



INVEST AD

شركة أبوظبي للإستثمار
Abu Dhabi Investment Company

Into Africa

Institutional
investor
intentions
to 2016

An Invest AD report written by the Economist Intelligence Unit

Economist Intelligence Unit

The
Economist

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Foreword

Africa is no longer a leap of faith

Even well informed observers have written off Africa as riven by war, corruption and poverty, but since the emergence of China and India as economic growth engines, many are now asking whether this continent of one billion people can also achieve its own “economic miracle”.

These are still early days but there is no doubting the promising signs, politically and economically.

At a time of huge change, societies are showing that they can adapt, on the whole, peacefully. In the last year, Nigeria, Tunisia, Zambia and Rwanda have held elections hailed as free and fair by international observers, while a referendum created the new nation of South Sudan.

Along with greater political stability, has come policy continuity and improved governance -- prerequisites for attracting the long-term investment to generate sustainable economic development.

As this report shows, many global institutional investors are now seriously intending to take a significant step into Africa. This is obviously good news, as it shows that large pools of capital are available to sustain the current high-single-digit growth needed to absorb a growing and youthful population into the workforce.

Interestingly, the Invest AD-EIU survey suggests that investors are largely drawn by the same “income convergence” story that has played out in China and India – not the worn, one-dimensional motivation of mineral extraction. The emergence of a strong middle class in Abuja, Accra, Nairobi and even Kigali is fuelling demand for all sorts of products and services, from mobile banking to canned drinks.

As investors see the potential for high returns in such ventures, they will commit capital, which in turn creates jobs and helps lift incomes. This virtual cycle has played out in Asia and Latin America in recent years. It is now Africa’s turn for an economic lift-off.

Nazem Fawwaz Al Kudsi
Chief Executive Officer of Invest AD

Preface

Into Africa: Institutional investor intentions to 2016 is an Invest AD report written by the Economist Intelligence Unit that seeks to capture the changing appetite for investing in Africa's frontier and emerging capital markets. It assesses the changing risk-and-return equation, and how asset allocation in these markets is likely to change in the coming five years. For the purposes of this report, it defines Africa's frontier and emerging markets as all but South Africa, which is at a more advanced stage of development.

The Economist Intelligence Unit bears sole responsibility for the content of this report. The findings and views expressed in this report do not necessarily reflect the views of Invest AD. The report was written by James Watson and edited by Aviva Freudmann. Stephen Edwards assisted with the research.

January 2012

About this research

Our research for this report drew on two main initiatives:

In August and September 2011 the Economist Intelligence Unit conducted a global online survey of 158 institutional investors on behalf of Invest AD. The respondents range from insurance and pension funds through to private banks, wealth managers, hedge funds and mutual funds. Investors represented firms with a range of sizes based on assets under management. About half have up to US\$499m under management, while 22% have at least US\$10bn under management. Respondents were split roughly evenly between North America, Europe, Asia-Pacific, and the Middle East and Africa. All respondents indicated an interest in frontier markets, although not necessarily in Africa.

To complement the survey results, the Economist Intelligence Unit also conducted a programme of in-depth interviews with a range of experts and senior executives. The insights from these interviews appear throughout the report. The Economist Intelligence Unit would like to thank the following individuals (listed alphabetically by organisation name) who participated in the interview programme:

- Ismail Douiri, chief executive officer, Attijariwafa Bank
- Antti Vesa, head of research, Aktia Invest
- Robert Mikkelsen, head of investment, Danske Capital
- Abebe Selassie, head of Africa department's regional studies, IMF
- Nick Greenwood, pension manager, Royal County of Berkshire Pension Fund
- Ronald Pfende, chief financial officer, Stanbic Nigeria

Additional interviews were conducted for background purposes only. The author would like to thank these individuals for their time and contribution.

Key findings

- **Institutional investors see Africa as holding the greatest overall investment potential of all frontier markets globally.**

At an aggregate level, when asked to choose two regions out of five, two-thirds (66%) of investors with an interest in frontier markets see African frontier markets such as Nigeria or Kenya as holding the greatest opportunity. This puts the continent ahead of frontier Asian markets (selected by 44%) and Latin American ones (29%). Many economic forecasters predict that the region's growth rate will outstrip all others in the coming five years. Ghana is likely to be the world's fastest growing economy overall in 2011, for example, expanding at an estimated 16.3%.

- **Institutional investors plan to increase their asset allocation in African markets over the coming five years.**

Even among frontier markets investors, most are only just starting to explore African markets. One in five of those surveyed have zero allocation; among larger investors with more than US\$10bn under management, this is closer to one in three. Another one-quarter (24%) overall has less than 1% allocation, often as part of a pooled investment in global frontier markets. By 2016, however, all expect to have some exposure to emerging Africa, with nearly one-third expecting to shift at least 5% of their fund value there.

- **Investors are moving towards longer-term investment strategies for Africa, rather than more speculative, short-term bets.**

Since 2004-05, Africa's capital inflows can be characterised in two waves: a pre-2008-crisis wave of low-cost capital in search of short-term yield, which evaporated at the collapse of Lehman Brothers; and a post-crisis emergence of more targeted country-specific investments. Nearly two-thirds (64%) of investors agree that market volatility, partly due to limited liquidity, now requires a longer-term investment approach.

- **Africa's emerging middle class is catching investors' eyes, ahead of commodities and natural resources.**

The continent's bountiful natural resources—from 10% of the world's oil to as much as 90% of its platinum group metals—has long made it a largely natural resources play. But it is its emerging middle class, which now numbers more than 300m of Africa's total 1bn people, that is increasingly catching investor attention. Four in ten investors (39%), when asked to choose the top three out of 12 features, selected this as the most attractive aspect of investing in African frontier markets, ahead of high commodity prices (34%) or high growth rates (35%).

- **Investors now worry more about technical concerns than about macroeconomic and political risks, at least in key markets.**

In some regards, Africa's biggest challenge is to overcome deeply entrenched perceptions. But a striking shift that can be observed among investors is a change in focus from macroeconomic and political worries towards more technical market concerns. Investors were asked to choose up to three main concerns out of a list of 15 challenges of investing in African frontier markets. Although bribery and corruption is the headline worry for investors (selected by 41%), concerns about weak institutions (40%) and illiquidity in capital markets (36%) are not far behind. This reflects the steady political and economic stabilisation of many key markets over the past decade. ■

I. Introduction: a north-south role reversal

Africa has had several false dawns. During its drive for independence in the 1950s and 1960s, hopes rose for a dynamic new generation of post-colonial leaders. But those hopes faded in the 1970s and 1980s, for reasons ranging from widespread corruption and despotism, to practical difficulties in realigning national economies that had been set up to cater for colonial needs. Following Russia's perestroika and the collapse of South Africa's Apartheid regime, hopes rose again, only for disappointment to set in as it became apparent that the post-communist "peace dividend" would take longer to pay out in Africa than first expected.

But the past decade has been, by and large, a good one for the continent. Various long-running wars have ended. Multi-party democracy has spread, even though progress remains patchy. Foreign debts and government deficits have been trimmed, and a more competitive

landscape for privatised companies has emerged. Of course, the performance of some countries has been dismal: Zimbabwe's economy contracted from regional breadbasket to near basket case, while the Arab Spring has disrupted several North African states. But barring such exceptions, there is a general sense of renewed optimism.

This may seem an odd time to be considering a renewal of hope in Africa. The good news notwithstanding, news-screens remain filled with images of famine, war and civil insurrections. But Africa is multi-faceted, and these difficulties mask a wider vibrancy in many countries. Despite a deep global recession in 2009, the McKinsey Global Institute argued in June 2010 that Africa's collective GDP would grow by US\$1tr by 2020, taking it to a total of US\$2.6tr¹

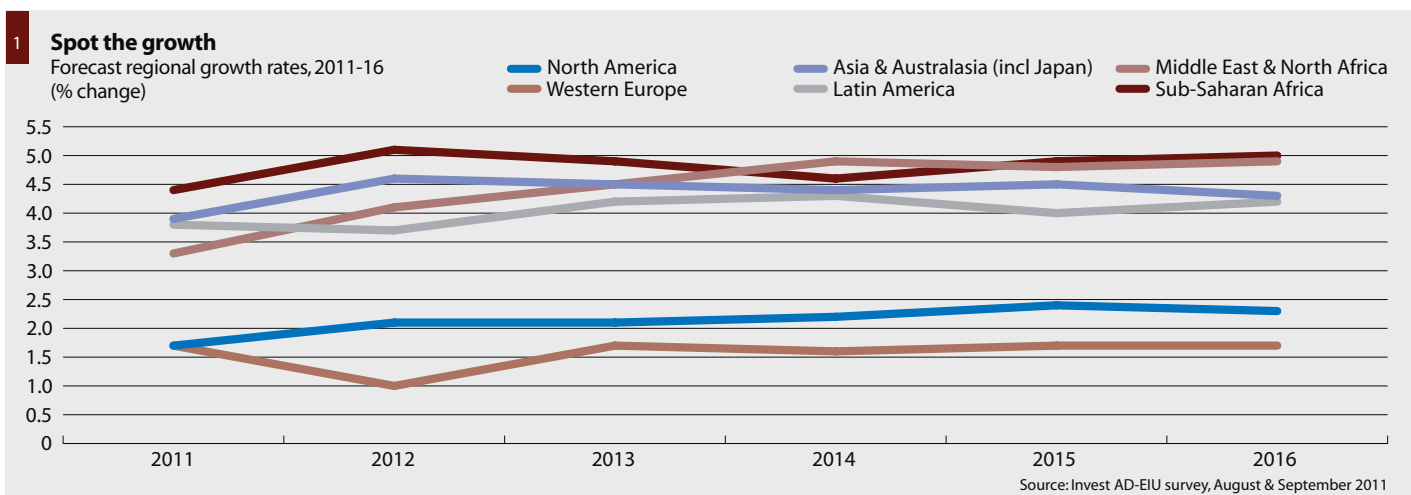
Such forecasts stem from a long-

running boom. During 2004-08, real GDP growth across sub-Saharan Africa was 6.6%, more than twice the pace of the 1980s and 1990s. This slowed to a still-healthy clip of 2.8% in 2009, before picking up again to 4.9% in 2010, according to the IMF². It forecasts growth of 5.5% in 2011, rising to 5.9% in 2012. The Economist Intelligence Unit is slightly less bullish, but still forecasts average real GDP growth of 4.9% between 2012-16. This is well above expected world growth of 2.9% in the same period—is far ahead of Western Europe or North America—and even outpaces Asia, where much investor attention is focused (see table).

Africa's risk-return equation is also put into stark relief by the situation in much of the developed world. The US and the Eurozone governments face years of trying to pare back debts. This will either require reduced spending, higher taxes

¹ *Lions on the move: The progress and potential of African economies*, McKinsey Global Institute, June 2010

² *Regional economic outlook: Sub-Saharan Africa*, IMF, April 2011



“The risk profile of Europe is high risk, low return; it’s the worst of both worlds.”

Ronald Pfende, the chief financial officer of Stanbic Nigeria



or some combination of the two – none of which will boost growth. As such, prospects for Western Europe are poor, with growth of just 1.5% expected over 2012-16.

All this makes for a striking role reversal between north and south. Indeed, many African countries could be forgiven a sense of *schadenfreude* as their northerly

neighbours tackle the same kinds of debt issues that they have had to cope with in past decades. “The risk profile of Europe is high risk, low return; it’s the worst of both worlds,” argues Ronald Pfende, the chief financial officer of Stanbic Nigeria, a Nigerian bank that was acquired by South Africa’s Standard Bank in 2007. “[Across key African markets] the risk has continued to decline, but the yields continue to be high. If people get rational, and not emotional, you will get progressively more money coming through to sub-Saharan Africa.”

