

Africa: The World's Most Exciting Investment Story

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The Global Economic Governance Programme was established at University College in 2003 to foster research and debate into how global markets and institutions can better serve the needs of people in developing countries. The three core objectives of the Programme are:

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- to create and maintain a network of scholars and policy-makers working on these issues;
- to influence debate and policy in both the public and the private sector in developed and developing countries.

The Programme is directly linked to Oxford University's Department of Politics and International Relations and Centre for International Studies. It serves as an interdisciplinary umbrella within Oxford drawing together members of the Departments of Economics, Law and Development Studies working on these issues and linking them to an international research network. The Programme has been made possible through the generous support of Old Members of University College.

Stephen Jennings

As one of the founders of Renaissance Capital in 1995, Mr. Jennings has been actively involved in building the Firm's investment banking and securities sales and trading businesses. He played a key role during the early years of the firm's development, serving as Head of Investment Banking, Head of Sales, and Chief Operating Officer. Today Mr. Jennings is Chief Executive Officer of Renaissance Capital and Chief Executive Officer of Renaissance Group.

Prior to establishing Renaissance Capital, Mr. Jennings served as Co-Head of Credit Suisse First Boston (Moscow) from 1992 to 1995. In this role, he was directly responsible for Credit Suisse First Boston's investment banking during a period when CSFB was recognised as the dominant market player in developing and executing pioneering transactions in the Russian marketplace. In 1992, Mr. Jennings led the State Property Committee's pilot voucher auctions, a project that established the foundations for the creation of Russia's capital markets. Subsequently, he has worked on numerous landmark financings and M&A transactions in Russia and throughout the CIS, many of which have won professional awards and commendations.

Before assuming his position in Russia in 1992, Mr. Jennings was with Credit Suisse First Boston in London, where he worked on investment banking and privatisation transactions in Central and Eastern Europe. Previously, he worked for Credit Suisse First Boston and the Treasury in New Zealand, advising the New Zealand and Australian governments on privatization and state enterprise restructuring and working on a wide variety of private sector M&A and capital markets transactions.

Mr. Jennings holds a Bachelor of Business Studies degree from Massey University and holds an M.Phil. in Economics with first class honours from the University of Auckland.

Transformational Growth in Africa – Many Paths, One Destination

Introduction

If I were to open this address by stating that the 21st Century would be Africa's Century, I think there would be some bemused smiles even in this room. This is supposed to be China's Century, or Asia's Century, or the Century of BRIC or emerging markets, but definitely not of Africa.#

In my career building businesses across the CIS, Africa and other emerging markets, I have learned to be wary of consensus.

I do not believe that this is China's Century, or Asia's Century. Neither do I believe that it is Africa's. Rather I believe that there is a transformation taking place which is global in scale and scope. The transformation is based around a virtuous cycle between the adoption of basic market principles and increased political pressure for improved governance. The economic recipe for transformational growth is almost universally understood in emerging markets today and has proven effective in a wide range of institutional settings. Accordingly, it is impacting a greater portion of the world's population than at any time in history.

Africa will be as much part of that transformation as anywhere. Parts of Africa will benefit, or not, as much as Asia, Latin America, BRIC or Europe. Any attempt to geographically confine the economic transformation taking place globally today is missing the point. The process is economic. Those regions of Africa which open themselves up to this process will benefit as least as much as anywhere else globally. The winners will be decided by the political commitment to change and by the economics, not the geography.

I see the opportunity in Africa as greater than anywhere else in the world today not because Africa is different, but precisely because it isn't a special case. The great majority of African countries will transform their economies in the coming decades just as most of Asia, America and Europe have done in their time. The difference with Africa is simply that the scope for catch up and convergence is greater and is likely to happen more rapidly.

However, the convergence path of individual African countries will be highly idiosyncratic and organic. It will reflect the specific institutional, political and economic circumstances of each country rather than idealized Western notions of top-down institutional reform.

All too often there is an implicit assumption that Western-type institutions are in some sense superior and more developed than those in poorer parts of the world without questioning the relevance of those institutions. It is frequently assumed that these institutions can be lifted out of one country and transferred relatively painlessly to others, which would then enjoy the same benefits as we have traditionally enjoyed in the West.

My experience working in the former-Soviet Union, sub-Saharan Africa and other emerging markets has definitely changed my views in this regard. I have seen firsthand how economic performance can be dramatically improved under a wide range of different types of institutional arrangements and styles of government. I have learnt, often at my own expense, just how difficult it is for outsiders to understand why particular arrangements have evolved in particular countries and why they “work” in those specific circumstances.

I would like to use the opportunity you have kindly offered me with this address to explore what is behind the transformative growth taking place across the vast majority of emerging markets and why over the last 15 years it has taken hold in Africa. I would like to offer my insight as a businessman and financier to talk about some of the key characteristics, opportunities and potential fallacies surrounding the accelerating economic growth in Africa and I will discuss why I think the outlook for Africa is even better than the impressive data of recent years would suggest.

