

a pressing issue

Intra-African investment is a critical source of growth for the continent, but is often overlooked. *Africa investor*, together with the **Vale Columbia Center on Sustainable International Investment**, reveals that intra-African foreign direct investment is a rapidly growing phenomenon



Intra-African investment is crucial for the continent's economic growth, yet figures are largely unknown and routinely ignored, often lumped in with figures on intra-African trade, which are more well-known, standing at between 10%-12%. Sunil Benimadhu, CEO of the Mauritius Stock Exchange insists that the two must be kept distinct: "Both are key components of a country's GDP and have a direct impact on economic growth. They are each as important as the other but there is not enough emphasis on either."

Jean-Louis Ekra, President of African Export Import Bank, agrees. "The current economic growth and development challenge is attributed to the low level of capital investment in Africa, especially during the 1970s and 1980s," he says.

"The distinction between investment and trade flows is quite well-known but the promotion of trade and investment flows has unfortunately not been given equal attention, either by national authorities, and trade and investment promotion agencies, as well as development partners."

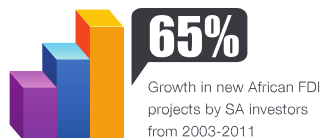
It is time to put a number to it and the opportunities across African borders need to be better promoted. "The opportunities in Africa are varied," says Andrew Alli, CEO of the African Finance Corporation (AFC). "If an investor wants to achieve diversification in their portfolio, investing across jurisdictions is important. Africa is quite fragmented; there is a population of one billion across 54 countries and the ability to tap into different markets across the continent is important."

Says Arnold Ekpe, CEO of Ecobank, "Investing continent-wide has two real

advantages; it gives a certain diversification and it also allows one to participate in a multitude of growth opportunities. For Ecobank, it provides a stability and sustainability to our performance, and that's in spite of the multiple jurisdictions; they represent a challenge, not an obstacle, to investing on a continent-wide basis."

While data limitations make it difficult to evaluate, intra-African foreign direct investment (FDI) appears to be a small but rapidly growing phenomenon on the continent, with investment from South Africa continuing to play a primary role in the region; but other players, predominately Kenya and Nigeria, are gaining ground.

Between 2002 and 2004, average annual flows of intra-African FDI were estimated at roughly US \$2 billion. Levels dipped in 2005 and 2006, but the trend overall has



since been upward, with flows of intra-African investment amounting to \$6bn in 2007, and growth of intra-African FDI into new projects at a compound rate of 42% from 2007 to 2011. As a share of total FDI in the continent, the percentage of intra-African FDI fluctuates, but remains low. One study of the value of all FDI projects in Africa from 2003 to 2010 calculates that only 5% of that value, or \$46bn, derives from intra-African FDI.

Data on the number of FDI projects, however, shows a different story, indicating that intra-African investment is largely comprised of investments in smaller, less capital-intensive projects rather than large, high-value investments (e.g. in mining, oil, and gas). In particular, while African investors' share in the value of FDI projects was 5% over the 2003 to 2010 period, their share in the number of FDI projects was 12%. Other figures build on that picture: although the annual number of new FDI projects in Africa from investors worldwide more than doubled from 2003 to 2011, the share of new projects originating in African countries has more than kept pace, growing from 8% in 2003 to 17% in 2011.

The data appears to show interesting patterns in the focus, form, volume, direction, and future of intra-African investment.

Intra-African investment appears concentrated in services and manufacturing

African investors appear to be concentrated in a narrower range of activities than non-African sources of FDI in the continent. Although FDI from outside the continent dominates in the primary sector (representing 74% of all M&A deals in the primary sector from 1987 to 2008, and 96% of all greenfield investments in the primary sector between 2003 and 2007), and in the manufacturing sector as a whole (accounting for 70% of M&As in manufacturing between 1987 and 2008 and 93% of greenfield investments in manufacturing between 2003 and 2007), intra-African investment takes a more significant share of projects in the services sector, including in financial services and in specific manufacturing industries, particularly those that are less technology- and capital-intensive (although, as noted above, foreign investment in manufacturing

as a whole is largely from non-African sources). In 2011, more than half of all M&A deals in Africa were intra-African deals, with 81, or 53%, of the 152 deals completed between African nations.

