The Economist Intelligence Unit

A report from The Economist Intelligence Unit

Risk and reward:
The Gulf's push into African infrastructure

Commissioned by

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Contents

About this research

Risk and reward: The Gulf's push into African infrastructure is an Economist Intelligence Unit report examining Africa's growth story, the current state of infrastructure, and the role Gulf-based investors are playing. The findings are based on desk research and interviews with a range of experts, conducted by The Economist Intelligence Unit. This research was commissioned by Dubai Chamber.

The Economist Intelligence Unit would like to thank the following experts who participated in the interview programme:

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- **John Sfakianakis**, chief investment strategist, Masic Group, Saudi Arabia
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Executive summary

Africa has enjoyed a decade of high growth, especially south of the Sahara, but this is now placing an increasing strain on the infrastructure stock. While investors, companies and donors have poured financing into roads, railways, information and communications technology (ICT), water and power, there remains a significant financing gap. As much as US$93bn is required annually to meet the continent's infrastructure needs through to 2020, with half of that amount currently being met, according to the African Development Bank[1].

That leaves a large gap for investors to fill, including sovereign wealth funds, multilateral lenders, individual companies and private consortia. Are the companies and investors based in the cash-rich Gulf region, with its cultural and historical ties to Africa, positioned to participate? This study, drawing on desk research and expert interviews, looks at the state of infrastructure in Africa, investment trends, the activities of Gulf players, and strategic lessons to be learned from their experiences so far.

Key findings

- **Africa has enjoyed a decade of high growth, especially south of the Sahara**, but this is now placing an increasing strain on the infrastructure stock. Economic growth over the last decade has been robust, consistently surpassing 5%[2]. Although welcome news, this is putting increasing pressure on infrastructure, as evidenced by transport congestion, high logistics costs, inadequate asset maintenance and insufficient service provision in critical areas such as water and power.

- **Gulf entities are increasingly investing in African infrastructure for profit, alongside traditional aid initiatives.** Gulf investors have focused on telecommunications and ports in Africa and are investing more heavily in power. Their investment follows a decade of oil boom-driven infrastructure expansion in their home markets. During this period many state-owned companies were corporatised and part-privatised and are now increasingly looking abroad for profits.

- **Gulf funding, both public (aid) and private, has focused heavily on North Africa and a small selection of sub-Saharan countries with which Gulf countries share historical and cultural ties.** This is shifting as Gulf firms broaden their involvement to parts of southern and eastern Africa, but there are key markets, such as Ethiopia, Angola and Nigeria, which have seen less Gulf infrastructure investment to date.

- **Smaller Gulf companies are well placed for Africa's power needs.** Given the perceived

[1] http://www.afdb.org/en/topics-and-sectors/sectors/private-sector/areas-of-focus/infrastructure-finance/. See also http://www3.weforum.org/docs/AF13/WEF_AF13_African_Strategic_Infrastructure.pdf.

In their 2010 report McKinsey & Company put the annual infrastructure spend of private and African government sources combined at US$72bn per year, but infrastructure investment figures have fallen since the onset of the global financial crisis in 2008.

McKinsey forecast that US$118bn per year would need to be spent to bridge the infrastructure gap. See: http://www.mckinsey.com/insights/africa/lions_on_the_move

[2] https://www.imf.org/external/pubs/ft/reo/2014/afr/eng/sreo0414.pdf.

political risks associated with mega-projects in several African markets, smaller-scale projects have growing appeal, especially in energy. While such prospects are too modest for major Gulf investors such as sovereign wealth funds, small and medium-sized power companies are making inroads. The renewable energy industry is attracting particular interest. While most Gulf funding has been for smaller, aid-driven projects, commercial ventures are increasingly in evidence.