Transformative Growth

Before talking about growth in Africa I would like to look back at the origins and dynamics of rapid growth in the rest of the world.

A sustained period of several decades of high economic growth has transformed different societies at different times over the course of the last 200 years. It began in the 19th Century with

the export of certain key ideas out from Britain into Europe and parts of the rest of the world. In the 43 years between 1870 and 1913, annual global economic output doubled. The jump in production was as great as the entire increase seen in the previous 1000 years of human endeavour. It took another 30 years to double again, then 20 years, then 15, and since 1980, global output has increased again by a factor of 3.

Just as extraordinary as the sudden increase in productive capacity was how geographically limited it was in scope, at least to begin with. Before 1600 there was remarkably little differentiation in global per capita income. Despite vastly different geographies, resource endowments and historical development, Western Europe, the richest corner of the world, was perhaps twice better off in per capita terms than Asia or Africa, the poorest regions in the world. By 1870, income levels in the US, then the richest geography, was 5 times greater than Asia or Africa. By 1973, the difference was 13 times and by 1998, 19 times, the greatest differential in history.

The early-adopters of the process of economic transformation shared a common cultural heritage. With very few exceptions, they were all either European or off-shoots of European countries. The temptation is therefore to conclude that it is something inherent in the socio-political traditions of European nation states that is necessary for a flourishing market-based economy to transform living standards.

Yet the evidence for the causal link between a Western model and transformative growth has become more and more tenuous over the last 50 years. Beginning in the 50s, the number and range of countries experiencing the transformative power of economic growth began widening and accelerating. It began quite slowly with Japan and Korea in the 50s and 60s and then the South East Asian tiger economies in the 60s and 70s, suggesting that these were exceptional cases.

But it did not stop there. Defining strong growth as GDP expanding by more than 3% on average in every year for a decade or more, the new entrants to the high growth league in the period from 1980-2010 comprise countries with hugely varied histories, geographies and cultural and political legacies: Botswana, Bhutan, Ireland, Singapore, Mauritius, India, Malaysia, Indonesia,

Chile, Sri Lanka and Malta. If we move the start date up to 1990, the list broadens to include Vietnam, Lebanon, Trinidad & Tobago, Laos, Mozambique, Poland, Guyana and Tunisia.

In 1900 there were around 300 million people in countries enjoying high economic growth. By 1960, there was 2.5 billion. Today, there are 5.5 billion people living in countries with growth rates higher than the average in the G7.

Increasingly, transformational growth is taking place in countries which consciously reject Western models of government and governance. There are very few political and social institutions that are universally applicable across markets. The institutional reasons for success are remarkably idiosyncratic. There were some common conditions that are crucial. But there are others that were demonstrably not. During the industrial revolution no country was a democracy which we would recognize today. The Rule of Law was only really robust in the UK. There was no free press in Germany or Japan or Russia. Capital markets were not regulated.

Many of the socio-political traditions we associate with market-based economies could just as easily be argued to have been the result of economic transformation, rather than the preconditions for it.

The only obviously common thread that links most of the countries that have started to enjoy the benefits of rapid economic growth is that they have increased the domain of the market in allocating resources. A combination of allowing markets to set the price of labour, capital and goods, and a commitment to opening up to trade and maintaining a degree of fiscal and financial stability has been enough to kick-start growth. The only other common factor all of these countries share is their diversity.

Moreover, alongside the *broadening* of countries experiencing rapid economic growth, the *rate* of growth is itself increasing. The growth rates during the Japanese economic miracle were surpassed by the Asian tigers before China smashed the Asian growth records. In a Western context, Ireland's average GDP growth of 6% per year for the two decades from 1988 to 2007 exceeded anything achieved by any Western nation in the so-called Golden Age of 1950 to 1973. And in recent years a series of often unexpected countries have matched Chinese growth rates: Kazakhstan, Angola, Ethiopia, Cambodia and Sierra Leone. There does seem to be an emerging

pattern of later take off leading to faster convergence. This is certainly the pattern of development we are witnessing first hand in sub-Saharan Africa today.

Transformation Growth in Africa

Almost 20 years ago, Miles Moreland the true pioneer and godfather of modern investment in Africa, recognized that many African companies were highly profitable and relatively well run. As Miles puts it, he ‘went along and began picking through the rubble’ in an exercise he likened to ‘salvage reclamation’, at a time when mainstream investors regarded Africa as toxic waste. The grass roots involvement of Miles meant that he was the first major investor to spot and understand the takeoff of the African economy. In sharp contrast, in 2000, the *Economist* magazine had an edition with a front cover showing a map of Africa and the title ‘Africa, the Hopeless Continent’.