Some projects falling into these categories include Coleus Crowns, a Uganda-South Africa joint venture in Uganda that manufactures bottle crowns and supplies them to major multinational enterprises (MNEs) and regional markets; a number of African MNEs in telecommunications such as MTN of South Africa, Orascom of Egypt and Seacom of Mauritius; and banks from Nigeria, Togo and South Africa, which have a relatively wide presence in the continent.

Growth in intra-African investment in financial services seems to be one of the continent's dominant success stories in the area of FDI. Between 1987 and 2008, African investors conducted 42% of cross-border M&As in the African finance sector, totalling 128 projects and representing the highest proportion of intra-African investment in any sector. As of 2010, there were six African banks with cross-border operations in eight or more African countries and an additional 11 African banks with operations in four or more African countries. Cross-border investment growth has been most rapid in the latter part of the last decade, and expectations are that these institutions, primarily through subsidiaries, will continue to expand outside their immediate sub-region, strengthened by more stringent capital requirements and with an interest in accessing other domestic markets.

African investors favour M&As rather than greenfield investments when investing in other African countries

Overall, the majority of FDI in Africa is made through greenfield investments. African investors, however, primarily conduct FDI through cross-border M&A deals, concluding 31% of all cross-border M&As in Africa between 1987 and 2008. That percentage was relatively unchanged between 2000 and 2008, during which time African investors concluded 404 cross-border M&As in the continent with a value of \$26bn. In terms of value, these intra-African cross-

border M&As were 28% of the value of all cross-border M&As in Africa over the 1987-2008 time period, and 20% over the 2000-2008 period, indicating that African investors provide a significantly greater, though potentially declining, share of the capital for cross-border M&A deals than for greenfield FDI flows.

South Africa provides the majority of intra-African FDI, but other countries seem to be gaining ground

Intra-African investment – both in terms of projects and value – seems to be on the rise in absolute terms and, though most of the projects are concentrated in manufacturing and services, some FDI projects are in the primary sector, including mining. African investment also appears to be originating from, and going into, a larger number of countries; though, among Africa's more than 50 sovereign countries, a relatively small number continue to send the majority of outflows and receive a vast portion of the inflows.

South Africa, with a diversified economy and well-developed financial sector, is the largest regional source of FDI in Africa, and its investors' holdings in other parts of Africa have been expanding: in 2005, FDI in Africa constituted 8% of South Africa's outward FDI stocks and in 2009 that number had risen to 22%. While in terms of value, much of that investment has been in the mining sector, research indicates that in terms of projects, South African FDI activity is more diverse. New African FDI projects announced by South African investors grew by 65% from 2003 to 2011. Based on the number of new projects announced over that period, South Africa ranks among the top five sources of investment in a number of African countries. Kenya and Nigeria, however, are both growing outward investing forces: new FDI projects in Africa announced by those two countries from 2003 to 2011 grew by 77.8% and 73.2%, respectively.

South African FDI has gone into every region of the continent, but flows have been primarily directed at a narrower group of countries. Over at least the period between 2006 and 2010, most FDI from South Africa has gone to Mauritius and Nigeria, followed by Mozambique,

Zimbabwe and Ghana. The proportion of South African FDI outflows into other African countries is rather modest, but can comprise a significant portion of the total inflows into those economies.

While South African investors may be able to take advantage of a range of opportunities throughout Africa (and the world), investors in neighbouring countries may be less well positioned to do so, and therefore concentrate their FDI into South Africa's sophisticated economy. This would explain why, although investment into Southern Africa is not a dominant destination for South Africa's FDI, South Africa is the primary recipient of FDI from Southern African countries.

The factors influencing FDI suggest challenges ahead for increased intra-African FDI, but also reveal opportunities

As noted above, intra-African investment remains relatively low, hovering at 5% of FDI flows into Africa. In comparison, figures from Latin America and the Caribbean suggest a somewhat higher, but not significantly different, degree of intra-regional FDI. When firms from Latin America and the Caribbean engage in FDI, they appear to do so primarily by investing in other countries within the region. Nevertheless, intra-regional FDI by Latin American and Caribbean firms stayed generally between 8% and 10% of total inward FDI in the region between 2002 and 2010 and, in 2011, dropped to 5%.

In contrast, according to data from the Association of Southeast Asian Nations (ASEAN), intra-regional FDI in Southeast Asia constituted 14% of that region's total FDI flows over the ten-year period from 2001 to 2010, rising to comprise 17% between 2008 and 2010. The value of intra-regional FDI flows in ASEAN countries grew at an annualised rate of 19% over the period between 2001 and 2010 while total FDI flows to the region grew in value at an annualised rate of 17% over the same period.