For investors seeking strong returns, the African story now seems more interesting. Robert Mikkelsen, head of investment at Danske Capital, a subsidiary of Denmark’s Danske Bank Group with more than €75bn of assets under management, highlights several particular drivers for considering African frontier markets. “We’re looking at perceived low returns in developed markets, so that’s one driver; next is lower correlation with [developed] markets, partially due to

lower liquidity; and finally, these are very emerging markets, so you should be able to pick up some good returns in markets like these.”

Indeed, institutional investors surveyed for this report – all of whom have an interest in frontier markets globally, even if no current asset allocation there – rate Africa ahead of all other frontier regions, in terms of holding the biggest opportunity (see chart). Of course, the key question is whether Africa’s new dawn will prove more durable than before. Inevitably, some doubts remain. For decades, Africa has been a target for aid, rather than trade and investment. Some investors still consider Africa more as a “social responsibility” investment, rather than a real opportunity for yield. This change in perception is exactly what other emerging markets have had to go through. A decade ago, the perceived risk of investing in China or Brazil was starkly different from today. Africa’s markets have yet to become a mainstream consideration for investors. This report sets out to assess whether this is now changing, on the back of a good decade. ■

Africa in figures

- 54 countries, hosting 29 stock exchanges
- Over 1bn people, speaking over 1,000 languages, with 41% under the age of 15
- 52 cities of at least 1m people, with mobile phone penetration of about 50%
- Over 300m people now classified as “middle class”; up 27% from 2000
- 60% share of the world’s arable land yet to be cultivated

- 10% of world’s oil reserves, 40% of gold reserves, and 80-90% of chromium and platinum group metals
- Average inflation during 2000s was 8%, down from 22% in 1990s
- Average government debt as a percentage of GDP was 59% in 2000s, compared with 81.9% in 1990s
- During the same period, average budget balances have narrowed from -4.6% to -1.8% of GDP

Sources: McKinsey, IMF, Ernst & Young, African Development Bank, Research and Markets

II. A hopeful decade: Africa's changing image

On the whole, the past decade has been a good one for Africa. In a continent commonly associated with autocratic rulers, there has been an encouraging spread of elections and multi-party democracy. The most recent has been in Zambia, where citizens peacefully voted out a party that had ruled for 20 years—and the defeated President actually stood down. As the Economist recently noted, such behaviour is still unusual, but democracy is now far more widely practiced³. Between 1960 and 1991, only one of Africa's 53 countries held peaceful elections—Mauritius in 1982. Since 1991, however, 30 ruling parties or leaders have been voted out, from Kenya and Ghana to Nigeria and Benin.

Greater accountability and political stability at the top has helped introduce other macroeconomic reforms. One spur to reform has been various debt-relief programmes, such as the joint IMF-World Bank HIPC (Heavily Indebted Poor Countries) scheme, which has given US\$72bn of debt relief to 36 countries,

³ *Democracy in sub-Saharan Africa: It's progress, even if it's patchy*, Economist, October 1 2011

including 30 across Africa, in exchange for various reforms⁴. Across the continent, average inflation rates have fallen from 22% in the 1990s to 8% during the 2000s, while average government debt overall has fallen 28%. Both corporate taxes and trade barriers have been cut, and institutional bodies strengthened in many places. A privatisation trend that started in the 1990s has continued and accelerated.

All this is steadily transforming the economic landscape. McKinsey estimates that after declining in the 1980s and 1990s, labour productivity increased by an annual average of 2.7% between 2000-08⁵. According to a recent forecast from Standard Bank, a South African bank, Ghana will grow by 16.3% in 2011, making it the fastest growing economy in the world⁶. It has not been alone: between 2001-10, six of the ten fastest growing economies in the world were in Africa⁷.

⁴ *Debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative*, IMF, September 6 2011

⁵ *Lions on the move: The progress and potential of African economies*, McKinsey Global Institute, June 2010

⁶ *African markets: navigating slowing global growth currents*, Standard Bank, 16 September 2011

⁷ *Africa's impressive growth*, Economist, January 6 2011

Related to this has been a steady increase in foreign direct investment (FDI), which rose to US\$55bn in 2010 from just US\$9bn in 2000, according to UNCTAD. On the ground, companies are paying far greater attention to Africa's emerging consumer class. Unilever is one example. In September 2011, it made Africa one of its eight global operating regions for the first time, to cater for an average 10% revenue growth in the region, compared with 4% across the firm as a whole⁸. Investors see similar interest rising elsewhere. "Three years ago, people were very uncertain about the risks of Africa, but we now see certain investments happening from some firms," says Mr Mikkelsen. "There's a belief in the corporates that they're willing to invest in Africa."

This upsurge in consumer interest has coincided with a fall in average risk ratings in many countries. Across 19 key African economies rated by the Economist Intelligence Unit (excluding South Africa), overall country risk ratings have fallen by an average of 7.6 points to 52.7 (out of

⁸ *Unilever: Mr Africa, I presume?*, Financial Times, October 4 2011

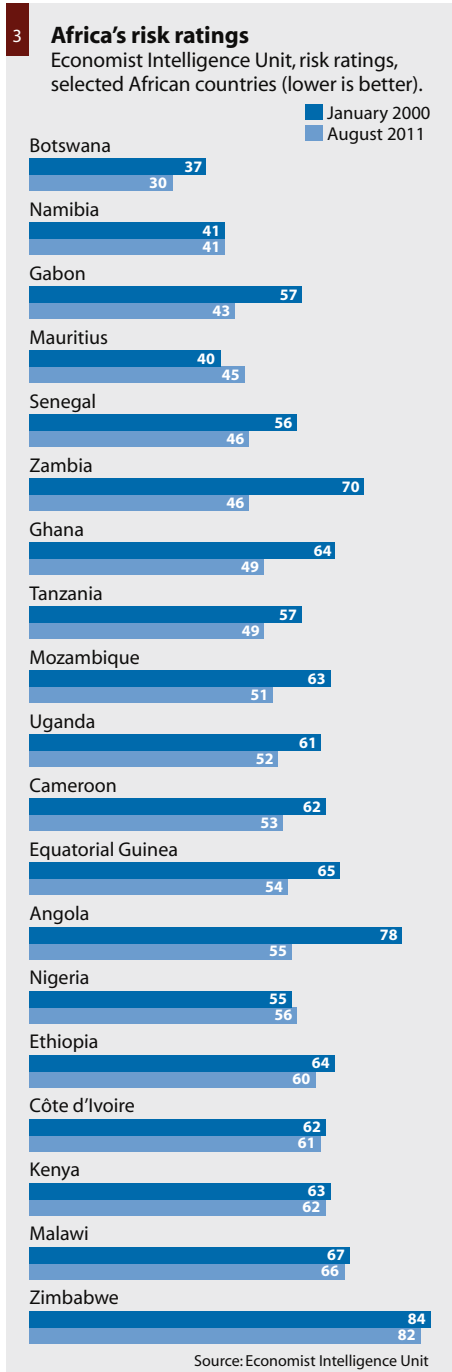
Not a bad growth story

Real GDP growth, 2004-12, by category of country

	2004-10 average	2011	2012
Oil-exporting countries – Angola, Cameroon, Chad, Rep. of Congo, Equatorial Guinea, Gabon, Nigeria	7.8	6.7	6.9
Middle-income countries (excluding South Africa) – Botswana, Cape Verde, Lesotho, Mauritius, Namibia, Seychelles, Swaziland	3.7	4.7	5.1
Low-income countries – Benin, Burkina Faso, Ethiopia, Ghana, Kenya, Madagascar, Malawi, Mali, Mozambique, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia	6.0	6.1	6.7
Fragile countries – Burundi, Central African Republic, Comoros, Democratic Rep. of Congo, Côte d'Ivoire, Eritrea, Gambia, Guinea, Guinea-Bissau, Liberia, Sao Tome & Principe, Sierra Leone, Togo, Zimbabwe	3.4	0.6	5.7

Source: IMF

Capital inflows to Africa's frontier markets have increased steadily over the past decade.



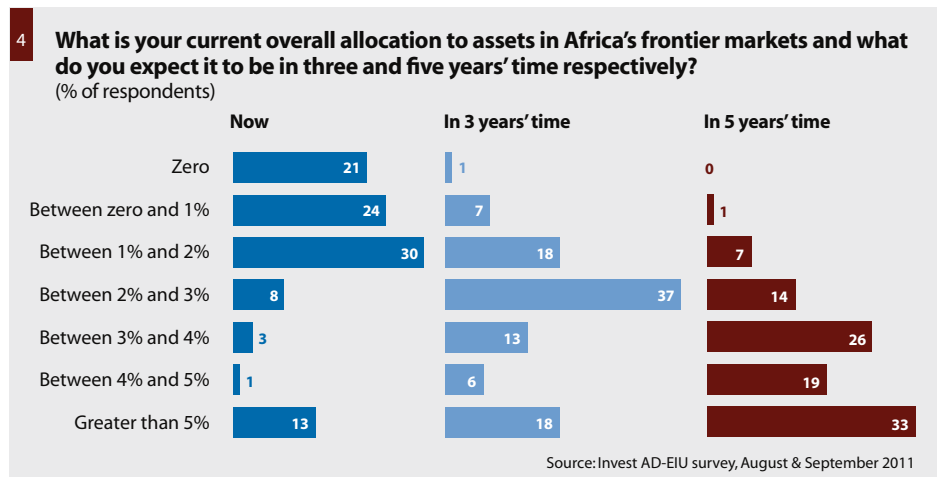
100) between January 2000 and August 2011 (see table). At a basic level, there has been a “peace dividend” paying out in Africa, as the average number of serious conflicts recorded each year has nearly halved from 4.8 in the 1990s to 2.6 in the 2000s, according to McKinsey. In each instance, such as in Angola, a strong growth spurt has followed.

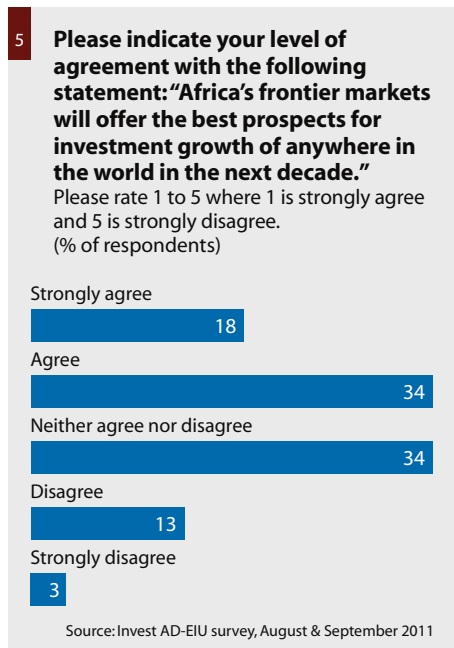
Given these two trends, capital inflows to Africa's frontier markets have increased steadily over the past decade. Abebe Selassie, head of the regional studies division within the IMF's Africa Department, says these inflows have come in several waves. One pre-crisis wave was driven in part by a global liquidity glut, which was halted sharply when Lehman Brothers collapsed in 2008. But over the past two years, capital inflows have picked up again, albeit with greater differentiation on specific markets.