Five years later, when Renaissance Group and our investment banking arm, Renaissance Capital, became actively engaged across the continent the hard data clearly confirmed what Miles had been saying: that Africa was becoming one of the fastest growing regions of the world and was making steady progress in addressing many of its most challenging macroeconomic and governance problems. One of the biggest opportunities we saw was to produce high quality capital markets research for the world’s major emerging markets investors. By breaking down investors’ deeply held prejudice against Africa we hoped to accelerate their participation in Africa and to build a new business for ourselves in the process.

Today Africa’s economic success is widely understood amongst global investors. In fact, within the next couple of years I expect that it will become conventional wisdom that Africa is one of the most attractive investment destinations globally. Ironically this may mean that Africa has access to too much rather than too little capital, but more of that later.

Detailed analysis by the World Bank, IMF, global investment banks and, most recently, McKinsey and Company means that there is now little debate on the speed, breadth and other key dimensions of Africa’s economic renaissance thus far. Briefly summarized, the key facts include the following:

- Economic growth in Africa has averaged 6% over the last decade, greater than that enjoyed by India between 1995 and 2005.
- Today 8 of the 20 fastest growing economies in the world are from Africa. Stunning as it may sound, Ethiopia's growth has been on a par with China's over the last decade.
- The resurgence is broadly based – between 2000 and 2008 economic growth accelerated in 27 of Africa's 30 largest countries. Remarkably, of 43 sub-Saharan countries only Madagascar is expected to have negative growth this year in comparison with more than a dozen such economies in the mid-90s. The naysayers' tired refrain, 'what about Zimbabwe', holds little weight today.
- Analysis by McKinsey suggests that natural resources account for only a quarter of Africa's growth with those sectors that benefit from strong domestic activity accounting for the majority.
- Similarly IMF data show that GDP growth is remarkably similar between African countries with significant resource exports and those without and the IMF has concluded that "natural resource endowments and geography.....have not been decisive factors in explaining the growth takeoff since the mid-90s".
- In 2009 despite the massive collapse in virtually all commodity prices Africa was the only region of the world not to record a single quarter of negative growth (if Asia is treated as a single region that is). Just compare the performance last year of two oil-dependent and supposedly hopelessly managed emerging markets: Russia which suffered a 7.5% economic collapse and Nigeria which achieved a stunning 7% growth rate.
- As in Asia in the 1960s, the acceleration of growth coincided with the cessation or reduction of wars and conflict. Post conflict, economic growth rates increased by 10 percentage points in the DRC and 15 percentage points in Sierra Leone for example.
- Africa's macroeconomic performance has improved very significantly – between the 1990s and the 2000s inflation has fallen 64%; government debt by 28% and fiscal deficits have by 60%.
- Finally, according to World Bank indicators the majority of African countries have implemented successful microeconomic reforms and those countries implementing the most reforms and greatest trade liberalization have experienced the greatest acceleration

in economic growth. By some measures Rwanda is the fastest reforming country in the world in terms of the ease of doing business.

At a more subjective level, I believe that the transformational economic success experienced by most of Asia and parts of Latin America and Eastern Europe has taken the ideological debate out of economic policy formulation in most African countries. The value of fiscal discipline, modest inflation, economic openness and private ownership are no longer in contention. Apart from the Ivory Coast, I have not talked to any African leader with anything but scorn for old-fashioned statism or socialism.

Private sector agents have equal conviction in the effectiveness of the basic reform recipe because the movie of economic transformation has been seen so many times before around the world. Local bankers from Lagos to Nairobi are totally aware of the boom in financial services achieved in countries as disparate as Chile, Poland and China. They fully believe they now have the opportunity to create the same success at home. This has underpinned the conviction necessary for major long-term investment in people, infrastructure and technology. The same applies across virtually all other domestic sectors from retail to real estate.

International strategic and financial investors have also seen the economic transformation movie many times before and are helping to dramatically reduce the cost of capital for African businesses. It is rapidly becoming conventional wisdom that virtually all of the world's growth is in emerging markets and that Africa is the last great frontier. For once, investors' herd mentality is working in Africa's favour. Hardly a week goes by without another global CEO extolling the virtues of the African investment opportunity. And I don't just mean the Chinese, who I will come back to later.

However, many aspects of Africa's ongoing transition continue to be hotly contested. I would like to comment on three aspects of Africa's future: 1) the overall outlook for growth in the continent; 2) the question of where to invest in Africa and 3) the role and importance of domestic African businesses.

Future Growth in Africa

Given the 50 year history of growth broadening across different countries while tending to increase in speed, I think it is probable that in the coming decades large parts of Africa will outpace the growth enjoyed by Asia. In the 1950s and 60s it was Asia that was considered the over-populated, politically incompetent, war-riven basket case. It's hard to imagine now, but in 1970, per capita GDP in China was less than that of Africa. The catch-up between Africa and Asia can spur economic growth which can be just as transformative for Africa as it has been for Asia. Already the IMF expects Liberia, Ghana, Ethiopia, Botswana, Mauritania, Angola, Tanzania, the DRC, Uganda, Niger, Libya and Mozambique to be amongst the 25 fastest growing economies in the world over the next 5 years.

