that doing business in many African countries is no more difficult than in many Latin American or Asian markets.

This article, which is an extract of an upcoming larger report, summarises discussions at Lex Mundi's Emerging Africa Conference in Cape Town in March 2016. The wide range of topics discussed included underlying growth drivers and investment trends, implementing growth strategies in line with local development objectives, changing regulatory frameworks and structuring transactions to satisfy broad stakeholder interests and public concerns.

Participants came away with insights from business leaders and legal experts on how to manage opportunities, challenges and risks when expanding in the region.

> "A burgeoning middle class is catalysing growth across a range of sectors"

Understanding the opportunity

The continent's jaw-dropping rates of population growth certainly capture attention. But during the conference, Patrick Mweheire, chief executive officer of Uganda's Stanbic Bank, outlined some other factors underpinning Africa's allure.

Firstly, the rapid rate of urbanisation that is expected to accompany population growth, coupled with the emergence of a middle class with more disposable income, creates an enormous market for companies investing in the region.

By 2030, it is expected that about half of Africa's projected 1.5bn population will live in cities, and by 2050, the number living in cities will hit 1.2bn. To put this into context, Johannesburg was the only African city with more than one million inhabitants in 1960; now there are 35.

Population growth aside, Africa's vast natural resources make it a compelling investment destination. For example, about 60 per cent of the world's available arable land is in Africa. Beyond minerals, oil and gas, the continent also has natural advantages for investments in renewable energy, particularly wind and solar.

According to data compiled by Clean Energy Pipeline, $29.9bn has been invested in renewable energy projects in Africa in the last five years.

Mweheire also stressed that improvements in governance and regulation in the past decade have created a more stable investment environment. Importantly, 70 per cent of sub-Saharan Africans now live in free or partially free democracies. Nine elections were held in 2014 and five in 2015.

There have also been significant improvements in financial regulation, with a number of African countries establishing independent central banks with liberalised current and capital accounts. Many central banks have been given responsibility for monetary policy and have been instructed to implement inflation targeting policies.

But despite these vast improvements, there remains a strong perception that macroeconomic uncertainty, corruption and unstable regulatory and governance structures prohibit doing business in Africa.

This was a point debunked by a range of speakers at the conference. According to the World Bank's 2016 ease of doing business rankings, African countries compare well with BRIC nations on factors including dealing with construction permits, getting electricity, registering property and enforcing contracts.

Eight African countries are ranked among the top 100 for ease of doing business. Russia was ranked 51st, China 84th, Brazil 116th and India 130th. Relative to other emerging economies, Africa is not a harder place to do business. That is not to say there are no challenges, but they can be overcome with careful planning.

Four major investment trends

Foreign direct investment (FDI) in Africa is increasing. But which countries and industries is it flowing to and who is providing capital? Dr Martyn Davies, managing director for emerging markets and Africa at Deloitte, spoke to the conference about four main trends that currently define foreign investment.

The first is Africa's evolving relationship with China. Since the introduction of China's Africa policy in 2000, China has become Africa's biggest trading partner. The majority of African goods exported to China are raw materials.

This has brought significant wealth to Africa, but in some circumstances has resulted in countries being over-reliant on commodity exports. China has also provided various economic aid programmes and loans.

The second main trend concerns the decline in commodity prices and exports. Reduced demand and, in some cases, increased supply, particularly of metals and crude oil, have triggered devaluation of some African currencies against the dollar.

Countries such as Angola and Nigeria have been hit particularly hard and have had to renegotiate debts with China.

A third trend is the bifurcation of the continent's growth prospects into east and west. East

> "Africa's vast natural resources make it a compelling investment destination"

Managing risk

The challenges to investing in Africa mean it is vital to have a clear risk management strategy in place. A panel of leading African companies discussed this at the Lex Mundi Emerging Africa Conference, and the following recommendations emerged:

1. Devise a process for identifying risks and implement policies to mitigate and monitor exposure.
2. Take action early when responding to adverse events.
3. Get a local perspective to assess each risk situation accurately, rather than relying on observations from abroad. Employ as many local people to management positions as possible.
4. A no-tolerance approach to corruption bears fruit in the long run, even if it takes longer and costs more to get things done.
5. Invest in relationships with political leaders to understand their goals and demonstrate how your business operations contribute to the community's development.

Samuel Ayim, group general counsel at Ecobank Transnational, a pan-African retail and commercial bank, underlines the importance of appointing local people to the management team when expanding into new African countries.