According to investors polled for this report, this trend is set to continue in the coming five years. Most strikingly, while

21% of institutional investors today have zero allocation in Africa, this drops to just 1% in three years' time. In five years' time, all say that they will have some allocations in Africa (see chart). Of course, such allocations will for the most part be small. Most have a less than 2% allocation today, but expect to hold between 1% and 5% by 2016. This is especially true for smaller funds, with less than US\$500m under management, and private banks: across these, nearly nine in ten have at least some allocation towards African markets, but there is significant appetite from a range of fund sizes and types.

One example is the Royal County of Berkshire Pension Fund, which expanded its asset allocation into Africa in 2010 for the first time, as part of a broader embrace of emerging markets. Overall, about 10% of its £1.4bn fund is now invested in emerging markets, of which about 2.5% goes to frontier markets, including Africa. “The intention is that this will be increased,” says Nick Greenwood,





the fund's manager. Larger funds polled typically show a bigger appetite for the longer term, not least as capital markets mature sufficiently to be able to absorb larger sizes of investment. Overall, 51% of investors polled – regardless of their size – agree that Africa's frontier markets will offer the best overall prospects for investment growth in the next decade (see chart).

Partly as a result of that conviction, about one in three investors, regardless of their size, expect to put at least 5% of their portfolio into Africa by 2016. Even if conditions cause this ambition to shrink a little, this will still mark a dramatic shift from a decade earlier. ■

III. Barriers to investment



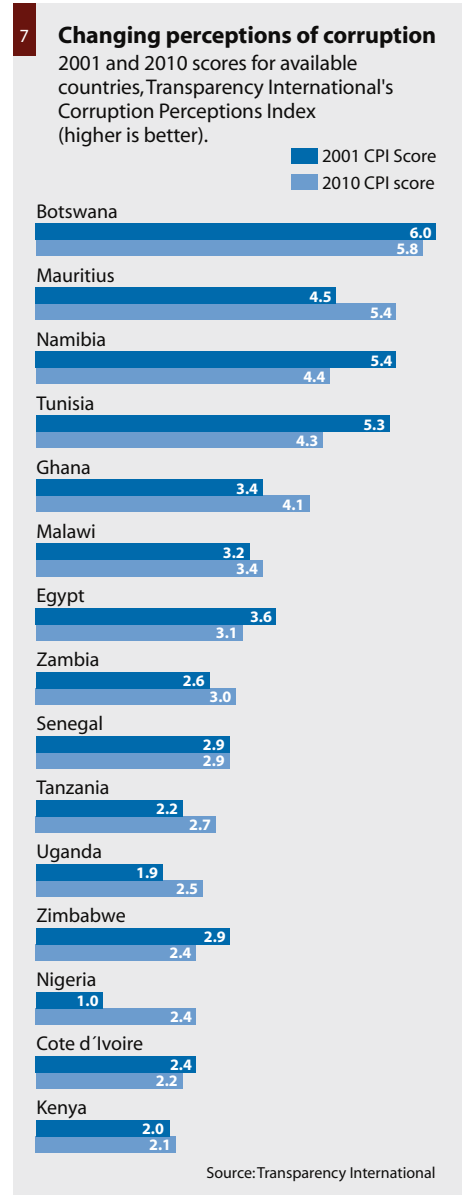
Africa has had much to cheer in recent years, but it remains the world's least developed continent. Wide-ranging risks remain and investor enthusiasm remains tempered by enduring concerns. The most obvious of these is the clear political risk in some countries. The Arab Spring has resulted in some government changes, but a stable new order has yet to take hold. It may have been a good decade

past, but that doesn't guarantee a good decade ahead.

From an investor perspective, what is interesting to note is that technical issues now jostle with traditional concerns, in terms of the challenges that worry them. Political risk is a concern, but less so than illiquidity in markets, or weak legal and governmental institutions. For smaller funds that are already more active in Africa, illiquidity tops the list by some margin. Near the bottom of the list is macroeconomic volatility, a sharp reminder of how far the continent has already come in some regards. The challenge for Africa, however, is that advanced economies such as Ghana and Botswana can sometimes be confused with their less advanced neighbours.

Overall, bribery and corruption remain investors' main worry (see chart 6). Anecdotally, many executives and interviewees suggest that improvements are being made on this front, but this is where Africa's perception problem is greatest. Most African countries remain lodged in the lower rankings of International's (TI) Corruption Perceptions Index. Of 15 African countries tracked in 2001, eight had improved their scores by 2010, with one remaining at the same level, but six had declined over the period.

As many executives point out – and as TI's index indicates – corruption is hardly unique to Africa. It is similarly rife in other emerging markets, including all the BRIC countries. "There's some corruption, but those risks are also within any other country," says Antti Vesa, the head of research at Aktia Invest, a division



of Finland's Aktia Bank. "We invest in emerging markets quite heavily, and it's a pretty similar situation [across those]." Mr Greenwood agrees: "There's a perception gap. You get this broad-brush approach

“I think there is a growing realisation that capital markets do need to develop. The democratisation process and this are interlinked, as [the former] flows through to better governance and better ownership rights.”

Nick Greenwood, fund manager

regarding corruption, whereas the reality is perhaps different. Some so-called frontier markets are less corrupt than some well known developed markets.”

Most tellingly, concerns about corruption are twice as high among investors with no current exposure to African markets compared to investors with current exposure (64% compared to 33%). Among those who are already invested in Africa, the main concern by a wide margin is illiquidity.

Institutional challenges

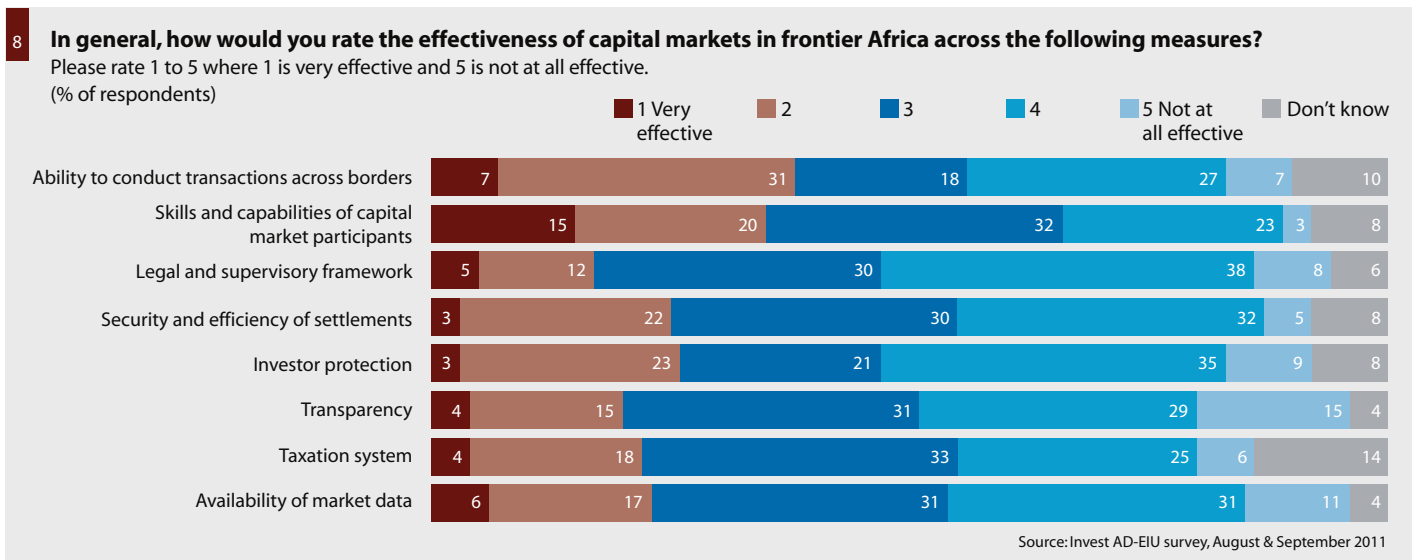
The mechanisms for conducting and executing trades are one of Africa’s greatest weaknesses, at least from an investor perspective. In general, investors rate the effectiveness of various key measures of Africa’s capital markets poorly. Only a handful considers issues such as the security and efficiency of settlements,

availability of market data, or the ability to conduct cross-border transactions to be “very effective” (see chart). Nevertheless, the overriding sentiment is that of slow, but steady improvement. “I think there is a growing realisation that capital markets do need to develop,” says Mr Greenwood. “The democratisation process and this are interlinked, as [the former] flows through to better governance and better ownership rights.”

Underpinning this is the fact that improvements to the overall business and political environment continue to be hard fought. Mauritius places highly (20th out of 183 economies) on the World Bank’s 2011 Doing Business rankings, but is a tiny market. Botswana is next highest in 52nd position, whereas bigger markets such as Egypt and Nigeria languish in 94th and 137th place, respectively. Some have improved, such as Zambia and Cameroon,

but all place relatively poorly and many have slipped.

imilarly, although the trend is moving in the right direction, democracy remains patchy. Only one country, Mauritius, is rated as a “full democracy” in the Economist Intelligence Unit’s 2010 Democracy Index. A further eight are regarded as “flawed democracies”, along with the likes of India, Poland and Peru. But all the rest fill the ranks of so-called “hybrid regimes” or “authoritarian regimes”, such as Ethiopia, Angola and Zimbabwe. All this isn’t necessarily as grim as it sounds. Regardless of the model of democracy, more granular indices suggest that governance in general has improved over the past half decade. The 2010 Ibrahim Index of African Governance shows that just 11 of Africa’s 53 countries had a worsening governance situation since 2004-05, while nearly all others improved,

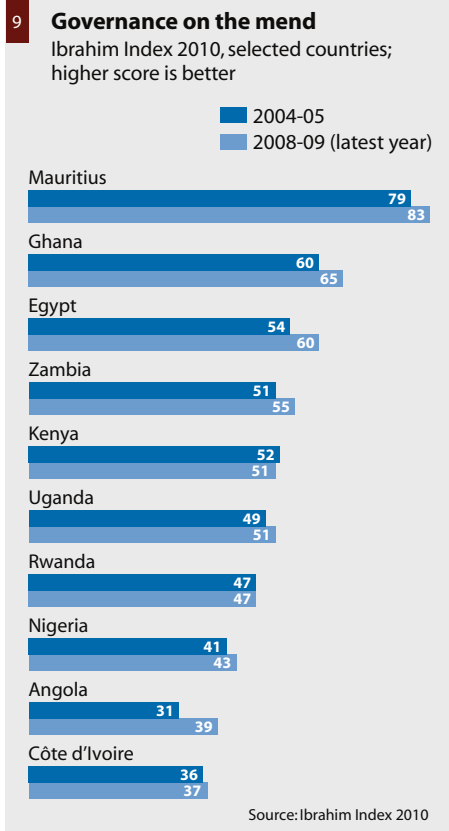


“Africa has been in similar stages regarding stock markets for years now, and hasn’t risen to the level of other emerging market countries, so we’re still a bit sceptical.”

Antti Vesa, the head of research at Aktia Invest

and several markedly so (see chart).

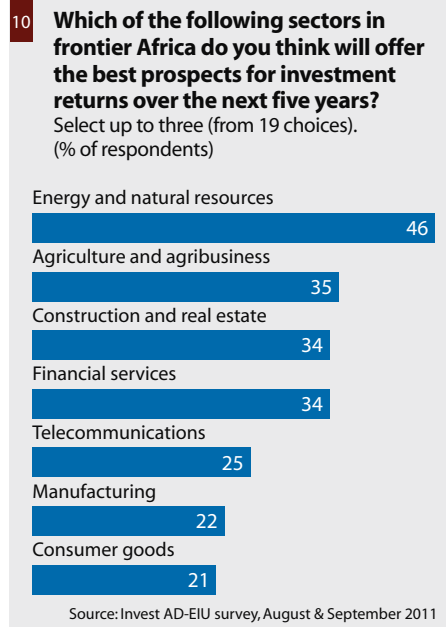
All this has been put to the test in the past three years, as Africa has taken on the massive exogenous shock of the global financial crisis. On aggregate, it has performed well, argues Mr Selassie, including being one of the only regions that actually grew during 2009. “Countries enacted policies very nimbly, very effectively. There’s no longer this sense that macro-populism is going to help countries [develop]. Rather, the challenge remains more that of micro-reforms, such as tax compliance, ensuring companies books are audited, those kinds of things.”