Improved governance, growth and stability across most of Africa have unleashed private sector value creation and investment in a wide range of industries. At an anecdotal level I see numerous examples, wherever I travel in Africa, of this private sector success creating stronger and broader domestic political constituencies for further reform and modernization. Put simply, my perception is that Africa's growth has kicked off and is being propelled by a virtuous cycle entailing the collapse of discredited ideologies, improved governance and greater business confidence leading in turn to further business and community-based pressure for additional modernization and reform. And this process is greatly increasing the expectations and aspirations of African political and business leadership. I am often stunned by the level of aspiration and commitment to development visible today, especially in comparison with the more muted confidence evident four or five years ago.

Why growth should be faster than that experienced by Asia is an interesting question. In essence I think that a number of the key transmission mechanisms for development simply operate faster than they used to. As I've already discussed, Asia's own success means that redundant ideologies are extraordinarily difficult to sustain and the key parameters of good economic management are clearer than ever. Similarly, business confidence and accelerating domestic investment happens faster because the formula for economic success has been tried and tested so many times before.

The global capital markets also react more quickly to emerging successes because of the increased conviction in the overall emerging market growth story. Through our emerging markets platform Renaissance Capital trades or has an active dialogue with every major emerging market investor in the world. Today we hear little skepticism regarding Africa. For once the facts are widely and well understood. Whether we are talking to Sovereign Wealth Funds, the worlds' largest institutional investors or savvy hedge funds the questions are more about how rather than if or even when to invest. Two dedicated Africa funds have already reached USD2 billion dollars in size and there is a proliferation of medium-sized specialist funds; I expect all of these numbers to rapidly multiply. Even Bob Geldof has gone from being the poster rock star for aid for Africa to launching his own USD250 million private equity fund.

The process of accelerating capital flows into Africa will be reinforced by the likely massive, tidal movement of capital from the West to the emerging markets. Foreign capital inflows into Africa had been growing strongly prior to the 2008 crisis. Total foreign capital flows, including bank lending, capital market flows and foreign direct investment increased from USD15 billion in 2000 to USD87 billion in 2007; more than 20 African countries received at least USD500 each in foreign investment in 2008. Moreover, according to analysis undertaken by McKinsey returns on African FDI exceed those in other regions of the world.

However, until very recently the allocation of global capital has been massively influenced by the historical economic dominance of the West together with the market dominance of Western financial institutions. The crisis of 2008 was in fact one manifestation of this, with savings from emerging markets and commodity producing countries being intermediated through the Western financial system to Western businesses and households. In effect, emerging market savings were being channeled into low return, structurally risky assets in the West and away from high return emerging market investment opportunities.

This process is now reversing. Capital market inflows into emerging markets are currently at their highest levels ever. Similarly, most of the worlds' major commercial banks have a deliberate strategy of moving their balance sheets out of low-growth Western markets into emerging and frontier markets. The combination of Africa's strong economic performance and its status as the last great emerging market frontier mean that Africa stands to be one the biggest

beneficiaries of this historical reallocation of global capital. Looking out several years, Africa's problem may well be one of too much rather than too little international capital as capital pours out of stagnant western economies into fast growing but still small African markets.

A related phenomenon is the increasing globalization and integration of the emerging markets themselves and the partial disintermediation of the West. One of the most oft-cited examples of this is that annual trade between China and Africa has grown ten-fold to USD100 billion over the past decade. The pronounced shift in Africa's trading pattern toward faster-growing emerging markets helped to maintain export performance through the recent global recession.

China's voracious appetite for African natural resources and other assets is equally well publicized - China has invested more than USD30 billion into Africa in the last ten years, the largest non-bond investment made by China into any regional block. However, this focus on China deflects attention from the fact that *all* of the major emerging market nations have become extremely active investors in Africa. Investors from India, Brazil and Kazakhstan have all completed billion dollar plus transactions in Africa in the last year and continue to pursue dozens of projects with increasing ardor. The Russian and Middle Eastern players are not far behind.

This achieves three things for Africa: more capital, more diverse capital and, I would argue, more relevant capital. Emerging market investors frequently have business models that are far more relevant for Africa than those offered by Western multinationals: they are accustomed to rapid change and legal and regulatory imperfections, they usually built their core businesses in environments with serious infrastructure constraints and they often have low cost business models designed to serve relatively low income customers as in the case of Bharti the India mobile operator which is now an active player across Africa.

