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Do’s, Don’ts, Gaps and Traps: Insiders’ View on Investing in the Mid-Market in Sub-Saharan Africa

ZURICH October 7, 2013 - What do GE, Dangote, DHL, Orascom, and Tullow Oil have in common? In the past year they are just a few of the larger corporations announcing multi-billion dollar cross-border investments targeting the healthy long-term prospects of Sub-Saharan Africa. Growth rates of upwards of 5%, several full percentage points higher than most of the world’s other major economic regions, have triggered an inflow of investment dollars. But these opportunities are not just reserved for billion dollar investments, as about 100 attendees of September 19th’s Africa Mid-Market Investment Seminar learned. There is clearly opportunity in providing finance to address mid-market business in multiple sectors and countries.

The event, hosted by the INSEAD Alumni Association of Switzerland, provided a rare opportunity to hear six experienced and successful African investment professionals describe their experiences and discuss the key factors that determine success or failure for investors in the rapidly growing Sub-Saharan market. “*The Heinekens and the Diageos of this world will invest as little as a quarter of a million dollars for bottling plants in the Democratic Republic of Congo (DRC) and have it pay itself back in eighteen months. It is just an amazing return, and illustrates one reason why our bank is focused on Africa*,” said Chris Clarkson, Head Corporate & Investment Banking, Standard Bank Africa in Johannesburg, in a keynote speech.

Clarkson's descriptions of Standard Bank's growing business in Africa reflected why African opportunities have become more attractive to businesses of all kinds as they seek to enter and develop new markets. But the key topic of the evening that Clarkson and his fellow panelists, all of whom currently work in Africa, addressed was the practical aspects of where and how to invest in Africa.

Two panels, moderated by Michael Southam (pictured left), a partner at Rockcliffe Partners, a Swiss boutique M&A firm specializing in African opportunities, focused on the practical aspects of investing in Africa and addressed some of the myths surrounding the subject such as the size of investments required to succeed on the continent. They described an investment landscape that is compelling despite the broad perception of risks and dangers generated by stories that often make headlines about investing in the frontier markets of Sub-Saharan Africa. “*You don’t have to exaggerate because it is Africa. The risks are known, understood and can be addressed. If you take a country by country approach, there is reliable information and competitive intelligence available to make informed investment decisions,*” said Christophe Asselineau, Partner, Shearman & Sterling in Paris.

Fellow panelist, Jean-Michel Lavoizard, founder of Aris Intelligence in Abidjan, Ivory Coast, agrees: “*I absolutely concur. It is necessary to have a country by country approach. Even countries that border each other can be very different from* *each other. However it is possible to get the necessary information with respect to the law, and I agree that you don't have to go overboard because it is Africa*."

The panelists (above L to R: Anat Bar-Gera, Christophe Asselineau, Chris Clarkson, Jean-Michel Lavoizard, Amber Mahood, Joe Delvaux), who were selected by Rockcliffe Partners from its extensive network of specialists and drawn from different sectors and professions, made the point that taking stock of each country's social and political environment is essential, but equally important is travelling to the country to meet partners, government officials, and local business leaders. "*You cannot just do desk research from a distance. Political risk is a real issue and you have to be comfortable with it. You need to get on the ground, meet and understand the people,*" said Joe Delvaux, Head African & Middle East Investment, Quantum Global Investment Management (Zürich, Switzerland). The knowledge gained on the ground cannot be replaced by a simple review of financial reports or market analyses. The wealth of knowledge to be gathered in situ is unique, as Delvaux made clear when he said, "*How to run a business during hyperinflation is not something you pick up in business school*."

An evaluation of all dimensions of the local landscape is crucial, agreed Jean-Michel Lavoizard of Aris Intelligence. "*I emphasize the importance of having local Information, the right information,*" said Lavoizard, who pointed out that in some jurisdictions basic records, such as commercial registers, cannot be relied upon, nor can data from local chambers of commerce. There are gaps in African governments' centralized information, and so his firm uses other methods for deep due diligence work.

"*You, as investors, need to have sufficient clarity on who you are dealing with and who your partners are. The correct information can anticipate, as well as mitigate risk and lay the ground work for problem solving in cases of fraud, for example*," said Lavoizard, who added that the mid-market was in his view less risky than large cap deals. "*I don't want to deter or discourage business investment with these examples,*" said the experienced African intelligence expert, "*On the contrary, I believe, as most of us here do… it is more risky to not invest in Africa than it is to invest in Africa."*

Some Do's and Don'ts

Having covered where and what to look for in African investments, the discussion turned to the more practical aspects of how to invest.

<u>Don't cut corners on the regulatory and legal aspects of investing</u>, was a key piece of advice offered to the audience. Contractual issues may occur, said several of the panelists. "*Do the commercial and legal due diligence and get legal advice. It doesn't have to be expensive legal advice. There are good local lawyers. Get the contracts in place, bearing in mind that arbitration will typically not bring back assets, but money and rights may be returned*", said Christophe Asselineau of Shearman & Sterling who has been working in Africa for more than a decade. "*There may be the need for contract renegotiations, even within a month, following the signature of an agreement due to regional conflicts or*

political changes. With that in mind, it is essential to have the initial contracts done properly. You are starting from a more solid base if or when renegotiations are required", said Asselineau.