Commodity market worries

Beyond such institutional concerns, a different worry is that of an overreliance on the global commodity boom. Africa’s vast mineral wealth has been a source of good fortune (although much remains untapped), but there is clearly a concern that many economies could slow if commodities collapse. This is also reflected in the fact that investors see the highest prospects for return from energy and natural resources (see chart). However, interest is also high in other sectors, including construction, financial services and telecommunications, as these steadily emerge.

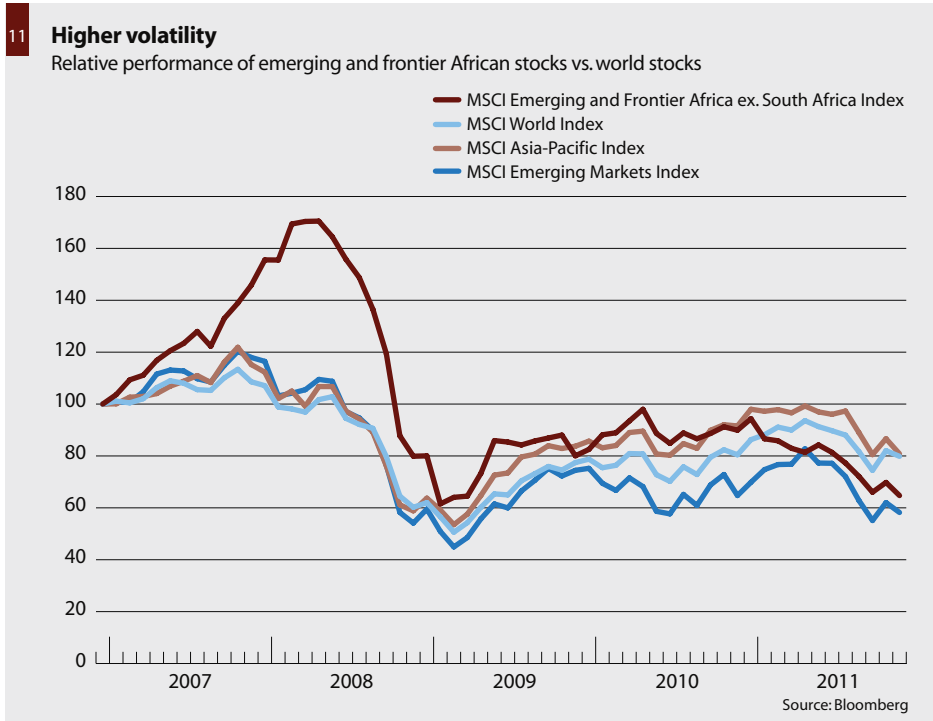
As such, an expanding consumer class is steadily helping to counteract concerns about an overreliance on resources, by driving up local demand. According to



McKinsey, the continent’s households spent a total of US\$860bn in 2008, more than in India or Russia. It projects this to grow to US\$1.4tr over the coming decade, with particular growth in food and beverages, banking, telecoms and housing. A thriving commodity market could help catalyse this, but a drop in prices likely won’t derail the process. Although oil-exporting countries have experienced the highest growth since 2004, strong performances have been made among both middle and low-income countries.

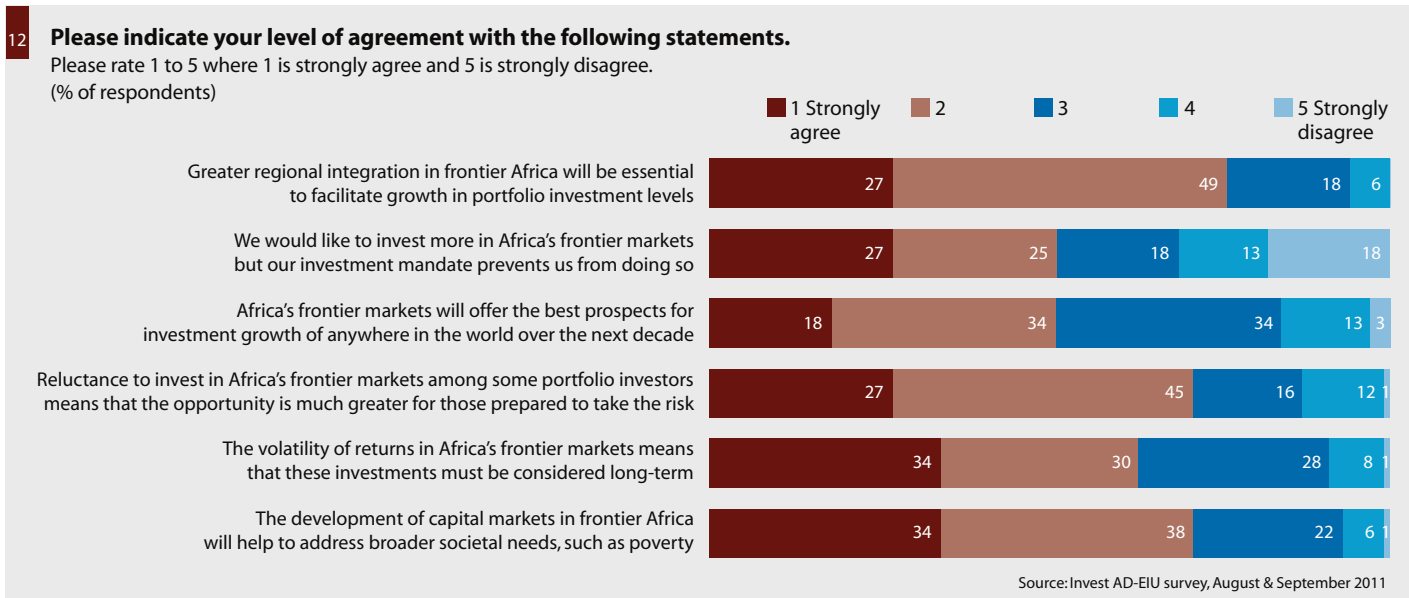
A related worry is that Africa’s equity markets are far from immune to global stock market turmoil. As chart 11 shows, Africa’s frontier markets have moved roughly in tandem with global markets. Despite the fact that few African companies were directly exposed to any toxic financial instruments in the financial crisis, equities have been punished anyway. The impact has largely been felt through indirect channels, such as reduced export demand and lower remittances. Nevertheless, it is not hard to find scepticism among investors, in terms of African equity performance. “Africa has been in similar stages regarding stock markets for years now, and hasn’t risen to the level of other emerging market countries, so we’re still a bit sceptical,” notes Mr Vesa.

Equally, when turmoil sets in, investors globally flee towards perceived safe havens. On the flip side, as many investors are quick to point out, the flight from risk has left a significant mismatch in valuations, meaning that otherwise



promising stocks are potentially trading very cheaply. This is a strongly held view: about seven in ten investors (72%) agree that reluctance among portfolio investors to target Africa's frontier markets gives them a greater opportunity to profit. And appetite for a greater weighting in these markets is notably higher among firms that already have some allocation there today.

But some are simply constrained in their ability to do so: over half (52%) of those polled say that they would like to invest more in Africa's frontier markets, but their investment mandates prevent them from doing so. "If things get better then we will probably see some African punts as well within our distribution. Our clients have risk limits, so they don't really have the buffer to go to the African markets," notes Mr Vesa. ■

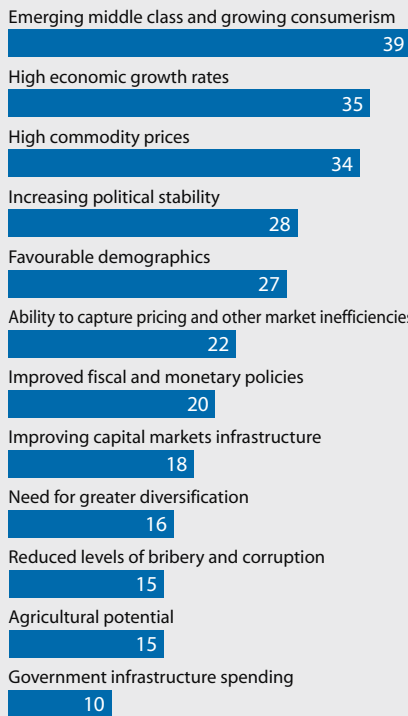


IV. The new investment case for Africa

As Africa's markets evolve, so too do investors' views of it. The continent has long been seen as a pure natural resources play, with many investors gaining exposure via international mining stocks. While this still holds true to some extent, investors' motivations are changing. At a high level, institutional investors show particular interest in the trend of rising consumerism and Africa's emerging middle class, rating this as the most attractive aspect overall of investing in African frontier markets,

13 What do you consider to be the most attractive aspects of investing in African frontier markets?

Select up to three (of 12 choices).
(% of respondents)



Source: Invest AD-EIU survey, August & September 2011

ahead of raw economic growth and high commodity prices (see chart). This view is especially held by both the largest and the smallest funds surveyed, whereas the mid-sized ones lean more towards growth and commodities.

Regardless, Africa's burgeoning middle class is gathering momentum. The African Development Bank estimates that about one in three Africans is now defined as "middle class", using an absolute definition of daily expenditure between US\$2 and US\$20⁹. This amounts to well over 300m people, a 27% increase since 2000. Along with this, sales of mobile phones, TVs, food and beverages, vehicles and other consumer goods have picked up. "Africa is definitely being looked at as a source of growth," says the IMF's Mr Selassie. "We see a lot of interest in the region. But markets remain fairly narrow, in telecoms, financial services, fast moving consumer goods, beer, soap and so on."

⁹ *The middle of the pyramid: dynamics of the middle class in Africa*, African Development Bank, April 20 2011

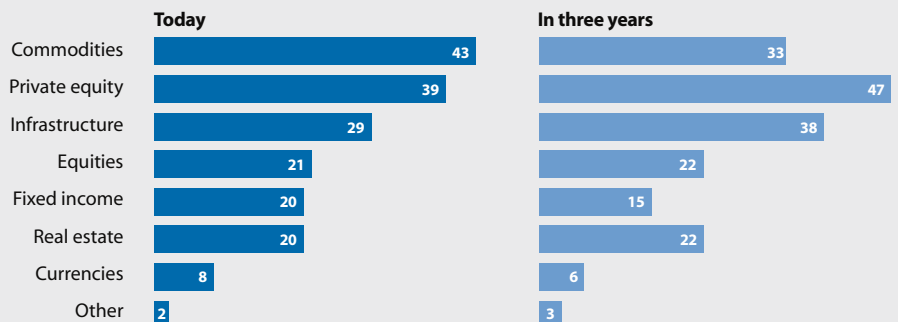
This gets to the heart of a key shift in investor interest in recent years. During 2005-07, according to Ernst & Young, FDI was largely focused on natural resources, including minerals, coal, oil and natural gas¹⁰. But between 2007-10, there was a strong diversification into more consumer-oriented areas, such as tourism, consumer products, construction, telecoms and financial services. The Invest AD-Economist Intelligence Unit survey shows a similar shift in focus playing out amongst institutional investors: commodities as an investment class is expected to decline in popularity, from the most popular today, to third overall. Private equity and infrastructure will gain the most ground to become the two most popular asset classes. Equities will remain part of the mix, as the fourth most popular asset class.