Similarly, capital market flows between and within emerging markets will increasingly play a more important role than Western flows. Last year Hong Kong saw more new equity issuance than either New York or London and I expect within the next three years Hong Kong will become the most important capital market for emerging market issuers. For example we are currently working on our first billion dollar Asian listing for an African business.

Another reason to believe that African growth may outpace Asia's is Africa's greater ability to leap frog in the adoption of new technologies and innovative governance and financing strategies. Telecom penetration in Africa has increased from 2% of the population in 2000 to 37% in 2008, not far behind the average in the BRIC. In addition, competition in African markets, particularly since the arrival of Bharti the Indian operator, is driving costs and tariffs down to extraordinarily low levels stimulating demand and the rapid uptake of new technologies. Safaricom, the leading Kenyan mobile operator, is moving beyond Kenya's modern telecoms infrastructure and is expanding its fibre optic network right through East Africa including into politically challenging markets like Somalia.

Less well understood is the potential for Africa to find leap frog solutions to one of its supposedly most intractable problems – core infrastructure. Between 1998 and 2007 Africa's annual private infrastructure investment increased four times, significantly outpacing the increase in global infrastructure spend. Going forward, there are reasons to believe that at least some African countries will find solutions to lack of investment in roads, water, ports, airports and rail which are as revolutionary as those achieved for mobile telephony.

The first reason concerns the way investors are addressing the infrastructure requirements of large-scale resource projects. To mine global scale iron ore deposits in Sierra Leone, Guinea or Cameroon or coal deposits in Mozambique, it is necessary to bring holistic solutions encompassing roads, rail, ports and, in some cases housing. And in an increasing number of cases this is exactly what is happening with mainly emerging market investors making multi-billion infrastructure investments to enable them to efficiently develop global scale resources. These investments will often have considerable positive externalities in the form of improved ability to develop other resources in the relevant region and improved infrastructure and logistics for other industries.

These types of opportunities are not limited to natural resources. Renaissance Partners, our principal investment arm, together with Kenyan partners is building a new multi-use city for 63,000 residents and 20,000 daily visitors on the outskirts of Nairobi. The next stage of the project involves USD250 million of investment in roads, water, sewerage and electricity distribution. At this stage we have several attractive options for funding this infrastructure

because of the incredibly high demand for quality residential and commercial real estate development and the increasing supply of domestic and international financing.

The final reason that I am positive about infrastructure development in Africa is the tremendous scope for greater private ownership and private public partnerships in both funding and operating large scale infrastructure projects. The combination of high growth, improved governance and regulatory stability and much greater and more diverse sources of finance mean that projects that were unimaginable until recently should become feasible. And in some cases the required reforms are not complex. McKinsey calculates that 85% of African utilities set their prices below the level required to recover capital and operating costs. This is something that many African governments will now address. For example, Nigeria's notorious power shortages actually represent a massive commercial opportunity which the forthcoming privatization of generating capacity will hopefully address.

The obvious question is why these supposedly simple reforms should happen now when their very substantial benefits have been apparent for more many years. As George Stigler once said, "all regulation is rationally devised". In the case of Nigeria, suppliers of diesel and diesel generators are major beneficiaries of the country's power crisis and have until now contributed to blocking the simplest reforms. However, following ten years of robust economic growth there is an explosion in the diversity and strength of Nigerian businesses vociferously advocating electricity reform. With any luck the political tipping point will have arrived.

Although commodities are not the primary reason for Africa's economic takeoff they are another factor increasing the likelihood that Africa will become the fastest growing region in the world. In the latter stages of the industrial revolution the fastest growing economies in the world were not the industrializing nations themselves but the major commodity producers – countries like Argentina, Australian and New Zealand – which were effectively the leading emerging markets of the time. The first industrial revolution created several hundred million middle class consumers; the current one will welcome as many as three billion people to the ranks of the middle classes over the next two decades. Just think of the demand for raw materials from supposedly redundant primary products like wool through to the totally new commodities like rare earths.

Africa's geological history means that it has one of the greatest stores of commodities in the world. The potential is vast. Let me briefly give just to give two examples in which I am involved, iron ore and agriculture. Currently there is about 1 billion tonnes of iron ore shipped globally, none of which comes from Africa. The reserves of ore being brought to market right now in Guinea, Cameroon and Sierra Leone will likely become the biggest supplies of iron ore globally. From zero now to one third of total traded iron ore is likely to come out of West Africa over the next decade.

In agriculture, sub-Saharan Africa, alongside Brazil, Southern Russia and Ukraine, offers one of the last remaining untapped resources globally. Only 10% of the 400 million hectares of land between Senegal and South Africa suitable for farming is actually exploited; Africa accounts for 60% of the world's arable land that is not in cultivation. The increase in demand for agricultural commodities can only be met by managing the potential in Africa. Improved political and economic stability, the rapid development of local banking markets and improved regulation of land ownership and agricultural markets will, in my judgment, underpin dramatic improvements in agricultural investment and productivity.