> "When we go to a new country, we look around for professional people who are well connected and know the territory who can sit on the board"
> *Samuel Ayim*

"We have learnt that it is absolutely critical to have local people in the management team," he says. "Lots of outsiders look at Africa as one country, but it is actually 54 countries. There is lots of commonality, but many differences and nationalistic tendencies within countries.

"For this reason, we have a local board in each country. When we go to a new country, we look around for professional people who are well connected and know the territory who can sit on the board.

"This helps us with the interaction with the local authorities and with cultural integration."

A snapshot of Africa's legal market

By 2025, it is anticipated that Africa will account for 12 per cent of global legal spend, according to Citibank's annual law firm study. This is a significant increase on 2011, when Africa accounted for only 4 per cent of global legal spend.

"A lot of work the international firms do in Africa is based around power," says Jonathan Lang, a partner and head of Africa at Bowman Gilfillan Africa Group. "The power capacity gap means this will continue, whether it be work related to traditional power or renewables.

"The total power capacity for sub-Saharan Africa is less than that of Spain. South Africa has population of 50m but a peak capacity of 43,000MW. Nigeria has a population that is three times this but has a peak capacity of only around 4,000MW."

"Oil-producing countries such as Nigeria and Angola are really suffering, and so are the law firms that are based there"

"Work will also be driven by the growing middle class. In Kenya, you can see this very visibly in terms of new residential developments and increased consumption of things like cell phones and soft drinks. There is a young, rapidly urbanising population and financial services and telecoms companies are looking to take advantage of this. There will be infrastructure and M&A work around this, which is good for law firms."

But on the flipside, the volume of work in other sectors is decreasing. "A couple of years ago, we expected there to be lots of work in mining and commodities, but this is not the case given where we are in the commodities cycle," says Lang.

"Oil-producing countries such as Nigeria and Angola are really suffering, and so are the law firms that are based there. There are very tough trading conditions."

Traditionally, the lion's share of corporate legal advice in connection with Africa-related matters has been performed in major foreign capitals such as London, Paris, New York or Washington DC. However, in recent years local and international firms have both built their capabilities in African jurisdictions.

The table below shows some of the most active local African law firms

Firm	Country	Offices
Aelex	Nigeria	Abuja, Accra, Lagos, Port Harcourt
AF Mpanga Advocates	Uganda	Kampala
Ajumogobia & Okeke	Nigeria	Abuja, Lagos, Port-Harcourt
Aluko & Oyebode	Nigeria	Abuja, Lagos, Port Harcourt
Armstrongs	Botswana	Gaborone
ATZ Law Chambers	Tanzania	Dar es Salaam
Banwo & Ighodalo	Nigeria	Abuja
Bentsi-Enchill Letsa & Ankomah	Ghana	Accra
Bookbinder Business Law	Botswana	Antananarivo, Cape Town, Dar es Salaam, Gaborone, Johannesburg, Kampala, Lagos, Nairobi
Bowman Gilfillan	South Africa	Cape Town, Durban, Sandton
Collins Newman & Co	Botswana	Gaborone
Coulson Harney	Kenya	Nairobi
Couto Graça e Associados Limitada	Mozambique	Maputo
Engling Stritter & Partners	Namibia	Windhoek
ENSafrica	South Africa	Accra, Alexandra, Cape Town, Dar es Salaam, Durban, Johannesburg, Kampala, Kigali, Mitchells Plain, Port Louis, Stellenbosch, Swakopmund, Walvis Bay, Windhoek
Hamilton Harrison & Matthews	Kenya	Nairobi, Mombasa
Helmy Hamza & Partners	Egypt	Cairo
Kaplan & Stratton	Kenya	Nairobi
Koep & Partners	Namibia	Windhoek
MMAKS	Uganda	Kampala
Perchstone & Graeys	Nigeria	Abuja, Benin, Lagos
Templars	Nigeria	Abuja, Lagos; Oghogho; Akpata
TRLP Law	Nigeria	Abuja, Lagos, London, California
Udo Udoma & Belo-Osagie	Nigeria	Abuja, Lagos, Port Harcourt, Uyo
Walker Kontos	Kenya	Nairobi
Webber Wentzel	South Africa	Cape Town, Johannesburg
Werksmans	South Africa	Cape Town, Johannesburg, Stellenbosch, Tyger Valley

Source: The Lawyer Africa Elite 2016 report supplemented with additional recent data

Africa is relatively less dependent on oil and gas exports, and so has been less severely affected by the decline in commodity prices. Certain east African nations have also invested in critical infrastructure, undertaken political and economic reforms and diversified trade links across the Middle East, India and Africa.

