The Rise of Africa's Institutional Investors: Making Indigenous Capital Work for Africa

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Introduction

The strong economic performance witnessed across the continent of Africa since the early 2000s, generally called the "Africa Rising" narrative, has been phenomenal for Africa with transformational developments. Africa's narrative has changed from a continent in need of foreign aid to that of an attractive investment destination for investors seeking high returns. Today, the continent can boast of indigenous companies that have become business champions in varied sectors particularly banking, telecommunications, manufacturing, oil & gas, agriculture, fashion and tech; these companies are expanding the frontiers of their businesses to other countries on the continent. A good number have attracted rounds of investments from local and international investors with some being listed internationally. Behind these companies are remarkable entrepreneurs who are determined against all odds to tackle problems, provide innovation and help create jobs for the young population.

The progress made on the continent is however not without its challenges which needs to be addressed if Africa's new narrative is to be sustainable. The challenges include the lack of adequate infrastructure which increases the cost of doing business, reliance on imported inputs with its attendance strain on the local currency, limited skilled manpower, political uncertainties, lack of robust business laws, access to capital and many others. However, it is amazing that a lot of African businesses have continued to thrive amidst these challenges which speaks to the fact that a lot more can be achieved on the continent if the challenges are addressed. One of the critical challenges on the continent is accessing capital for businesses. It is important to note that a lot of initiatives have been developed on the continent to address the difficulties of accessing capital, although a lot more still needs to be done to be able to harness the opportunities. One of the significant developments in relation to accessing capital on the continent is the increasing number of institutional investors, such as the pension funds and sovereign wealth funds on the continent that are beginning to serve as a steady source of capital as they provide medium to long term capital for business.

These African institutional investors are in the early stages of their operations on the continent. They have a significant role to play in unlocking value in the African business environment as well as taking ownership of deployment of capital on the continent. Africa cannot continue to depend mainly on foreign capital for the growth of its businesses. More indigenous capital is required to drive and chart the course of development on the continent.

Institutional Investors and their Role in Development

Institutional investors are a significant segment of the financial sector of many developed countries. Unfortunately, very little is known globally about institutional investors including in developed countries. Institutional investors are specialised financial institutions which manage savings collectively on behalf of small investors, towards a specific objective in terms of acceptable risks, return maximisation and maturity of claims[1]. This means that institutional investors are able to mobilise huge funds from individual investors and institutions with a view to managing the funds usually over a long period of time by finding suitable investment opportunities that meet certain risk and return profile in order to achieve increased investment value and projected returns. The growth of institutional investors has been associated with the concept of "institutionalisation of saving" arising from the growth of pension funds, life insurance companies and mutual funds[2]. The concept of "institutionalisation of saving" refers to the increasing move of household savings to professional portfolio managers to manage savings on behalf of households as opposed to being saved in banks, buildings or co-operative societies (or the post office in past times).

The institutional investors are of different types; they include endowments, family offices, insurance companies, pension funds, sovereign wealth funds, mutual funds, hedge funds, private equity and venture capital funds and may be set up as statutory companies, limited liability companies (either listed or unlisted). Some of the sovereign wealth funds are set up as statutory corporations. The investments typically will be made through funds that may be set up as trusts, limited partnerships, investment companies (list or unlisted) and managed by a fund manager with an investment committee supervising the quality of the investments made.

Institutional investors, in carrying out their role in relation to the funds under management, make contributions to development. The role of institutional investors in development has been made possible by the fact they are large investors and can take advantage of the economies of scale in the deployment of their resources. Some of their roles in development are discussed below: -

1.) <u>Provision of Financing</u>

One of the main contributions of institutional investors to a market is the provision of large and reliable financial resources[3]. Their ability to mobilise huge amount of resources enhances their capacity to serve as a stable supply of capital for the economy. According to the European Central Bank, investment funds in the Euro area held stock of debt securities amounting to EUR 2,437 Billion and quoted stocks amounting to EUR 6,593 Billion as at end of September 2016[4]. These funds are able to provide the market with liquidity as well as financing for expanding businesses.

2.) <u>Provision of Long-term funds</u>:

The ability to provide financing over a long period of time has the positive effect of financial stability and can also foster economic growth and development[5]. This is particularly useful in financing costly and long-term development projects and allows users of funds adequate time to utilize the funds provided, to create value and wealth for the stakeholders.