In terms of the investment vehicles favoured, 40% of investors expect to use

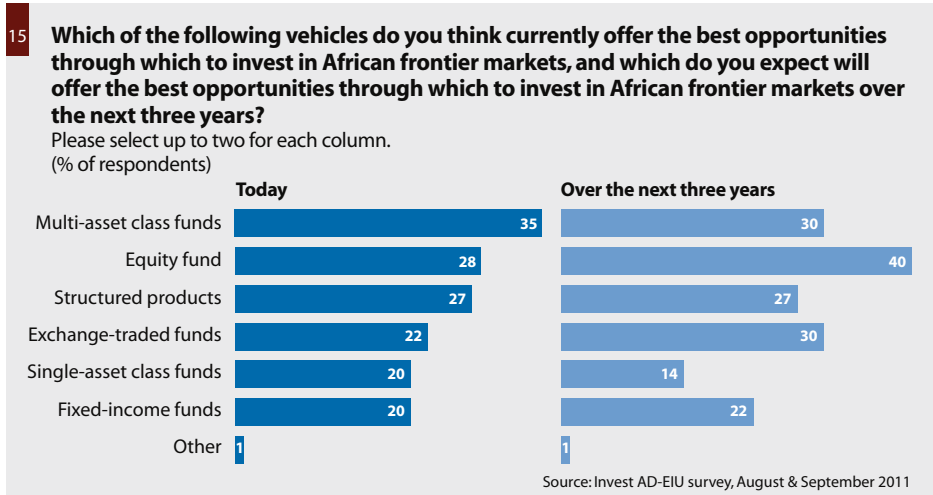
¹⁰ *It's time for Africa: 2011 Africa attractiveness survey*, Ernst & Young, 2011

14 Which of the following asset classes do you think offer the best opportunities for investment in Africa?

Please select up to two for each column.
(% of respondents)



Source: Invest AD-EIU survey, August & September 2011



equity funds in the coming three years, trailed by both multi-asset class funds and exchange-traded funds (both 30%). All this is a shift from today, where multi-asset class funds are currently most popular (35%), followed by equity funds (29%) and structured products (27%).

To some degree, this picture will likely evolve as more investment products become available. Berkshire Pension Fund's Mr Greenwood uses one pooled vehicle, as "there are not many alternatives". Another benefit he sees in such an approach is that it limits the time and processes involved in settling and holding stocks directly. "If there's 25 emerging market countries and a 10% weighting [towards those], it's less than half a percentage of the fund, requiring powers of attorney and local accounts and so on. So it's easier to do via a pooled fund."

Maturing corporates—and investors

Another factor that is helping boost interest in equities has been a general improvement in corporate governance, with increased transparency, reporting and dialogue between investors and corporates. All interviewees talk of a marked improvement. "I've been in Nigeria for about three years now, and from what I saw then and today, it's chalk and cheese," says Mr Pfende. "As you started to get to the tail end of 2006-07, more people globally were investing in Nigeria and they wanted information, so that's been a push, and there's been progressively more data provided."

Mr Pfende also notes other shifts, such as more investor conferences to discuss results; firms publishing regular reports to their websites; and business leaders holding investment road shows both locally and abroad. "All of that has developed quite well over the past three

years, but there's still a long way to go," he says. Investors agree, noting that while the availability of information is far from uniform, there has been a marked improvement. "[Corporates] understand they've got to be better on transparency and governance," says Mr Greenwood.

A broader shift in investor perceptions is towards a more selective, longer-term view of African markets. In this sense, the financial crisis has at least had one positive effect, which has been to deter the short-term speculative investments, or "hot money," that had been a major facet of capital inflows up until late 2008. Ismail Douiri, the chief executive officer of Attijariwafa Bank, a long-established Moroccan financial services firm operating across several North African markets, says foreign investors have typically been opportunistic, looking primarily at the valuation side. He notes that investors



CASE STUDY:
Stanbic Nigeria & Attijariwafa Bank

Two African banks see strong, but contrasting, growth prospects ahead

Morocco's Attijarawafa bank already has a long heritage, stretching back over a century, but is still finding scope for growth. It is Africa's 6th largest bank, but second biggest overall outside of the South African market. Given Morocco's relative maturity and banking penetration, it has been eyeing future growth in its less developed neighbours for some time now. "We're looking for growth in markets with similar attributes to ours, but with limited competition and huge margins, against a higher cost of risk," explains Ismail Douiri, the bank's CEO.

Since 2005, it has expanded its retail banking into new markets, with a mixture of M&A and greenfield sites, capturing market share in Tunisia, Senegal and Côte d'Ivoire, through better processes and local innovations. "Usually foreign banks skim the market and just address multinationals or private banking clients, but we're now doing what we did in Morocco 20 years ago, which is going deep into the economy and increasing our banking penetration," says Mr Douiri. One example of its innovation has been to partner with others to target poorer neighbourhoods, such as money transfer

firms, offering simple, low-cost banking products under a different brand. More recently, the Arab Spring in Tunisia has given it a further boost, by making business simpler and more transparent than before.

By contrast, Stanbic Nigeria is closely focused on its domestic Nigerian market. Here, growth opportunities feel vast, with less than one in seven of the country's 158m people holding a bank account. Despite this, many local banks have struggled to come back from a 2009 downturn that exposed how overleveraged many were. "From an industry perspective, the last two years have really been to a large extent a very inward focused approach, with banks reassessing risk appetite and risk management processes," explains Ronald Pfende, the bank's CFO. Thanks in part to its 2007 acquisition by South Africa's Standard Bank, which involved deleveraging its entire capital market exposure, Stanbic has come out sailing. "We've been one of the few looking externally," says Mr Pfende. "The private sector has had single digit growth, while we grow at 40% per annum [albeit from a low base]."

As in other African countries, the future of banking in Nigeria is very likely to be mobile. Although fewer than 20m people hold bank accounts, over 90m now use mobile phones. "There's 11 licenses for mobile banking and so now it's a race against time to see which bank comes out with an offering that captures people," says Mr Pfende. Across both mature and more vibrant African markets, much potential awaits.

have come in when price-to-earnings (P/E) ratios have been at 15 or below, but leave when it reaches 18 or above.

Mr Selassie characterises this earlier capital flow as a first wave, which came to a screeching halt with the collapse of Lehman Brothers. As capital inflows

have returned since 2010, there has been significantly more capital targeted to specific markets, with countries such as Ghana, Mauritius and Zambia in particular attracting capital flows. This more focused targeting is being matched with a generally longer-term perspective from

institutional investors. Nearly two-thirds (64%) of those polled agree that due to the volatility of returns in Africa's frontier markets, such investments must be considered long-term. ■

V. Investor perceptions versus market reality in key markets

As this report has argued, investors are starting to differentiate between African countries, although far more of this will be needed. Investors are naming highly diverse countries as offering the best prospects for investment returns in the coming three years. In terms of popularity with investors, Nigeria and Kenya top the list, followed by Zimbabwe and Egypt (see chart).

Of these four leading countries, Zimbabwe is a special case. Prior to its disastrous agricultural reforms and destabilising politics of the past decade, it had a well-educated populace and a thriving economy. Much of this lies dormant, as its leader – Robert Mugabe, one of Africa’s last “big men” – clings to power. But his departure, when it comes, could pave the way for a rapid economic turnaround. Of the other three leading markets, a potential gap remains between investor sentiment and market reality, in terms of both downside risks and missed opportunities. This chapter touches on three examples of these.

1. Nigeria—investor’s primary target, but challenges remain

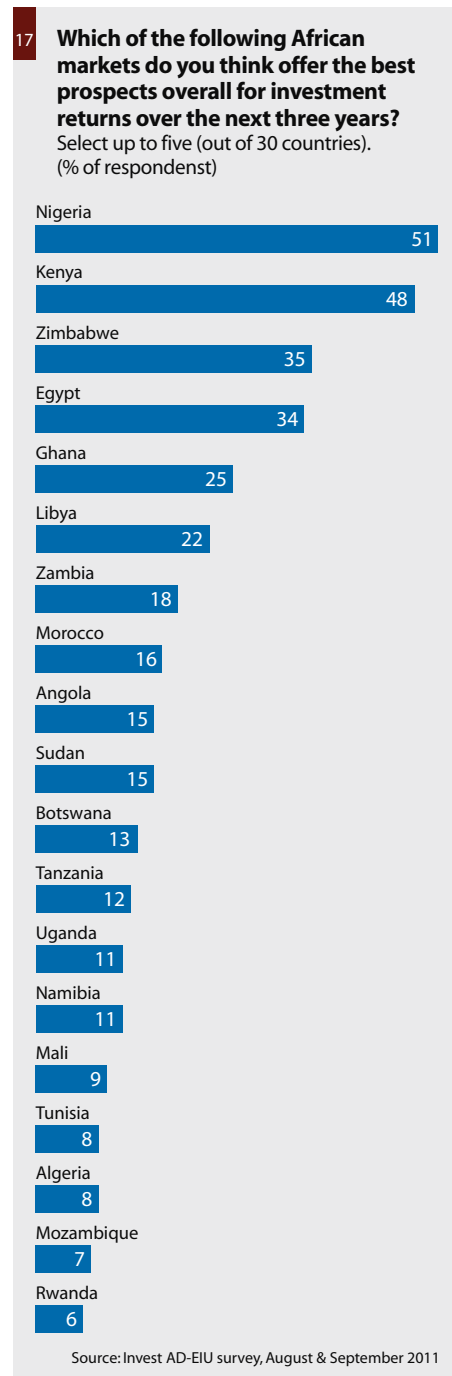
Nigeria tops investors’ list overall, chosen by more than half as the country with the best prospects for overall investment returns over the next three years. Why are investors so bullish? And more importantly, are they right? The country’s most compelling trait is its large population: at 158m, it has three times as many people as South Africa and over half that of the USA. It also has 37bn barrels of proven oil reserves, making it one of the

top ten oil countries globally.

Nigeria has also reformed its economy in significant ways in recent years. For example, the Central Bank reformed the banking sector, which had been labouring under the weight of nonperforming loans. It set up an asset management company which took on bad loans from troubled banks. At the same time, the regulator allowed failed banks to be taken over by local and foreign financial institutions. The result was a consolidation—with the sector going from a peak of 90 banks in the mid-2000s to 24 banks by the end of the decade—and a stronger sector overall.

All this fuels Africa’s second largest economy (after South Africa), with average real GDP growth of over 7% for nearly a decade now. This has clearly been boosted by demand for oil, but other sectors are also developing. Agriculture and services together contribute just as much to GDP as the oil-dominated industrial sector. Meanwhile, consumer prospects are huge, and most companies expanding into West Africa see Nigeria as the gateway to the region.

But despite this vast potential, there is good reason for caution. Corruption is endemic, bureaucracy is slow and crime rates are high. Ethnic and religious conflict leads to sporadic violence and uncertainty over Nigeria’s stable democratic future. Democracy remains fragile, despite a largely successful election in April. Infrastructure spending is increasing rapidly, but much existing infrastructure is creaking, particularly in power generation (there are widespread shortages) and transport (of which



there is not much). Nigerian businesses also have to cope with an inconsistent regulatory environment, restrictive import regulations, inadequate access to capital and a relatively weak judiciary. The country is ranked 137th out of 183 in latest edition of the World Bank's Doing Business report. In short, huge potential awaits, but investors need strong nerves.