I can understand if you are now shaking your head as I lose my last vestige of credibility. Again though, this prediction is based on extrapolation from other emerging markets not a psychedelic imagination. Against all expectation, over the last 15 years Brazil has developed one of the world's most efficient agricultural sectors following decades of under investment and neglect. Wise public policy and the rapid uptake of state of the art crop types, new farming techniques and advanced technologies have transformed yields and production. Improved productivity has in turn unlocked large scale investment in storage, logistics, and transportation and processing.

We are now seeing the same trends emerge in Ukraine. Vast tracts of seriously depleted or fallow land have been consolidated by modern, large scale, domestic farming operations. Again this has been accompanied by major investment in processing, logistics and infrastructure and rapid improvements in yields and productivity. Unlike Brazil, where the government has been an important catalyst for the country's recent agricultural revolution, the best thing that can be said in Ukraine is that the state has not unduly impeded private sector initiative.

Based on the private sector dynamism and policy improvement taking place across Africa there is reason to expect that many African countries will also travel the road of vast improvement in agricultural productivity and output over the next decade or so creating hundreds of billions of dollars of additional economic output in the process.

The final reason I expect outsized economic growth in Africa relates to demographics and urbanization. It is no coincidence that the fastest wave of urbanization in history occurred in the last ten years, at the same time as the fastest period of economic growth in history. Population growth in general and urbanization in particular are drivers of growth, and they are happening faster in Africa than anywhere else on earth. Of the top ten fastest growing cities in the world today, one is in China, two are in India and three are in Africa – Lagos, Bamako and Dar es Salaam. Similarly, Africa's labour force is the fastest growing in the world. According to McKinsey, over the past 20 years 75% of the continent's increase in per capita GDP resulted from a growing labour force; the balance from higher productivity.

Where to Invest in Africa?

One of the questions I am most frequently asked about Africa is: which countries and regions of Africa will be most successful and where will the most attractive investment opportunities be? Once again, useful parallels can be drawn between Africa and Asia. We tend to talk about Asian growth as a collective concept, as if growth had been uniform across the continent in a steady process of improvement. This is, of course, misleading. Transformative growth has been anything but steady. Different countries have enjoyed radically different growth paths at different times.

Africa is just as much a geographic term as Asia. Loose talk about a great African revival risks confusing geography with economics.

While the acceleration of economic growth across Africa is very broadly based, there are major regional differences. When it comes to picking specific winners I confess that I prefer circumspection to bold predictions. Africa will have its Chiles and Taiwans. It will also have its

Argentinas and possibly (but hopefully not) its North Korea. How all of this will play out is unclear to me. Most accounts of why a particular country has taken off at a particular point in time amount to ex post or rear vision mirror analysis. The same applies to theories as to why today's laggards will never make it. These theories often have a cultural or historical bent. Unfortunately their predictive power is virtually nil and they are quickly modified as the view in the rear vision mirror changes. In one decade we are told that Confucianism is a barrier to capitalism; in the next experts extol the Chinese work ethic. India's colonial past goes from being a liability to an asset.

Jim Rohwer in his excellent book *Asia Rising* describes how, in 1955, it seemed to be the Philippines that was destined to be South East Asia's economic success story. With relatively high income levels and with a set of western-style institutions inherited from the US, the Philippines looked set to boom. War-ravaged Korea and desperately poor Taiwan looked highly unlikely to succeed. Both were military dictatorships and neither had any reason to expect any material assistance from the West. But fifty years later, the world looks rather different. The per capita income of South Korea and Taiwan is considerably greater than that of the Philippines. Moreover, South Korea and Taiwan are two of the most stable countries in South East Asia.

The point I am trying to make is that I think it is very difficult to predict which African countries will be most successful and when their success will commence. I certainly don't think that conformity with simplistic Western notions of good institutions has very much predictive relevance at all. What will stop Ghana from being another Philippines? Who would have expected the economic renaissance underway in Rwanda? Where will Angola really end up on the quality of governance continuum between Venezuela and China?

The complexity arises because the sequencing and emphasis of market liberalization will vary enormously from one successful African country to the next. Even the most basic reforms will create first round benefits that broaden the constituencies supporting further reform. This virtuous cycle of reform and benefit will be highly idiosyncratic, organic and dynamic. It will often occur without massively disrupting established political or power structures. In other words the early stages of success will often not conform well to Western preconceptions or templates of good governance. I expect that it will be transformational economic change that eventually

drives a process of institutional change and, over time, great political pluralism, not the other way round.

As an investor and a banker I cannot entirely dodge the task of trying to pick winners, but in doing so I try to avoid making country-wide generalizations. To begin with, at Renaissance we try to avoid concentration risk. Across Africa, political and conflict risk is falling, governance is improving and the economies are increasingly robust. Management teams are also becoming stronger. But the political risk in most individual African countries is still high and few Africa businesses have world class management just yet. Through diversification high returns can be achieved without commensurately higher risk.