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[1] E. Philip Davis and Benn Steil, *Institutional Investors* (2001) The MIT Press

[2] *Ibid*

[3] Kuhan Harichandra and S.M. Thangavelu, *Institutional Investors, Financial Sector Development and Economic Growth in OECD Countries* (2004) NUS, Department of Economics Working Paper No. 45

[4] EFAMA, *Annual Asset Management Report* (2017) 9th Edition

[5] Jaksa Kristo, Alen Stojanovic, Anita Pavkovic, *Impact of Institutional Investors on Financial Market Stability: Lessons from Financial Crises* (2014) Dubrovnik International Economic Meeting, 2(1/2) 102-117

3.) <u>Risk Appetite and Management</u>

Institutional investors have been able to take bigger risks that provide commensurate returns. They also have the resources to adopt appropriate risk management framework to ensure effective management of the risks. Consequently, institutional investors are able to reduce risk to individual stakeholders as well as to the financial system. One of the major advantages of institutional investors is seen in the diversification of their investments, competent risk assessment, asset and liability management, reduced information asymmetry and cost efficiency[6].

4.) <u>Improvement of Corporate Governance Practices[7]</u>

Institutional investors have been able to influence shareholder participation, particularly in public companies, which has changed from a passive approach to active and thereafter to activism. The influence of institutional investors has given a voice to shareholders in the management of the companies resulting in shareholder engagement by managements of companies. This engagement has resulted into maintenance of appropriate standards of corporate responsibility, integrity and accountability to shareholders. The requirements for shareholders "say-on-pay" proposals for executives, support for director elections, succession planning, or corporate social responsibility issues are results of active shareholder engagements.

The Rise of Africa's Institutional Investors

Africa has not only attracted foreign institutional investors to the continent but has also began to establish institutional investors for the continent. This is a very positive development. These institutional investors have helped to deepen the capital market by providing liquidity, growing the bond market and have helped to strengthen the financial system. Their asset allocation is expanding to a variety of asset classes that range from stocks, corporate bonds, municipal bonds, money market instruments, open and closed-ended investment funds, real estate investment funds, infrastructure funds, private equity funds. Based on an Africa Development Bank report, assets under management by African institutional investors are expected to rise to $1.8 Trillion by 2020 from $670 Billion in 2012[8]. Price Waterhouse Coopers estimates pension fund assets under management in 12 African markets to rise to about $1.1 Trillion by 2020 from $293 Billion in 2008[9]. Assets managed by African sovereign wealth funds grew from $114.27 Billion in 2009 to $159 Billion in 2015[10].

Apart from pension funds and sovereign wealth funds, African institutional investors include (a) development finance institutions like Africa Finance Corporation, African Development Bank, ECOWAS Bank for Investment and Development; (b) family offices and proprietary investment companies like T.Y. Danjuma Family Office, Heirs Holdings, Man Capital; (c) insurance

[6] *Ibid*
[7] V. Magnier, *Comparative Corporate Governance: Legal Perspectives* (2017) Edward Elgar Publishing
[8] Africa Development Bank Group, *African Economic Outlook* (2018) page 104
[9] Pricewaterhouse Coopers, *Africa Asset Management 2020 Report* (2015) page 7
[10] Quantum Global Research Lab, *Sovereign Wealth Funds as Driver of African Development* (2014/17) page 6

companies like Old Mutual, an insurance and asset management group based in South Africa. These institutional investors at times utilise private equity funds, infrastructure funds and other specialised funds as vehicles for channelling their investments; they co-invest with foreign institutional investors and may make direct investments.

Pension Funds

Pension reforms in Africa resulting in the adoption of defined contributory schemes, universal pension schemes and growth of pension fund assets on the continent has made it possible for pension funds to invest in a broad array of asset classes. About 90% of the assets are concentrated in Botswana, Namibia and Nigeria, South Africa[11]. Examples include Government Employees Pension Fund (GEPF) in South Africa, Government Institutions Pension Fund (GIPF) in Namibia, Botswana Public Officers Pension Fund (BPOPF) in Botswana and pension fund administrators in Nigeria.

The Nigeria Pension Reform Act 2014 (PRA) gives examples of the types of instruments that pension funds invest in Africa. Section 86 of the PRA provides that pension funds and assets can be invested into government securities, corporate securities, closed-end and hybrid investment funds, real estate development investments, specialised investment funds. The Regulation on Investment of Pension Fund Assets 2017 includes in the array of investment options (a) infrastructure projects through eligible bonds including railroads, toll roads, airports, ports, power, gas, pipelines; (b) infrastructure funds with multilateral development finance agencies or minimum investment manager rating of 'BBB'; (c) private equity funds with multilateral development finance agencies or minimum investment manager rating of 'BBB'; (d) real estate investment trust with minimum investment manager rating of 'BBB'; (e) Global Depository Receipts/Note and Eurobonds issued by Nigerian corporates or listed on a securities exchange that is a member of the World Federation of Exchanges.

