Positive impact in Africa

A local presence and a tilt towards impact investing is the way to succeed on the final frontier, writes **Nina Röhrbein**

Investments in BRIC and emerging markets are already part and parcel of the average investor's portfolio. However, Africa has so far failed to make it onto the radar screen of most investors.

The main reason for this is the continent's image problem. Although it is a very diverse continent of more than 50 countries, the western media has portrayed Africa as a place wracked by famine, disease, war and corruption. It is seen as a charity case where the only appropriate investment appears to be microfinance.

However, more recently, the continent has also become associated with impact investing, which is essentially about financially superior returns, and quantifiable social and environmental benefits.

"Investors are slowly starting to see Africa as a diverse, huge consumer market," says Steve Beck, co-founder and CEO at US-based SpringHill Equity Management. "Sub-Saharan Africa alone has around 900m consumers. A lot of African countries have experienced rapid, sustained growth in GDP per capita over the last 10-15 years. We have, for example, seen growth rates at 5% or above, which, apart from China and India, are difficult to match anywhere else. Economic zones in east, south and west Africa have started to take down some barriers of trade and opened up larger regional markets to investors."

Herta von Stiegel, founder and CEO of Ariya Capital, agrees. "Africa is the next big frontier," he says. "By 2050, Africa will have 2bn people. Its energy needs are enormous, which presents a big opportunity to investors. Chinese investors recognised Africa's commodity play some time ago. But while Africa has 20% of global land mass and more than 30% of the world's natural resources, it currently has less than 3% of foreign direct investments, making it a very underinvested, fast-growing continent with tremendous long-term opportunities."

Indeed, most of the capital flowing into Africa has, until today, come from development finance institutions such as the World Bank Group's International Finance Corporation (IFC) and the UK-based CDC Group.

Gaëtan Herinckx, senior investment analyst at Sustainable Capital, points out that Africa is also a good source of diversification, because while other emerging markets have a correlation with developed markets of 0.85, Africa ex-South Africa comes in at more like 0.25.

For money to be invested in an African country, basic infrastructure, a certain amount of security and a functioning legal system need to be in place. Countries that tend to be avoided by investors in Africa are those in the middle of or immediately after conflict, such as the Democratic Republic of Congo, Somalia and Zimbabwe.

The investment policy of CDC Group calls for 75% of its money needs to go into low-income countries and 50% into sub-Saharan Africa, including South Africa, Sierra Leone, Ghana, Nigeria, Uganda and Kenya. The group also watches developments in Ethiopia and Zimbabwe.

Sustainable Capital is currently overweight Morocco and Mauritius, the latter because of its rule of law, its political stability and the accountability of people in charge and the former due to its education system, its rule of law and infrastructure.

Netherlands-based SNS Asset Management (SNS AM) is split into two parts: its responsible mainstream activities, home to normal index, equity and bond funds with a responsible overlay; and impact investing, which deals with thematic funds, namely microfinance, water and agriculture in developing countries. It has just launched the SNS African Agricultural Fund (SAAF), which has a 50% tilt to South Africa as well as a large exposure to Botswana, Ghana, Kenya, Malawi, Namibia and Tanzania, which have high stability and with low corruption compared with other African economies.

What other sectors make sense across Africa?

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Shonaid Jemmett-Page, chief operating officer at CDC Group, insists that good investments can be made across all sectors, picks out infrastructure as particularly relevant. "The telecoms, retail, agricultural and mining sectors are also important," he adds.

One of SpringHill's investment themes is leapfrogged technology, which is based on the sharp growth in mobile phone use in the absence of a fixed line telecommunications infrastructure but also applies to energy and financial services. "We see opportunities in providing value-added services in mobile telecommunications that use SMS texts as an internet bypass," says Beck. "Mobile phones also enable the un-banked to be banked and allow consumers to store value in more secure ways than in the past. In energy, renewable energy sources like solar are of particular interest at the household level. The theme is to take existing technology and adapt it into an African context. This benefits people's lives by giving them lower-cost lighting and energy sources and better financial services but also allows our investors to make money in the process."

The critical factor for investors in Africa is to have a network on the ground that does the on-site due diligence and manages the investments.

"To invest in Africa, having a local buy-in is absolutely crucial," says Theo Brouwers, director at SNS AM. "Without strong relationships with the governments and local communities in situ, investing in Africa is too dangerous. Your products also need to create added value for the local community and the country as a whole. In a nutshell, you cannot run a business in Africa from a desk in Europe."

SNS AM's SAAF product has selected South Africa-based United Farmers Fund (UFF) as its investment manager, which sources it opportunities. UFF uses a model based on improving yields, educating farm workers and training them on the job through the Open Learning Group, as well as providing a healthcare programme for the workers on the farm together with doctors network organisation Care Cross.

Part of SAAF's strategy is driven by the South African Land Reform Act, which means that at least one third of all South African land has to go to the black community. SNS AM buys farms from white farmers and employs the black community, which will – through sponsorship by the South African government – become the owner of the land within the next 10 years.

SpringHill assesses the social benefits of its investments by measuring the aggregate economic savings of low-income households – for example, by working out how much money an energy-efficient cooking stove saves a household on cooking fuel and the carbon emissions. "Where investments lead to the creation of jobs we will report on the number of jobs created, the income, any non-salary-related benefits and taxes paid by the businesses as a measure of profitability," says Beck. However, he points out that certain things cannot be quantified. For example, it is impossible to tell how many respiratory illnesses are avoided by eliminating 80% of cooking smoke through the use of these stoves.

But while there is little doubt about the positive impact investments in Africa can bring, the continent is often still deemed too risky. Corruption makes investors particularly hesitant. "Corruption is something to be mindful of," admits Beck. "However, corruption is a bilateral transaction, not a unilateral one. For us, the very first screen on a potential investment is the character of the leadership team of the company. If there is no good alignment of values, integrity and honesty, then no matter how good the business, we will not invest in it, which is our way of managing the corruption risk."

Von Stiegel says that Ariya Capital's message to every company is that "we will not accept corruption. In our experience the risk of corruption is exaggerated. As an investor you find what you are looking for and the likes of Botswana and Rwanda try to be very open and transparent these days."

Still, investors are advised to undertake very careful due diligence on the people they are doing business with and conduct thorough money laundering, background and reference checks.

Macro-political risk is also an issue in certain African countries. However, investors can buy insurance against macro-political risk from the World Bank or insurers such as Opic, which protects assets and offers downside protection.

"The issue of sovereign risk always comes up with investments in Africa," says von Stiegel. "As we are in the process of launching a clean energy fund, we wanted to take the whole issue off the table so decided to insure the fund against sovereign and exchange control risks."

Jemmett-Page says that the main risks are straightforward business risks around management and business models. "The good thing is that because money like ours is going into Africa, it must adhere to very high ESG standards," he observes. "Some of the fund managers in Africa do a better job than their North American or European counterparts because their funds have only ever come with strong ESG requirements. The required ESG standards should ideally be written into enforceable legal agreements."