Secondly, we try to match the type of investment we are making or business we are building with the characteristics of a particular country. Nigeria arguably has incredible attributes for emerging market investment banking. It is very big, fast growing and uncompetitive. It will have deep pools of domestic liquidity and the barriers to international players are high. Sounds like – well Brazil and Russia not so long ago; probably the two best emerging markets in the world for domestic investment banks. Accordingly we have made a big investment in and commitment to our investment banking hub in Lagos.

In urban real estate we are looking for very large conurbations in fast growing countries with reliable property title and reasonably sound rule of law. Our major real estate project is in Nairobi where, as I mentioned, we are building a new city for 63,000 inhabitants which will be one of the largest ever foreign direct investments in the country.

In natural resources you have to go where the assets are. In the last year we have raised money for resource projects in Guinea, Cameroon, Sierra Leone, Kurdistan, the DRC, Zimbabwe, Mozambique and South Africa amongst others.

In commercial banking we are the largest shareholders in ETI which operates in 30 sub-Saharan countries with more than 11,000 employees and more than 750 branches. This gives us access to a business that has scale and tremendous exposure to African growth and consumer development without a high level of country risk.

For a small proportion of our portfolio and for certain of our clients we are prepared to accept high risk in return for potentially outsized return. What could be better than Zimbabwe in this regard, a country in which we have an active presence?

In making these comments I'm not suggesting that at Renaissance we have mastered African investment. We haven't and I'm sure we will make plenty of basic mistakes including some quite costly ones. Rather I'm trying to share with you our investment thinking and how it affects our view on individual African countries.

As a general rule, given the dynamism and complexity of the African investment opportunity, to gain real understanding you need to participate in an active and committed fashion. Watching and trying to learn from the sidelines is, in my opinion, basically a waste of time. Active participants will be the first to understand which countries, sectors and businesses provide the best opportunities. More importantly, they will have the skills, credibility and relationships to do something about it.

The Role of Domestic Businesses

The final issue concerning African growth which I wish to discuss is the importance of domestic African businesses. As in politics, Western business concepts are not directly transferable into high growth emerging markets. The most successful emerging market businesses have evolved in a manner that is highly adapted to their local environment. Nowhere is this truer than in Africa.

There are two inter-related aspects of high growth emerging markets which have enabled the formation of a very large number of hugely successful local businesses that have often proved, quite unexpectedly, to be competitively superior to their multinational counterparts. These are: 1) their highly idiosyncratic nature; and 2) their extremely rapid pace of change.

It goes without saying that markets like Kenya, Zimbabwe and Nigeria are highly idiosyncratic. But think what this means for business. A successful business must work with existing

infrastructure and labour; it must navigate very specific local product market dynamics; it must manage local regulatory and legal realities. Think of the challenges this presents. How do you form a joint venture when the courts are corrupt? How do you manage risk in a consumer finance business when there's no credit bureau? As a manufacturer, how do you develop a reputation as reliable supplier when there are daily power cuts? Imagine how challenging these questions are if you are a bureaucratic multi-national, especially when every African market has its own distinct peculiarities.

The pace of change rounds out the story. In economies growing at 2-3 percent a year, industrial change is relatively gradual. In these countries explosive change is usually associated with rapid technological change such as with the IT industry in the '80s and '90s. In fast-growing emerging markets all industries are like IT. Market growth and changes in competitive dynamics are explosive. For Kenyan retailers or Nigerian banks, 100% plus growth in revenues or profits is totally normal. Small businesses can become multi-hundred million dollar value enterprises in just a few years. Needless to say, with these stakes the winners tend to be highly organized and extremely aggressive in their business style and strategies.

Successful emerging market businesses also have what I call deep local 'platforms'. They have very broad trust-based relationships – with customers, suppliers, and, yes, politicians and regulators. They tend to have a lot of specialized infrastructure and ancillary capabilities and to be more vertically integrated than their Western counterparts. These platforms enable the entrepreneur to manage the vagaries, inefficiencies and infrastructure gaps of the local environment in an effective manner. They also tend to provide resilience in difficult times. Critically, these platforms are 100% local – you can't deploy your Zambian relationships and logistics capabilities in Ghana.

Not surprisingly in many emerging markets and in an increasing number of industries the market leaders and fastest growing players are local or regional businesses that have local roots. The largest metals group in the world is Indian; most of the fastest growing companies in the sector are Russian, Brazilian or Kazakh. The fastest-growing mobile businesses in the world are owned and operated in emerging markets including Africa. The fastest-growing and largest banks in China, Nigeria and Kenya are all domestic. Across Africa foreign banks with many decades of

local presence are being lapped by the local players. Even in a global industry like brewing, the world's two largest players have emerging market roots: South Africa in the case of SA Brewing and Brazil in the case of InBev. Similarly, the world's rich lists are increasingly dominated by entrepreneurs from the emerging markets. The region with the fastest growth in the number of high net worth individuals is, for the first time, Africa, the majority of who are business people and entrepreneurs.