2. East Africa—Kenya is popular, but a wider story is emerging

The East African Community (EAC) is an emerging economic cluster comprising Burundi, Kenya, Rwanda, Tanzania and Uganda. It aims for economic and political integration between the states, although developments so far remain modest. A customs union was established in 2005, followed by a common market in 2010, but bigger steps are planned, including a common currency (the East African shilling), with the distant possibility that the five states may federalise at some point, creating a single sovereign state that would become the second most populous in Africa.

Of these countries, Kenya receives the most investor attention. But sentiment is less bullish on its neighbours, which could be a significant missed opportunity. Uganda, for example, averaged GDP growth of 6.9% per year between 1990 and 2009. Rwanda and Tanzania have also expanded rapidly since the early 2000s (7.7% per year in Rwanda, 6.8% in Tanzania). In fact, since 2005, these three EAC countries have been among the fastest growing economies in the world, with annual average growth rates of

nearly 8%.

Looking ahead, Rand Merchant Bank, a South African bank, forecasts that four of the five EAC countries (Tanzania, Uganda, Kenya and Rwanda) now rank in the top twelve most attractive African countries for investment¹¹. It is still early, but the civil strife and economic instability that held these countries back last century has been replaced by sound monetary, fiscal and macroeconomic policy, increasingly open markets, and strengthening institutions. They would well usher in another decade of rapid growth.

3. Egypt—where to next for North Africa's giant?

The dust is yet to settle following Egypt's political upheaval. After 30 years, the regime of Hosni Mubarak has finally ended, but this dramatic change has left considerable political uncertainty, which has caused the economy to stall. Real GDP growth is expected to be just 1.2% in 2011. As such, investors are clearly in 'wait and see' mode, but there is good reason for optimism.

Egypt is the most populous Arab country, with most of its 83m people located in a concentrated geographical area. While the country spans nearly 1m square kilometres of land, just 5% is inhabited and cultivated. This makes it a relatively accessible market for many companies. Its location at the crossroads of Europe, Africa and the Middle East also makes it an important and influential

market. A further reason for optimism is the country's sizable middle class of around 8m people, with similar spending power as some developed countries. This number will likely grow rapidly: the Economist Intelligence Unit forecasts GDP per head to expand by 70% between 2010 and 2015.

But although a more stable political system is expected to emerge in Egypt, the uncertain scope and timings of the process represents a clear risk. The country remains in the hands of the military, while many contentious issues around elections, government formation and the constitution remain unresolved. Egypt could well be without a president until December 2012, if not later. ■

¹¹ *Where to invest in Africa*, Rand Merchant Bank, August 15 2011

Conclusion

The 2008-09 financial crisis has done much to alter the perceptions of investors about Africa's frontier markets. As this report has argued, the global risk-return equation between North and South, while far being reversed, is giving investors seeking yield pause for thought. At a high level, this reflects a long-overdue assessment of highly-performing individual African economies, rather than the continent as a whole. The same process has been underway for the past two decades in China, as investors have shifted from simply making a "China play"; to more targeted investments within specific regions.

For their part, African markets, and a swelling crop of rapidly growing corporates, clearly need to do more to inform markets of their relative merits. Similarly, investors need to start devoting more attention to understanding individual markets. What would further speed this would be greater consolidation

and integration between countries, as well as national bourses. Africa now boasts some 29 stock exchanges, but most only host a handful of stocks. This limited liquidity impedes investors from realistically considering these markets. Two regional bourses have emerged, Abidjan's BRVM and Libreville's BVMAC. But further consolidation would do much to help, as would clearer, standardised rules.

Such challenges reflect the nature of the issues ahead, which deal less with the macroeconomic concerns of yesteryear, and more with the microeconomic factors that currently slow down the flow of capital. For both African markets, and potential investors, this has been the most significant transition in recent years. To a large extent, the growth story is now widely known; the new questions concern the pattern, quality and sustainability of that growth. ■

Appendix: survey results

What type of institutional investor are you?

(% of respondents)

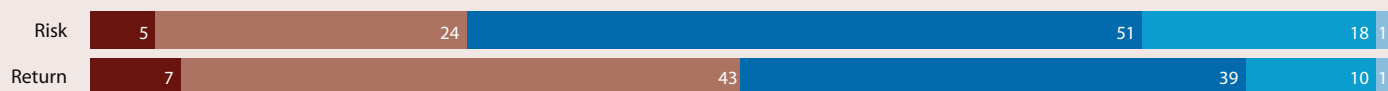


Over the next three years, what change do you predict to the level of risk and return on your overall portfolio investments?

Please rate 1 to 5 where 1 is significant increase and 5 is significant decrease.

(% of respondents)

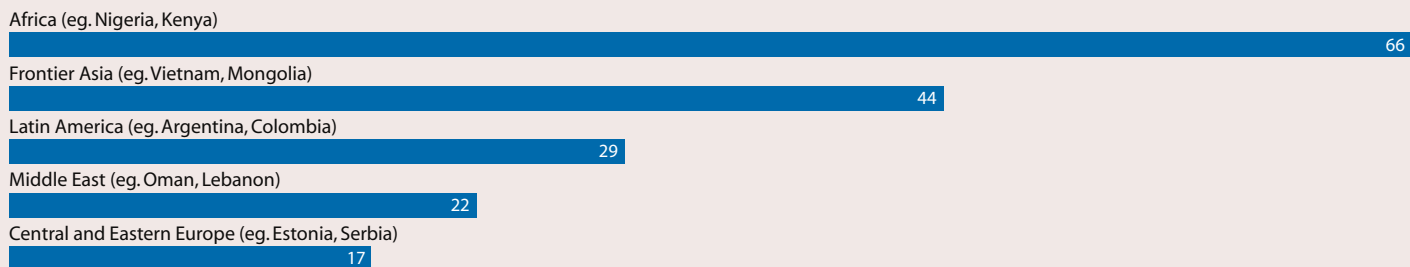
1 Significant increase 2 3 4 5 Significant decrease



In which of the following frontier markets do you see the biggest opportunity?

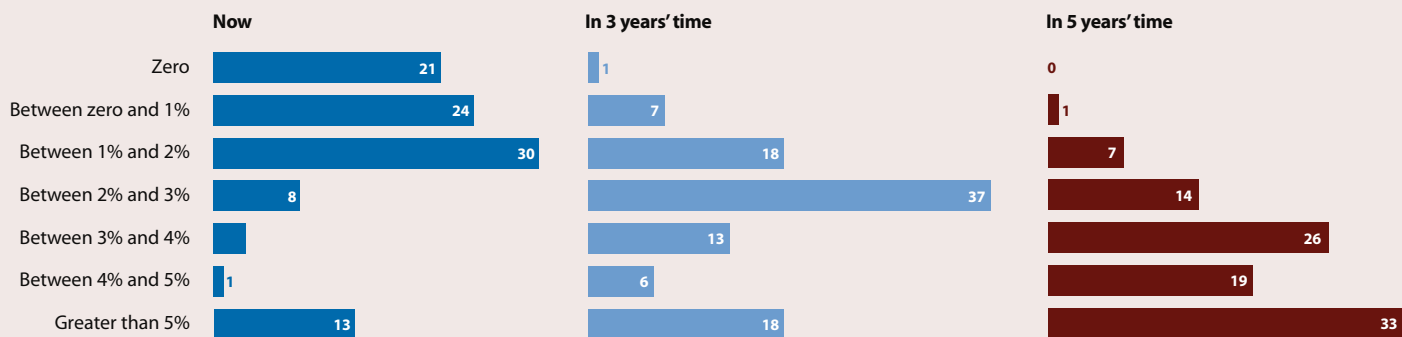
Select the top two.

(% of respondents)



What is your current overall allocation to assets in Africa's frontier markets and what do you expect it to be in three and five years' time respectively?

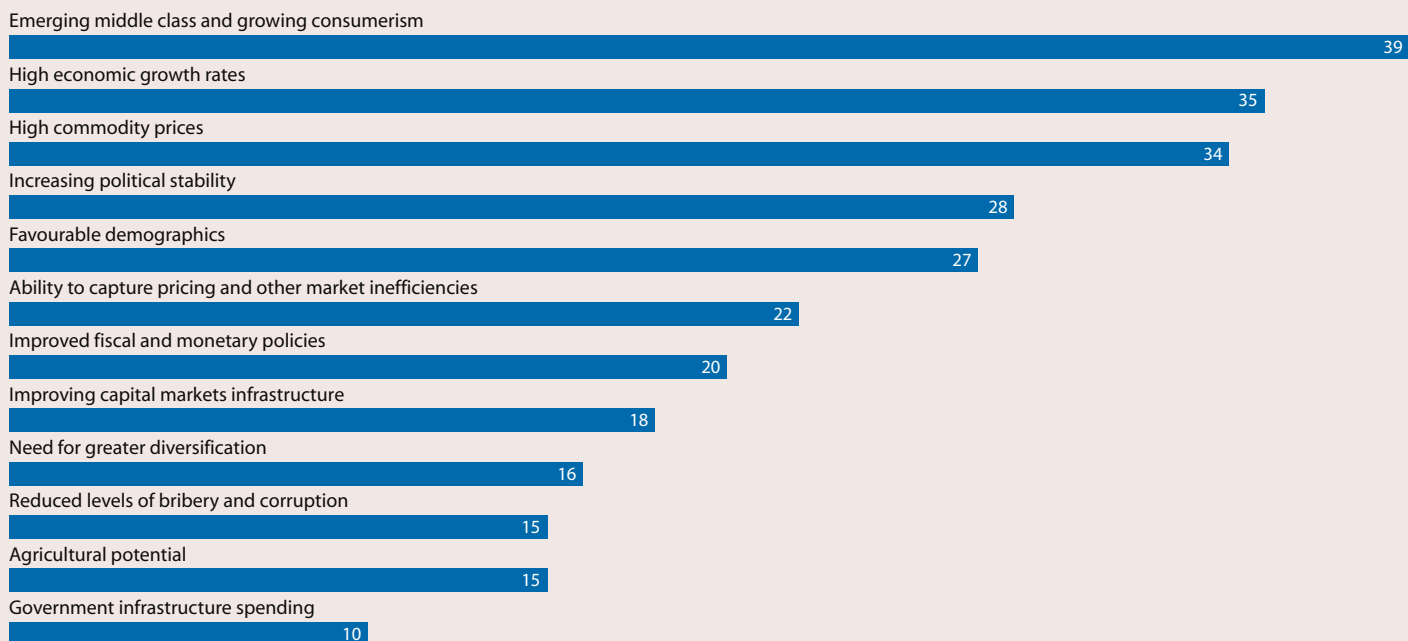
(% of respondents)



What do you consider to be the most attractive aspects of investing in African frontier markets?