Sovereign Wealth Funds

Having become important to safeguard the wealth realised from commodity exports in Africa for both the current and future generations, many African countries have established sovereign wealth funds. Today, there are 20 sovereign wealth funds on the continent, half of which were established after 2010 including Ghana, Angola, Nigeria, Senegal, Rwanda, Tanzania, South Sudan, Kenya, Zimbabwe[12].

Sovereign Wealth Funds in Africa

S/N	Country	Name of SWF	Year of Establishment	Asset Under Management (US$ Billion)	Source of Funding
1.	Algeria	Fonds des Regulation des Recettes	2000	77.2	Oil
2.	Libya	Libya Investment Authority	2006	67	Oil
3.	Botswana	Pula Fund	1994	6.9	Diamonds
4.	Angola	Fundo Soberano de Angola	2014	5	Oil
5.	Gabon	Gabon Sovereign Wealth Fund	1998	2.4	Oil
6.	Congo Republic	Fonds de Stabilisation des Recettes Budgetaries	2005	1.64	Oil
7.	Nigeria[13]	Nigeria Sovereign Investment Authority	2012	1.4	Oil
8.	Morocco	Morocco Sovereign Wealth Fund (Ithmar Capital)	2012	1.4	Oil
9.	Senegal	Senegal Fonsis	2012	1	Non-mineral
10.	Ghana	Ghana Petroleum Fund	2011	0.54	Oil
11.	Mauritania	National Funds for Hydrocarbon Reserves	2006	0.3	Oil and Gas
12.	Equatorial Guinea	Future Funds for Generations	2002	0.08	Oil
13.	Chad	Fonds de Stabilisation des Recettes Budgetaries	2006	0.03	Oil

[11] Riscura, Africa Pension Fund Assets (http://www.riscura.com/brightafrica/africas-institutional-investors/africa-pension-fund-assets/)

[12] Quantum Global Research Lab, *Sovereign Wealth Funds as Driver of African Development* (2014/17) page 6-7

[13] As at 2017, government contribution to the fund stood at $1.5 Billion

14.	Sao Tome and Principe	National Oil Account	2004	0.01	Oil
15.	Sudan	Oil Reserve Stabilisation Fund	2008	0.2	Oil
16.	Rwanda	Agaciro Development Fund	2013	0.041	Non-minerals
17.	Tanzania	National Gas Reserve	2013	-	Gas
18.	Kenya	Kenya Sovereign Wealth Fund	2014	0.12	Minerals
19.	South Sudan	Oil Reserve Stabilisation and Future Gener. Fund	2013	-	Oil
20.	Zimbabwe	Zimbabwe Sovereign Wealth Fund	2014	-	Minerals

Source: SWFI (2015), ESCADE Geo (2015), Investment Frontier (2015), Sovereign Wealth Funds Websites[14]

The Nigerian sovereign wealth fund provides some understanding into the mandate of sovereign wealth funds in Africa. The Nigerian Sovereign Investment Authority Act 2011 (the "Act") provides in its long title that the Nigerian Sovereign Investment Authority (the "Authority") is established to receive and manage in a diversified portfolio of medium and long-term revenue from government to prepare for the eventual depletion of Nigeria's hydrocarbon resources for the development of critical infrastructure in Nigeria that attract and support foreign investment, economic diversification, growth and creation in Nigeria.

Section 3 of the Act provides that the objectives of the Authority shall be to (a) build a savings base for the Nigerian people; (b) enhance the development of Nigerian infrastructure; (c) provide stabilization support in times of economic stress. Section 4 (1) of the Act provides for the establishment of the following three separate "ring-fenced' Funds: (a) "the Future Generations Fund", a diversified investment portfolio for the benefit of future generations of Nigerian citizens; (b) "the Nigeria Infrastructure Fund", dedicated to servicing an investment portfolio whose purpose is to assist "the development of critical infrastructure in Nigeria that will attract and support foreign investment, economic diversification and growth"; and (c) "the Stabilization Fund", a portfolio of investments geared at providing supplemental stabilization funding for the Federation of Nigeria in times of need, essentially when other funds set aside for fiscal stabilization purposes are insufficient for that purpose.