Let me give a couple of specific examples from Africa to illustrate what I'm talking about and why Africa already has more than 100 companies with revenues in exceeding USD1 billion. Equity Bank is the largest bank in East Africa with 4.1 million accounts and 52% of all bank accounts in Kenya alone. With a market capitalization of USD1.2 billion equity bank has grown from nothing over the last ten years despite the existence of vastly larger, entrenched competitors like Barclays and Standard Bank.

Equity Bank revolutionized the concept of banking in Kenya before expanding in Uganda and Southern Sudan. The core of their strategy was very low cost but scalable technologies to make banking accessible to a majority of the Kenyan population who could not afford the exorbitant bank charges or meet the complex requirements demanded by other banks. Its customer-friendly features have enhanced the image of the bank and it is seen as a "Mwananchi" or common man's bank that listens and cares.

The bank uses non-traditional securities like household goods to provide loans from as little as USD6. Customers are accessed through over 100 branches, 500 ATMs and armored trucks that serve as mobile branches as well as the heavy use of mobile telephony. The latter includes mobile banking and the revolutionary M-Pesha and and M-Keso joint venture with Safaricom the leading Kenyan mobile operator. M-Pesha provides cash transfer transactions using mobile telephony and Equity Bank's ATMs while M-Kesho will transform M-Pesha into a bank account from its existing virtual status. Basically, with very little investment Equity Bank and Safaricom intend to offer bank accounts to all mobile users, potentially increasing the number of individuals with bank accounts over the next five years from 22% today to 80%, the current level of mobile penetration. This process took decades in the West.

Dangote Cement started operations as a cement import terminal in 1999 before venturing into cement production on the back of the Nigerian government's programme to stimulate domestic cement production. Through organic growth and acquisition Dangote Cement has gone from 900 thousand tonnes per annum of capacity to a forecast of 20 millions tpa for next year and a target of 30 million tpa by 2015. Dangote has established itself as by far the largest Nigerian cement player and now has an increasing pan-African focus with assets in Ghana, Benin, South Africa and Senegal and plans to expand into Zambia, Tanzania, the DRC, Equatorial Guinea, Ethiopia and Cameroon. This expansion is backed by billions of dollars of new investment and state of the art processing technology. With forecast net profit of USD1.2 billion dollars in 2011 and a market capitalization of over USD13 billion it is not surprising that Dangote Cement is attracting intense interest from global equity investors.

Conclusion

In summary, Africa has now experienced 15 years of economic growth and is following the trend of transformative growth which has taken place in the great majority of the world's emerging markets. In this sense Africa is not a special case, it is simply late to the party. As in all other regions, much of Africa's growth has and is taking place in countries which do not conform to Western models of government and governance. Growth in Africa is primarily due to economic liberalization and improved regulation, not to strong commodity prices. While African growth is now broadening and accelerating, in my opinion it is quite uncertain which countries will be relative winners and which will be losers.

I do predict that over the next five years Africa will become the fastest growing region in the world. Africa has much greater scope than any other region for convergence and leap frogging. In addition, in my opinion, Africa is benefiting from the fact that several of the key transmission mechanisms for economic development have sped up. These include the breakdown of redundant ideologies, consensus about what good policy looks like, stronger business conviction and confidence in future growth and the availability and responsiveness of domestic and international finance. In Africa I believe these factors are reinforcing each other in a virtuous cycle of development.

In addition, Africa also stands to be perhaps the biggest beneficiary of the historic movement of capital from the West to emerging and frontier markets and the integration of the emerging markets themselves. Further positive factors include the scope for innovative, large scale solutions to infrastructure investment, rapid urbanization and labour force growth, high commodity prices and the associated development of the agricultural sector.

In fact there is every chance that Africa's structural strengths will become a mirror image of the West's entrenched structural weaknesses.

Yes, this address is biased – it's very positive! But what a change that is. We are all brainwashed about Africa's problems and supposed inferiority. The stunning progress made by Africa is beginning to be understood but its tremendous potential is far from being properly reflected in investment decisions and resource allocation. Positive expectations and high aspirations will be key components of the next chapter of Africa's dramatic growth story.

Thank you.



The Global Economic Governance Programme was established at University College in 2003 to foster research and debate into how global markets and institutions can better serve the needs of people in developing countries. The three core objectives of the programme are:

- to conduct and foster research into international organizations and markets as well as new public-private governance regimes
- to create and develop a network of scholars and policy-makers working on these issues
- to influence debate and policy in both the public and the private sector in developed and developing countries

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