As these figures on intra-regional investment suggest, and as has been supported by studies, the factors that influence whether FDI occurs

and where it goes may be relatively uniform in theory, but in practice, FDI sources and destinations can depend on a complex interaction between host-state characteristics and particular investor assets and strategies that can be influenced by dynamic regional patterns. More specifically, factors that influence whether, when, and where FDI occurs are myriad, but fall into three primary categories: attributes of the investor, the investor's strategies, and the attributes of the host country. The investor's home country is also relevant, as its policies, institutions and infrastructure can impact the investor's willingness and ability to venture abroad.



President Obasanjo speaking at the launch of the Africa investor Heads of State Investment Advisory Council at the New York Stock Exchange

In the context of Africa, the drivers that may be prompting intra-African FDI include an aim to seek other markets (e.g. the growth of the banking and telecommunications firms), to acquire strategic assets, to seek resources (e.g. South African firms' investments in foreign mining projects), to decrease costs of production (e.g. investment by Mauritian firms in Madagascar), to escape challenges in home countries relating to corruption, civil strife, or competition from other domestic and international firms, and to accomplish these aims by establishing an affiliate in a foreign country, as opposed to simply entering into a contract with a foreign company for trade in goods or services.

Further, the characteristics of the host country that are relevant to whether an investor will establish an operation within its borders include the potential host country's cultural and geographical proximity, availability of

human and natural resources, reliability of infrastructure, and ease of doing business.

Examining these determinants of FDI offers a potential explanation of why intra-African FDI appears to be at depressed levels; a lack of skilled labour, limited access to markets, and persistent gaps in infrastructure and integration are among the factors that negatively impact the attractiveness of many potential host countries in Africa and can make FDI in those countries challenging for African and non-African firms alike.

Yet African firms likely often face even greater hurdles when seeking to invest in other countries in Africa because they may lack the capital, technology, competitive strength, supportive policies of their home countries, and/or other assets that can be crucial for enabling a firm to engage in FDI.

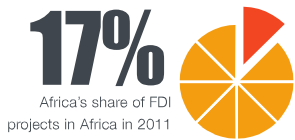
In terms of historical comparables, looking at the "tipping point" in emerging Asia, where inward bound FDI exploded at the same time that the countries themselves were building out their own corporate giants, one could postulate that a similar phenomenon in terms of relative growth would be realistic as the "Dangotes" and "MTNs" of Africa grow.

In order to better facilitate intra-African investment, Ekra says, "The best way to raise the level of investment in the continent is for the national authorities to create the enabling environments and for the national and regional investment promotion agencies to show the countries are attractive investment destinations."

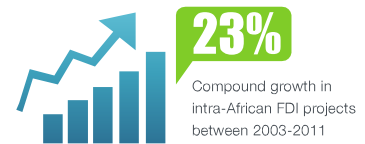
He continues, "There are increasingly important investment flows from Africa itself, and they should be attracted on exactly the same terms as investment from Europe, the US or China, and it should be given a fair chance."

The AFC's Alli agrees. "Africa should not be discriminatory in terms of the approach to different groups of investors," he says. Alli cites the example of Botswana, which is allowed to invest 70% offshore.

Ephraim Letebele, CEO and Principal Officer of the Botswana Public Officers Pension Fund, says, "Africa's financial markets are still in their infancy. There is a lack of investment vehicles and if we take the position of keeping investment



\$ 100 billion
UNCTAD projects that FDI flows into Africa could reach these levels in 2014



AFRICA INVESTOR COUNCIL'S TEN YEAR ROADMAP

The *Africa investor* (Ai) Heads of State Investment Advisory Council, launched in 2011 at the New York Stock Exchange, was created to channel private sector expertise to support the African Union (AU) and African Heads of State plan and prioritise programmes to attract and retain long term, productive intra-regional investment flows and foreign direct investment (FDI).

Says Hubert Danso, CEO of *Africa investor*, "Intra-African investment that catalyses mass job creation is a key part of Ai's roadmap, in which the Ai Heads of State Investment Advisory Council is partnering the AU, the UN Global Compact and the UN Office of the Special Adviser for Africa to address. The Ai Council brings together the continent's largest and most committed investors to advise and support African Heads of State, governments and the African Union to originate investment projects and frame the policies, and increase and retain long term productive investment flows." The Council's roadmap (produced with the support of Afrexim Bank) sets out clear goals, priorities and opportunities to increase intra-African investment flows over the next ten years with recommendations on the required actions and partnerships to achieve targets.

