International Growth Centre

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Financing Africa's Future

The costs of doing business in Africa have historically been great, but the socio-economic achievements witnessed over the last decade are considerable. The African Development Bank's large appetite for infrastructure projects proves that investing in Africa is now a very attractive proposition

The socio-economic achievements in Africa over the last decade are considerable. Average incomes are up by 30% — between 1980 and 2000 incomes had actually declined by 20%. Contrary to popular perceptions, while strong commodity prices have indeed played a part, many other factors have as well.

Indeed, 30% of Foreign Direct Investment (FDI) is outside the extractive industry. That is why countries like Rwanda and Ethiopia, not rich in either oil or minerals, are among the strong performers. Domestic demand has spurred growth thanks to demographic dynamics and urbanization while stronger links with the emerging markets have also been important. By some measures gross fixed capital formation is up to 23% from around 12% a decade ago. There is a tendency to focus on the role of China in this, but we have also Brazil, whose investments in the last decade have increased from $4.3 billion to $27 billion, and Turkey whose investments have increased from $2.1 billion to $13.3 billion.

Obstacles to overcome

Nonetheless there remain issues that need to be addressed. Poverty is falling, but not fast enough. Social indicators are improving, but inequalities remain too high. FDI has increased, but there is not enough job creation. The reason for this is limited structural change and diversification: agriculture's share of GDP — and thus jobs — has declined; manufacturing is hampered by fragmented markets, poor infrastructure, and especially energy and port capacity.

Going forward there will be many obstacles to overcome, but I want to focus on the critical role of infrastructure because infrastructure is both a challenge and an opportunity. African countries are currently only able to spend about 5% of GDP on infrastructure, a figure which must rise to nearer 15%. Until then, this gap will continue to cost the continent 2% of GDP annually. A decade of rapid economic and population growth, urbanisation, and increased investment in extractives has raised demand for everything from rails, to ports, to roads. For example, the 49 countries of Sub-Saharan Africa (SSA) with their combined population of up to 1 billion currently generate approximately the same amount of power as Spain, which has a population of 45 million. Until these infrastructure shortages population of 45 million. Until these infrastructure shortages are addressed, congested ports and power cuts will continue to reduce opportunities for business growth.

Closing the financing gap

At 60% of all its operations, the African Development Bank (AfDB) is currently the largest funder of infrastructure investment in SSA. We lend about USD 4-5 billion each year and since 2006 have overseen at least 50 Public Private Partnerships (PPPs). The Bank's large appetite for infrastructure projects proves that these are very attractive propositions.

Yet private investors seem to be constrained by a number of factors – OECD rules, rating agencies, etc. – which means that they invest very little (less than 1%) in infrastructure as a whole. It is clear that if this financing gap is to be closed a new approach is needed to tap into both Africa's pool of savings and encourage international investors.

The new landscape for innovation and business

African governments need to understand and be opportunistic in utilizing an attractive investor base made up of sovereign wealth funds (SWF), pension funds, insurance companies, and high-net-worth individuals (HNWI). Having analysed our own experience, the gaps, the concerns of investors, and the limited traditional resources, the AfDB decided to design a new vehicle, known as **Africa50**, to respond to all those concerns.

Africa50 aims at mobilizing private financing to accelerate the speed of infrastructure delivery in Africa, thereby creating a new platform for Africa's growth. It will focus on high-impact national and regional projects in the energy, transport, ICT and water sectors. Africa50 will establish two business segments, as follows

1. **Project development:**

The primary objective of this segment is to increase the number of bankable infrastructure projects in Africa. This will be accomplished through substantially increased funding of early stage project development activities, made possible by innovative partnerships and incentive schemes. Further, Africa50 will make skilled legal, technical and financial experts available to projects from an early stage of development, sharing costs with member governments and developers and recovering its funding at financial close or through a carried interest in the project.

2. **Project finance:**

This segment will focus on delivering the financial instruments required to attract additional infrastructure financing to the continent. These will include, but will not be limited to: A) bridge equity, B) senior secured loans, C) refinancing/secondary transactions, as well as D) credit enhancement and other risk mitigation measures geared at attracting non-traditional funders such as institutional investors and international investment banks.

Africa50's critical objective is to shorten the time between project idea and financial close –from a current average of 7 years to under 3 years, thereby delivering a critical mass of infrastructure in Africa in the short-to-medium term. To deliver on Africa's current infrastructure pipeline, including PIDA, Africa50 will need an equity investment of USD 10 billion, thereby attracting USD 100 billion worth of local and global capital. Depending on funding needs and the project pipeline, Africa50 will augment its financial capacity by raising debt in the international capital markets. In order to ensure reliable access to capital markets while also offering additional operational flexibility, Africa50 will target an investment grade rating of single A.

As a commercially oriented financial institution, Africa50 will seek to preserve and grow its capital base as well as provide a return to shareholders. It will have three broad groups of investors: A) African Countries; B) the AfDB and other major development financiers; C) institutional investors such as sovereign wealth and pension funds. The ownership of the founder's equity by African countries is central to the strategy of Africa50. Such ownership is intended to send a strong signal to developers and financiers about the commitment of African countries to address the continent's infrastructure challenges.

An asset to the world

Africa is at a turning point, but we will have to wait and see whether it is a tipping point. The socio-economic achievements seen over the last decade are considerable, but there remain issues that need to be addressed. One of the key issues to address is infrastructure, but funding infrastructure requires a paradigm shift that attends to the concerns of the global pools of funds looking for a good return. Governments have begun to step up mobilisation of resources and the African Development Bank is helping to ensure that investing in African infrastructure projects remains a highly attractive prospect. Ultimately, an Africa that is growing fast is an asset to the world.