These efforts are bearing fruit. Ethiopia's economy is growing at double-digit rates while Rwanda is growing at 6.3 per cent and Kenya at 6.2 per cent. There is also renewed confidence in Tanzania's economy.

In contrast, Africa's western nations are generally more reliant on oil and gas exports, which are declining. Also, FDI in some west African countries has been stifled by adverse regulatory conditions. But within these regions, investment is particularly strong in certain countries and cities.

This was the fourth major investment trend Davies highlighted at the conference – the emergence of four countries and cities as investment hubs where international companies are establishing platforms to expand to other parts of Africa. These are Johannesburg, Lagos, Morocco and Nairobi.

For example, Lagos state government reported FDI of N5bn (£13m) in the city of Lagos in the first quarter of 2016, which is 50 per cent more than the total volume of FDI in 2015.

Last year, the city established the Office of Overseas Affairs & Investment to boost international investment in Lagos. This is just one of a series of measures to encourage inward investment. Lagos state has already created investor-friendly legal and regulatory frameworks, such as the land reform act, double taxation treaties, limited liability reviews and free trade zones.

Four key challenges

But investing in Africa presents a wide range of challenges, and Kaberuka cited four major problems that are inhibiting FDI in Africa.

The first is the macroeconomic climate. Many African nations have made great strides to implement economic reforms in the past three decades, including the formation of independent central banks, financial market liberalisation and budget deficit management. That said, many African economies have not reformed sufficiently and are still over-reliant on commodity exports. These nations have been particularly vulnerable to the fall in commodity prices.

Kaberuka called for countries that still depend on natural resources to swiftly carry out further reforms, including cutting expenditure, identifying new sources of revenue, managing exchange rates and removing import controls.

The second challenge relates to a lack of economic transformation, which means Africa's strong rate of economic growth over the past decade has not been matched by corresponding increases in employment, equality and productivity. To achieve true economic transformation, Kaberuka advised African countries to invest in infrastructure, cross-border market integration and the development of mid-level skills.

The third challenge is institutional and regulatory risk. How can companies invest significantly in Africa if they are not confident that the regulatory environment will not change suddenly?

In the past, the main regulatory risk was nationalisation, asset confiscation or dividend repatriation. Now weak institutions are the main problem. In South Africa, for example, tariff policies for energy are clear, but the regulator underpinning the market is not independent.

Apart from measures in the 17 countries that belong to OHADA (Organisation for the Harmonisation of Business Law in Africa), national regulatory frameworks are not consistent. Inward investors therefore need to become au fait with multiple regimes.

The level of corruption in some African countries also causes issues when it comes to complying with the international reach of the US Foreign Corrupt Practices Act, the UK Anti-Bribery Act and similar laws from other countries.

"When we went on our big African expansion drive, we had a clear and uncompromising policy of no bribery or corruption," says Samuel Ayim, group general counsel at Ecobank Transnational. "In some countries, this practice was so ingrained that it was hard, but it was a fundamental principle for us.

"Ecobank has a culture that is total compliance. Every central bank knows this. It is critical to ensure discipline and compliance with this. We have some written rules of business ethics and all directors are required to sign a code of conduct."

Over time, such an unyielding commitment to compliance can become a valuable asset and even a competitive business advantage.

The last challenge, but certainly not the least important, relates to security. True, the continent is politically more stable than it ever has been over the past 20 years, but high-impact terrorism incidents still occur. These not only take a heavy human toll, but also knock investor confidence.

Foreign companies must consider a range of issues, including liability as well as providing adequate training and protection of staff. It should be remembered that the level of security risk varies within countries and across Africa. The security threats in Africa are also not dissimilar to those in other emerging markets.

Conclusion

Rampant population growth, urbanisation and a burgeoning middle class make Africa an attractive continent for foreign investment. But despite the continent's obvious potential, important challenges and risks remain part of the landscape.

Although significant progress has been made in recent decades, unemployment rates remain very high, economies are still over-reliant on commodity exports and regulatory institutions are not yet as effective as in developed economies. And that's not to mention ongoing security concerns.

Yet risks can be mitigated with astute planning and adaptation to local conditions. Detailed risk management strategies, employment of local managers and advisers, zero tolerance policies against corruption and alignment of company goals with local development requirements are all easier said than done. But get them right and Africa offers rich rewards.

Africa

1.5bn
Population by 2030

1.2bn
Living in cities by 2050

70%
of sub-Saharan Africans live in free or partially free democracies

8
African countries rank in global top 100 for ease of doing business

$29.9bn
invested in renewable energy projects in Africa in last five years

"When we went on our big African expansion drive, we had a clear policy of no bribery or corruption"
Samuel Ayim