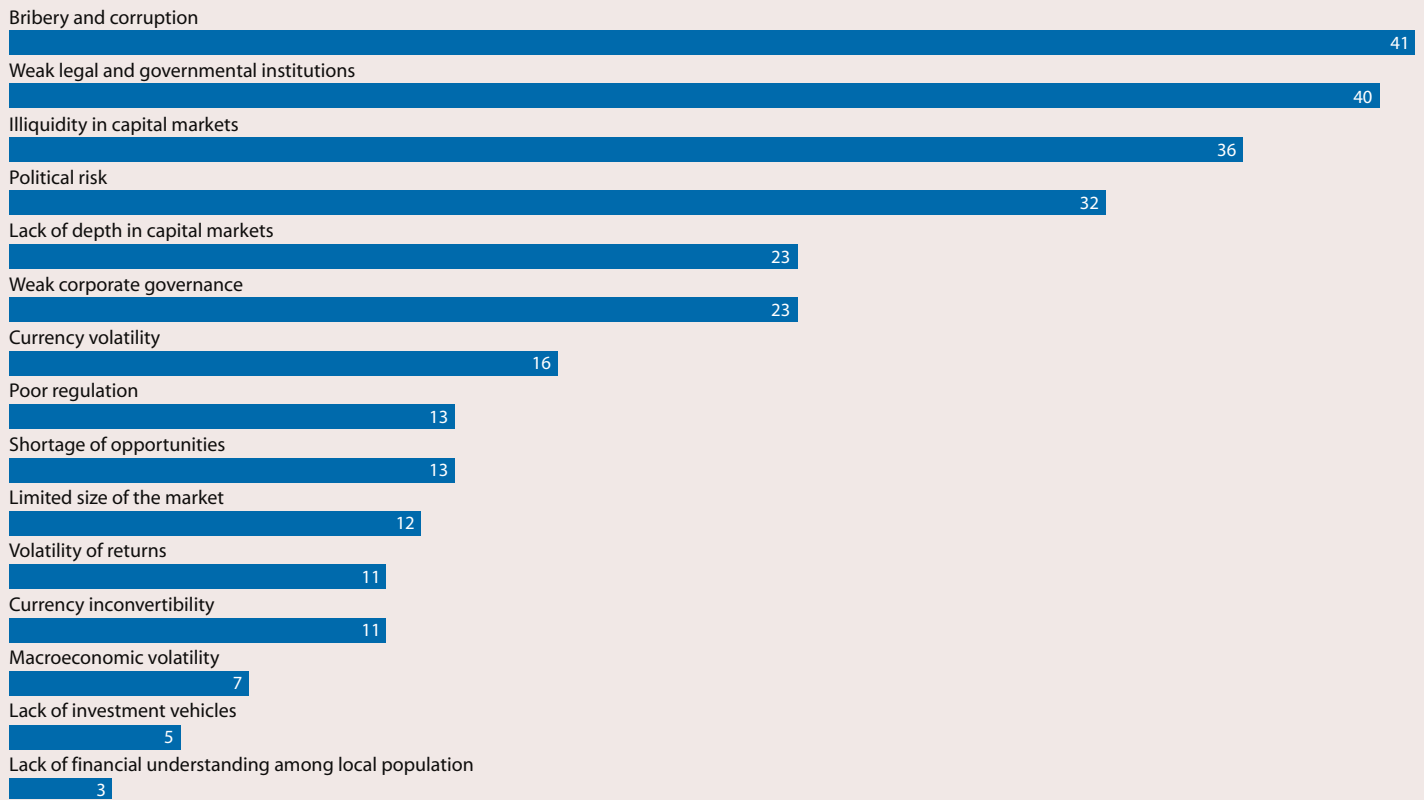
Select up to three.

(% of respondents)



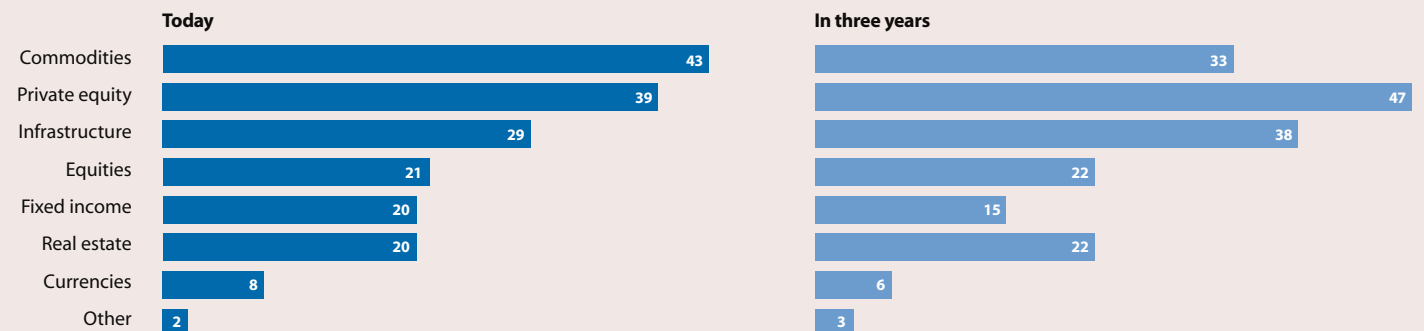
What do you consider to be the main challenges of investing in African frontier markets?

Select up to three.
(% of respondents)



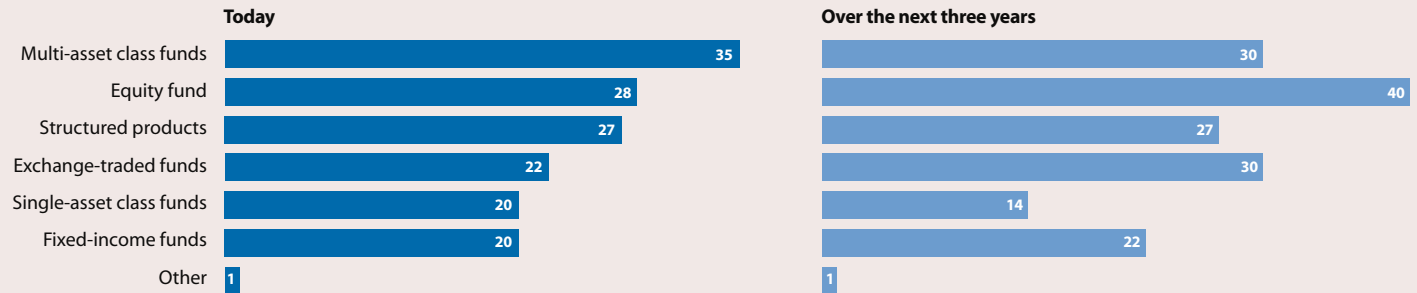
Which of the following asset classes do you think offer the best opportunities for investment in Africa?

Please select up to two for each column.
(% of respondents)



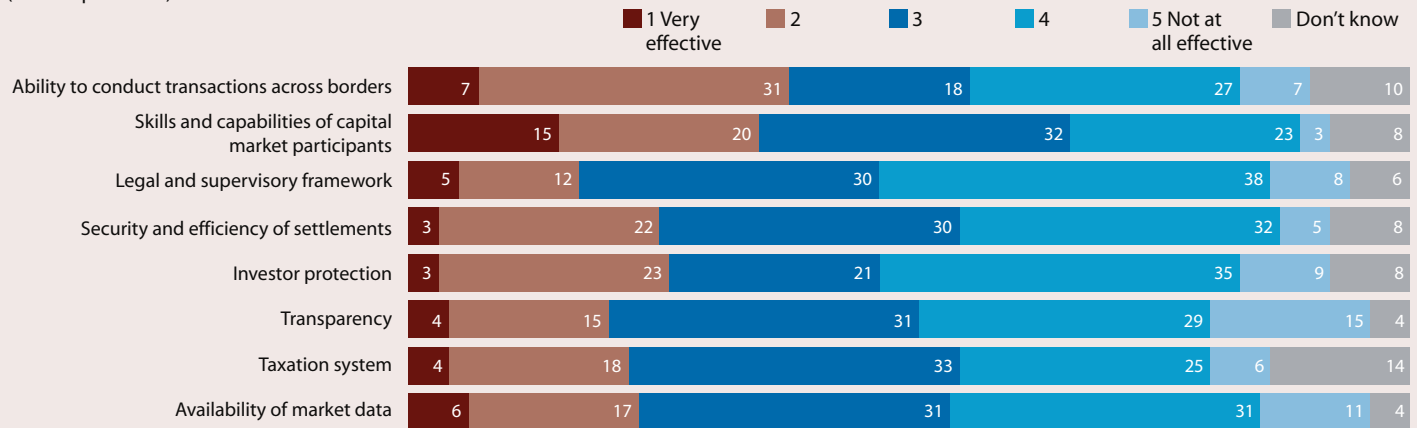
Which of the following vehicles do you think currently offer the best opportunities through which to invest in African frontier markets, and which do you expect will offer the best opportunities through which to invest in African frontier markets over the next three years?

Please select up to two for each column.
(% of respondents)



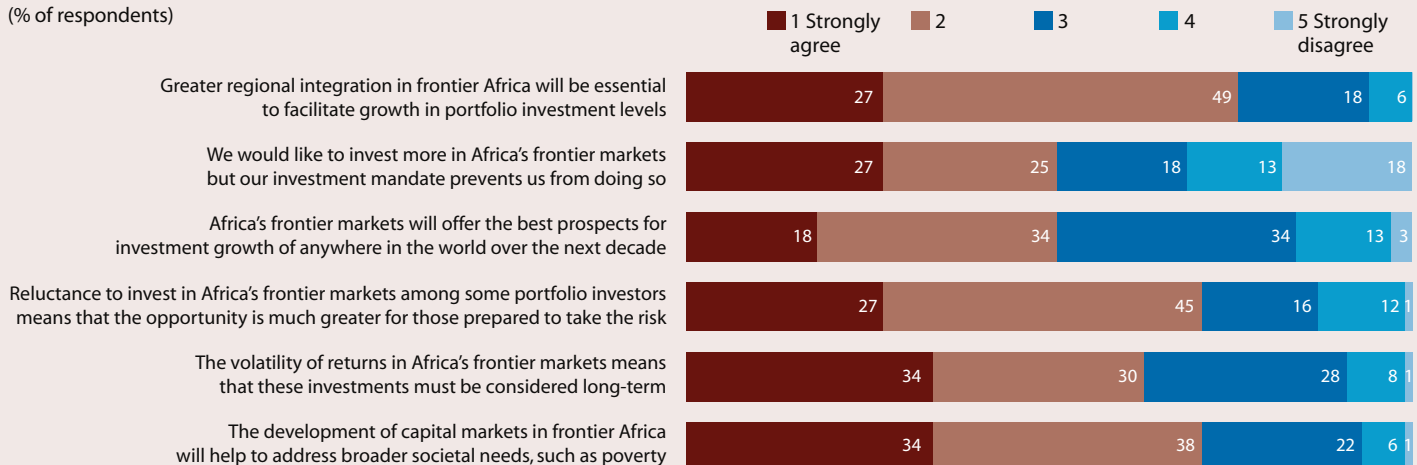
In general, how would you rate the effectiveness of capital markets in frontier Africa across the following measures?