Between 2003 and 2011, there has been 23% annual compound growth in intra-African investment into new FDI projects. This growth has been accelerating, with the growth rate up by 42% since 2007.

Using indicators such as market size and trade openness, econometric modelling from UNCTAD has projected that FDI flows into African countries may double from 2011 levels of \$43bn to anywhere between \$75-100bn in 2014. UNCTAD conservatively projects intra-African investment flows to be in the region of 5%, while Citi estimates them to be at least 7%. Ecobank, the pan-African bank operating across 33 countries in Africa, projects intra-African FDI levels currently to be as high as 15%. Both Citi and Ecobank align on the projected annual growth rates for intra-African investment being between 25-30% compound growth per annum.

Africa investor projects that, with the right public and private sector leadership, based on a 7% mid-case base for intra-African flows, and a 25% compound growth rate over the next ten years, the continent has the opportunity to grow intra-African investment over the next ten years to over 60%, from its current base of 5-7%. This is in line with intra-European investment levels at their height, which, according to the OECD, was 82% in 2010.

Economic growth through increased trade and investment will be a precursor to Africa's job creation agenda. As intra-African investment increases, job growth will be a natural by-product. The continent's workforce is more educated and is employed in a more diverse array of sectors than is commonly perceived. According to McKinsey & Company's Africa at work, job creation and inclusive growth report (August 2012), Africa has the potential to create between 54 million and 72 million more stable wage-paying jobs over the next ten years, with much of the growth coming from the manufacturing, agriculture, retail and hospitality sectors – all key targets for intra-African investment.

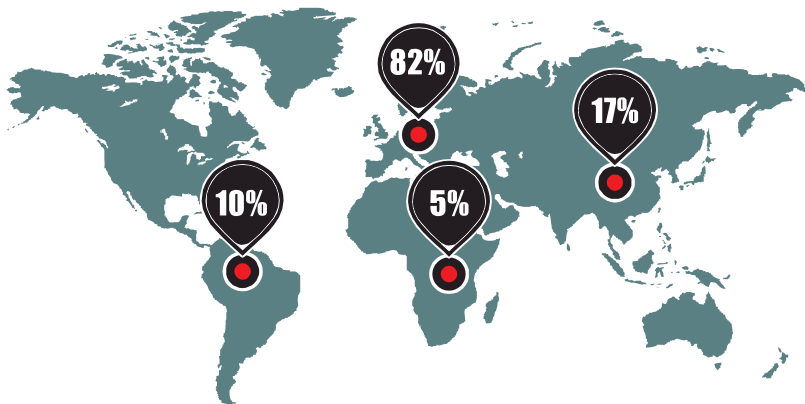
in the home country, we are going to lose opportunities." However, Letebele says, "As and when opportunities come by, we disinvest and come back home."

Looking forward, however, the coming decade holds potential for growth in the volume of intra-African FDI, as well as the range of countries contributing to and benefiting from such investment flows. Using indicators such as market size and trade openness, econometric modelling done by UNCTAD has projected that FDI flows into African countries may double from 2011 levels of \$43bn to anywhere between \$75-100bn in 2014. Whether and to what extent that projection will materialise will vary based on a host of factors not captured by the model, including host-country risk and investor perceptions.

Similarly, the share of intra-African investment in that mix is an open question given both the complex range of variables that can impact such a number and the large gaps in current and historical data from which to base any projections. Yet growth in the African population and consumer class, democratic transitions across the continent, increases in infrastructure spending through African initiatives and foreign investment, continued efforts at integration, and rich supplies of natural resources are promising ingredients.

The challenge is for governments to leverage their existing competitive advantages and inflows of foreign capital and technology to push forward the improvements in infrastructure, institutions, and education that can build and sustain domestic enterprises and continue to attract – and benefit from – investment by foreign ones. In turn, the task for businesses is to capitalise on the opportunities (and even the challenges) that exist by, for instance, identifying and meeting the supply-chain needs of other primary-sector, manufacturing, and services investments. **A**

INTRA-REGIONAL INVESTMENTS, BY REGION 2010



Europe - 82% Latin America - 10% Asia - 17% Africa - 5%

Source: Africa investor

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This report draws particularly on research and statistics gathered by Ernst & Young, the Reserve Bank of South Africa, and the United Nations Conference on Trade and Development.