In Section 4 (2), the Act sanctions the Santiago Principles which promotes transparency, good governance, accountability and prudent investment practices and requires the Authority to implement best practices in management of the funds as well as co-invest with strategic, sovereign and internationally recognised investment funds. Section 4 (2) (d) and (e) of the Act provides that,

(d) Implement best practices with respect to management independence and accountability, corporate governance, transparency and reporting on performance as provided in this Act. including with due regard as appropriate for the Santiago Principles or other similar principles or conventions as may be adopted by the Governing Council as representing international best practice;

(e) attract co-investment from other investors, including strategic investors, sovereign and internationally recognised investment funds and private companies, to enhance the Authority's

[14] Quantum Global Research Lab, *Sovereign Wealth Funds as Driver of African Development* (2014/17) page 7

capital and maximize risk adjusted returns"

Making Indigenous Capital Work for Africa: Looking Inward

It is amazing to see that collectively, African institutional investors have a large amount of capital available and also have the potential to grow these funds. Africa has always looked outward for aid and capital; however, it is high time for the continent and its leaders to look more inward to grow and deploy the resources and skills that will make capital available for sustainable development on the continent.

Below are some thoughts on what can be done to make capital available for sustainable development: -

1.) Growing the Capacity of African Institutional Investors

Growing capacity will involve growing the funds available for deployment, skills and experience of personnel involved in management of the funds; and research into the ways in which performance of the funds can be optimised to provide the significant returns as well as efficient risk management for the investment portfolio. African sovereign wealth funds are small in comparison to funds in emerging and developed markets, in fact, private equity funds in developed countries have bigger funds to deploy than African sovereign wealth funds. It is therefore important for African governments to make sacrifices and save more from foreign exchange earned from commodity exports.

2.) Infrastructure Development

Infrastructure development is crucial to reducing the costs of doing business on the continent. There should be a focus over the next decade on building infrastructure that can sustain the population boom that has been projected to occur on the continent. If the cost of doing business is reduced, businesses will thrive, and the continent will be able to attract more investment to provide jobs for its growing population. Just like the African Development Bank has made infrastructure development its focus, Africa governments and the private sector should collaborate and do the same.

3.) Developing Partnerships

Partnerships and collaboration amongst African institutional investors will be necessary to make some of the required capital available. Collaboration with foreign institutional investors is also important for co-investment opportunities and capacity building for African fund managers as there will be a lot to learn from experienced institutional investors in developed countries particularly in relation to portfolio management and risk management. However, in collaborating with foreign institutional investors, African institutional investors should be at the driving seat of seeking investment opportunities on the continent.

4.) Improvement of the Business Environment

A favourable business environment is important to attract investment, even the African institutional investors will not invest funds in the absence of a favourable business environment. African governments have sole responsibility for this and should create favourable regulatory environment for business, pass investor-friendly business laws, eliminate corruption in government agencies and ensure security of business property and assets.

5.) Good Governance

African leaders need to continue to promote good governance across the continent. It was noted at the Brookings Africa Growth Initiative Roundtable Series of 7th October, 2016[15] that "[c]orporations have a wide range of options when picking an investment destination, [i]n order to make their investment environment attractive, African nations must boost investors' confidence, largely by enacting stable policies and *consistently recognizing the rule of law*".

Conclusion

The government of the African nations that have established sovereign wealth funds should be commended for taking this step. The funds will ultimately have a cushion effect on the financial system of the countries. It is a good development in view of the fact that sovereign wealth funds arose to prominence during the financial crises and acted to recapitalise a number of the world's largest financial institutions including Morgan Stanley and Merrill Lynch[16]. Price Waterhouse Coopers has identified the impact of sovereign wealth funds to include (a) lowering of government borrowing costs as investors will be willing to lend money on better terms to a country with a sovereign fund; (b) limit of foreign exchange rate appreciation in situations where inflow of foreign exchange can lead to "Dutch Disease" where appreciation of domestic currency can damage the competitiveness of export reliant sectors like manufacturing[17].

Hence, it is appropriate to say that African nations should look more within the continent to harness, create and develop value. We need to develop our people, industries, businesses, financial and political institutions. In this article, the call is to support and develop the growing number of institutional investors that will be able to provide the much-needed capital for growth and development on the continent.

For further information, questions and clarifications, please contact:

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[15] Brookings Institution, https://www.brookings.edu/events/doing-business-in-africa-a-risks-trends-and-opportunities-roundtable-2/

[16] Pricewaterhouse Coopers, *Impact of Sovereign Wealth Funds on Economic Success* (2011) page 2

[17] *Ibid*