Please rate 1 to 5 where 1 is very effective and 5 is not at all effective.
(% of respondents)



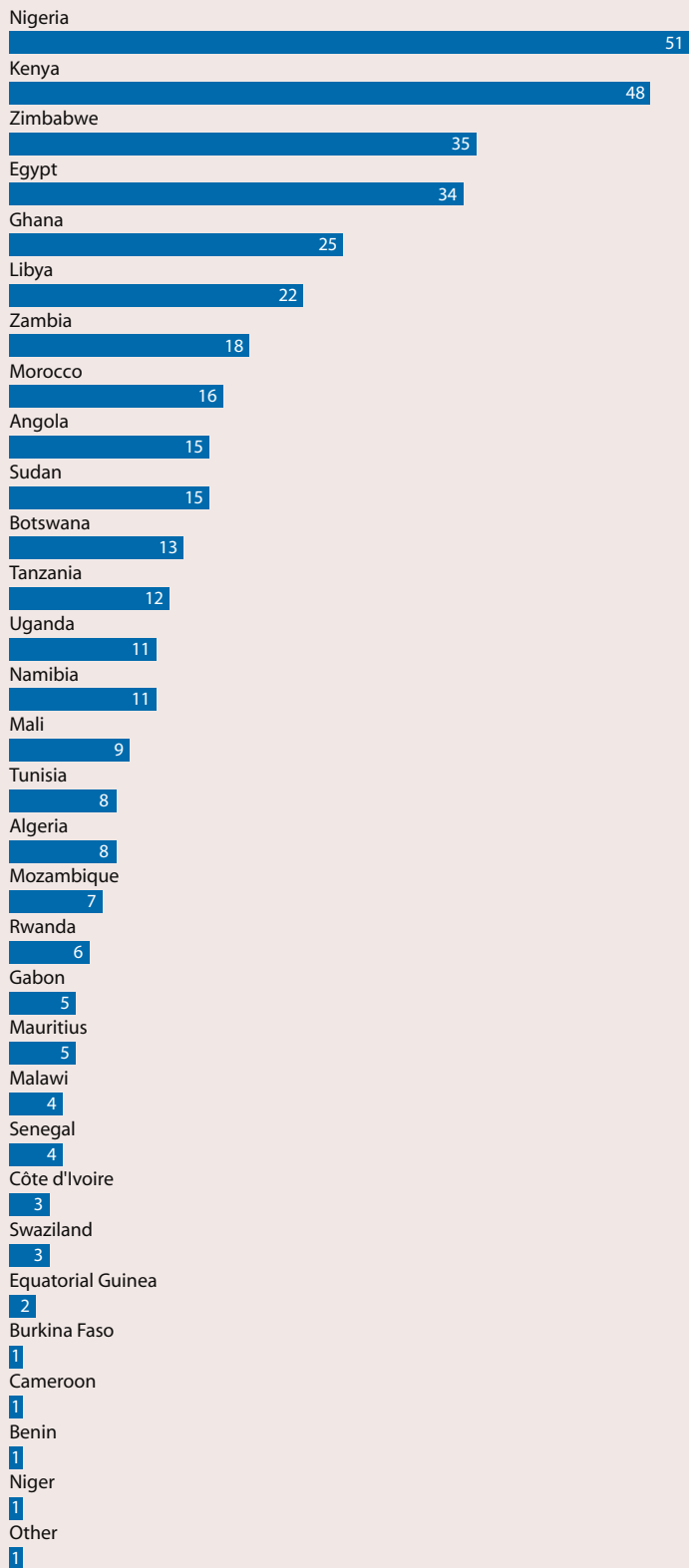
Please indicate your level of agreement with the following statements.

Please rate 1 to 5 where 1 is strongly agree and 5 is strongly disagree.
(% of respondents)



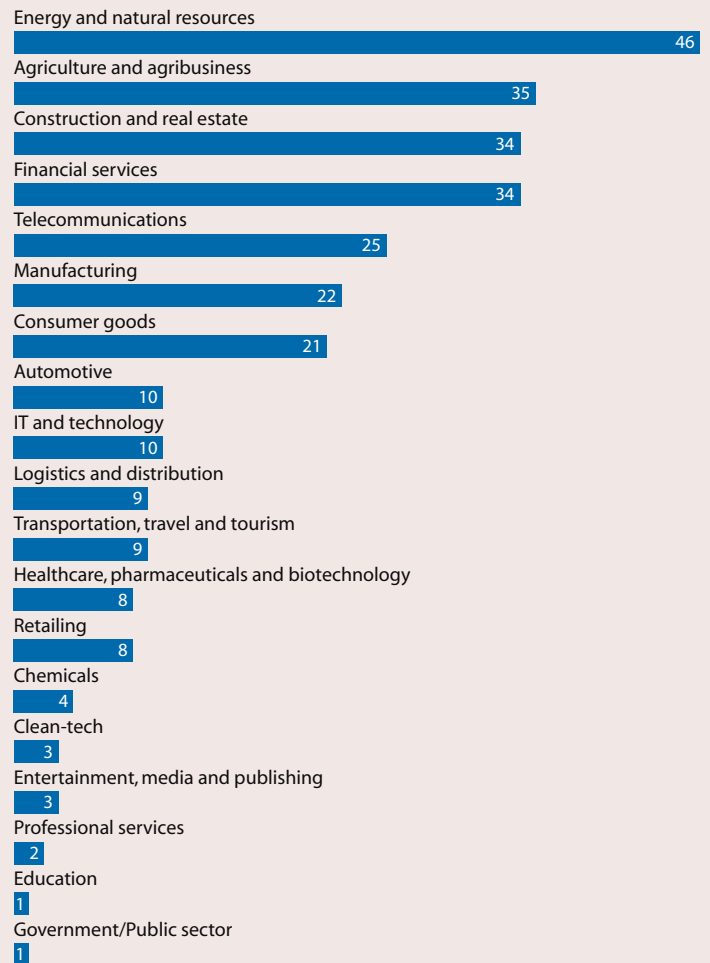
Which of the following African markets do you think offer the best prospects overall for investment returns over the next three years?

Select up to five.
(% of respondents)

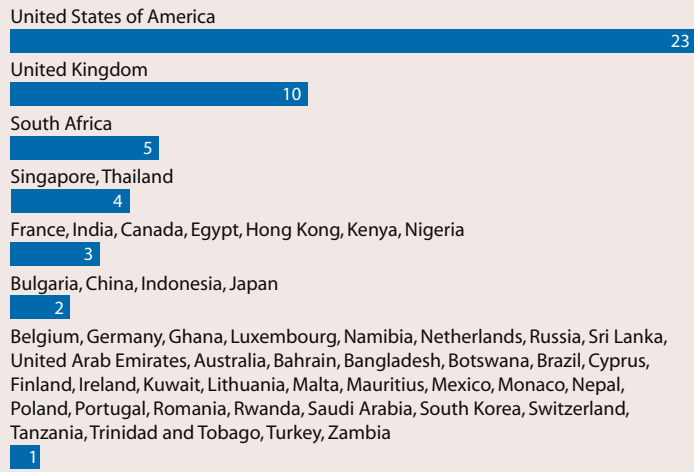


Which of the following sectors in frontier Africa do you think will offer the best prospects for investment returns over the next five years?

Select up to three.
(% of respondents)



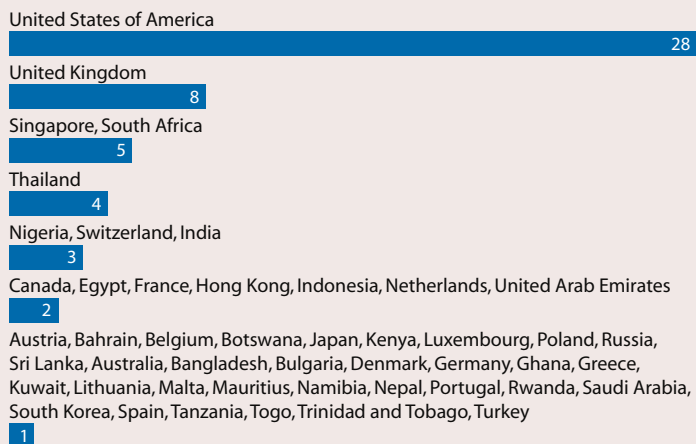
In which country are you personally based?
(% of respondents)



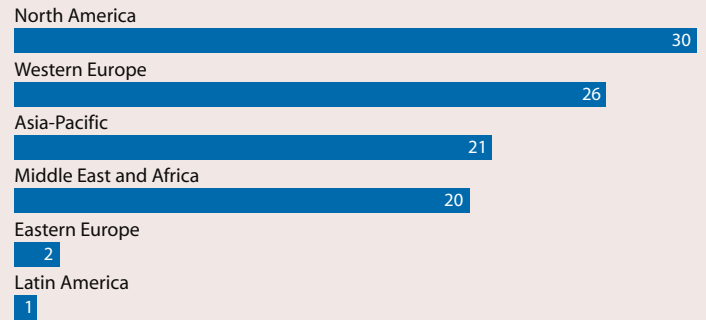
In which region are you personally based?
(% of respondents)



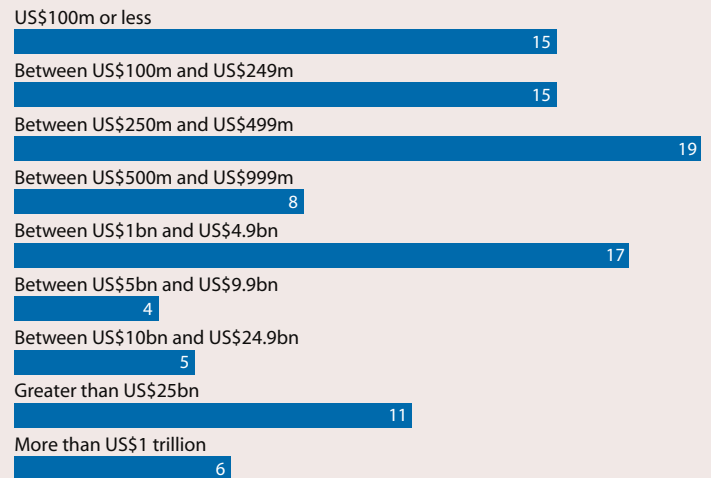
In which country are your company's global headquarters based?
(% of respondents)



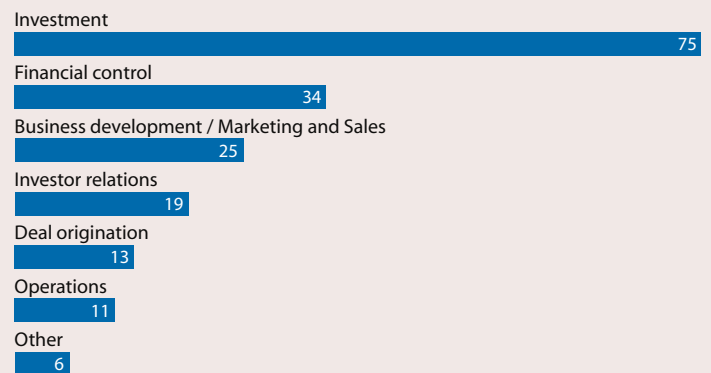
In which region are your company's global headquarters based?
(% of respondents)



What are your company's global assets under management?
(% of respondents)

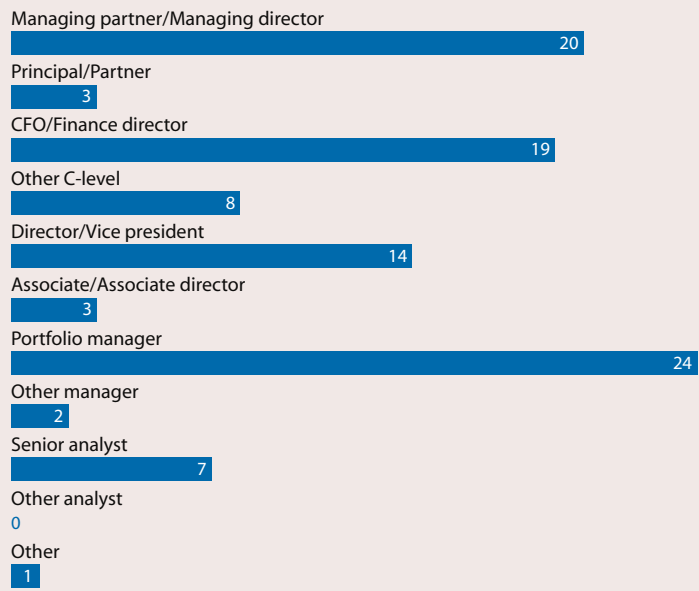


What are your main functional roles?
Please choose no more than three functions.
(% of respondents)



Which of the following best describes your title?

(% of respondents)



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