Panelist Anat Bar-Gera's experience as an entrepreneur and Chairperson of YooMee Africa, a Cameroon- based Internet services provider, confirmed Asselineau's comments. "*In Côte d'Ivoire we obtained our original license in the correct manner and thanks to that were able to go back when the war was over and get our contract back into place and the business up and running*."

Clearly, attempting to conclude business deals by relying on legal or regulatory shortcuts is not a sound alternative. "*I know of a few big deals done like that, multibillion dollar deals done on the back of an envelope. Those were proved to be very expensive mistakes,*" said Asselineau who did not reveal the name of the companies involved.

Don't pay for corruption. "*If you pay once, you will have to continue to pay forever. You must stick to your principles and it is not, in fact, very difficult. We tell corrupt officials that our institutional backers required us to commit to not commit corruption,*" said Bar-Gera. This stance has served to give her company an effective means to avoid being asked for improper fees or indulge other forms of commercial misconduct.

The Opportunity: Addressing the Mid-Market Financing Gap

Because it is significantly under-serviced financially, the African mid-market is offering returns that are difficult to find in other markets. According to Clarkson the region is underserved because traditionally equity investors have sought the security of large cap companies, such as Heineken, Nestlé or Unilever. Senior debt too is also typically reserved for companies from outside of Africa or sovereign bonds. "*Investment is largely reserved for deals that can get a rating. You get a rating and there is somebody (international banks and commercial banks) who will take it to the international markets,*" he said, giving the examples of Mozambique and Tanzania, which both recently raised international capital at "astounding" rates.

The opportunity for investors willing to approach African mid-market companies is significant. Mezzanine financing is particularly attractive according to Clarkson and Southam. "*If the PE players are covering the whole continent, there is a clear opportunity for mezzanine financing or structured debt which is a bit more risky but also more rewarding to the investor than senior debt,*" said Clarkson. The international banks are not interested in addressing the mid-market opportunity due to the relatively high costs of small deals.

On the sell side, debt has also become more attractive to entrepreneurs. "*African entrepreneurs are increasingly drawn to a debt solution as it offers an attractive alternative to giving away their equity*", said Delvaux of Quantum Global. He went on to explain that entrepreneurs clearly understand the long-term value of the business they are building. Delvaux added, "*Do they really want to give away control of the company just to raise a few million dollars?*"

Sector Specifics

While some investors in the mid-market tend to be opportunistic, relying on their networks of contacts to identity "low hanging fruit", Clarkson said that there are clear growth nodes and asset classes to focus on. Presently the most rewarding asset classes are oil and gas opportunities, mineral resources, infrastructure development such as power generation and transport networks, projects linked to the region's rapid urbanization (FMCG and real estate), and agriculture; "*I would be amiss not to mention agriculture,*" said Clarkson, explaining that "*There were earlier stop and* *start forays by international players which had problems, but now local countries themselves have shown some resolve, have come through and are now producing.*"

This trend has not escaped the attention of multinationals in Europe and the BRIC countries. "*You are now seeing London based sugar companies investing in mills in Mali and Tanzania,*" said Clarkson.

Other panelists confirmed this trend towards mid-market projects. Amber Mahood, Director of Fund Development, Fusion Investment Management in London, commented: "*We've moved into real estate investment, green energy, and infrastructure investing from a base in small and medium sized consumer goods and industrial businesses*." According to Mahood, real estate and mortgages are attractive due to growing urbanization and the emergence of the middle class and high income earners. "*Our investment activity has a goal to provide the capital to take local business owners to the next level,*" said Mahood, whose company has historically invested locally in East Africa and now employs a team of forty in the region. Mahood added that the region was selected by her UK-based parent company due to the potential for cross-border trading, potential for a single currency and cultural, legal, and language affinities.

Other areas favored by panelists were telecommunication and mobile services but the panelists warned that investing in Africa is not like winning the lottery. "*Don't come to Africa with a me-too business idea. You have to bring a competitive edge and cannot just copy/paste what has worked elsewhere,*" said Anat Bar-Gera of YooMee Africa.

Bar-Gera rejects rolling out identical services to those that are on offer in Europe or North America because many African countries are in fact leapfrogging technologies, and are already ahead of Europe. Clarkson agreed that leapfrogging technology is evident in several nations. "*Nigeria and Kenya, for example, have moved directly to mobile, skipped satellite and [legacy] underground cabling,"* said Clarkson.

Other countries have bypassed traditional banking and gone straight to mobile banking. Clarkson said that Kenya's ecommerce and mobile payments and mobile money transfer boom is an example. "*Kenya has something called airtime money,*" said Clarkson. "*The system has revolutionized banking."* It was originally created to enable microfinance-loan repayments to be made by phone. Because it dramatically reduced the costs associated with handling cash, and users repaid the loans on time and in full, it enabled lower interest rates and it has spread into many other banking segments for the same reasons.

A networking cocktail followed the panel discussions. The consensus on the evening's event, as expressed by a senior banker at one of the largest Swiss-based banks " *…was that it proved again that Africa is simply one of the strategic themes of our times for investors, financiers, entrepreneurs, corporations, NGOs and last but not least politicians"*.