- **A nuanced approach to risk is needed.** While investors are lured by Africa's natural resources and consumer markets, many remain deterred by political risk from committing to public infrastructure projects—and with good reason. Yet Gulf investors must take care to differentiate between the region's many countries, rather than view them as a homogenous "African" market. Moreover, co-investing with international lenders under the umbrella of investor protection agreements can reduce investors' exposure.

- **African governments can promote Gulf investment by demonstrating commitment to investor protection.** Governments must showcase successful infrastructure projects if they wish to counter blanket perceptions of Africa as a risky investment environment. Stable rules, consultative approaches during disputes, transparent procurement and bidding processes, a zero tolerance policy on corruption and the upholding of legitimate projects despite changes in government are among the most powerful signals. Strengthening regulation of Islamic finance could also catalyse infrastructure funding from the Gulf.

1 Investing in Africa's infrastructure gap

Over the last decade the majority of African economies have achieved robust GDP growth. Public finances are stronger, macroeconomic indicators have stabilised, foreign direct investment has expanded beyond natural resources, and levels of conflict have fallen compared with the pre-millennial decade.

Yet the continent now finds itself at a crossroads. Last year Standard & Poor's, a rating agency, warned that Africa's "'boom years" might be over owing to the shifting dynamics of global commodity markets.[3] The return of developed markets to stability and growth gives investors more outlets for their capital. Within Africa, several countries face political challenges. Civil conflict has been affecting Nigeria, Kenya, Mali, South Sudan and, of course, North Africa. Africa's rise is not over. But its growth has been tempered, and its future is far from assured, according to the IMF[4].

Of all the challenges Africa faces, ensuring adequate infrastructure ranks high. Increasing numbers of people, goods and vehicles are travelling on an insufficient supply of quality roads, railways and ports. Longer life expectancy across the continent is pushing up demand for utilities such as water and power, which few countries are providing in sufficient quantities.

The urgency of the challenge is hard to overstate. In India and Brazil, years of good economic performance have now stalled, in part because of their failure to address infrastructure shortcomings in a timely manner. African infrastructure is similarly insufficient to support long-term growth. As much as US$93bn is required each year to meet the continent's infrastructure demands through to 2020, according to World Bank estimates. To date, less than half of that amount has been forthcoming on an annual basis[5].

"When we talk about priorities for infrastructure in Africa, energy is number one," claims Symerre Grey-Johnson, head of partnerships and resource mobilisation at the New Partnership for Africa's Development (NEPAD), part of the African Union. Nearly 600m people in Africa lack access to electricity, and existing systems are prone to blackouts. Reliance on power generators costs some African economies up to 5% of their GDP per year[6]. North African countries fare better, with access to electricity for some 98-99% of the population in Egypt, Tunisia and Morocco.

Water systems in Africa are in a poor state in low-income countries compared with those in other developing regions. The percentage of the population with access to improved drinking water sources[7] stands at just 51.5% in Ethiopia, 49.6% in Madagascar and 49% in Mozambique and Mauritania, compared with 93.8% in Sri Lanka, 85% in Myanmar and 88% in Nepal[8]. Sanitation infrastructure is deteriorating in some regions as investment fails to keep up with population growth. Sanitation and water poverty has climbed over the past two decades in southern Africa, according to Water Aid, a non-governmental organisation[9].

Turning to transport, citizens, businesses and travellers are all too familiar with the deficiencies, from traffic congestion and unsafe roads to defunct railways and congested ports.

[3] https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1136869&SctArtId=158285&from=CM&nsl_code=LIME

[4] https://www.imf.org/external/pubs/ft/reo/2014/afr/eng/sreo0414.pdf

[5] http://www.afdb.org/en/topics-and-sectors/sectors/private-sector/areas-of-focus/infrastructure-finance/

[6] http://www.irena.org/DocumentDownloads/Publications/Prospects_for_the_African_PowerSector.pdf

[7] Improved drinking water sources include piped water on premises, public taps or standpipes, tube wells or boreholes, protected dug wells, protected springs, and rainwater collection.

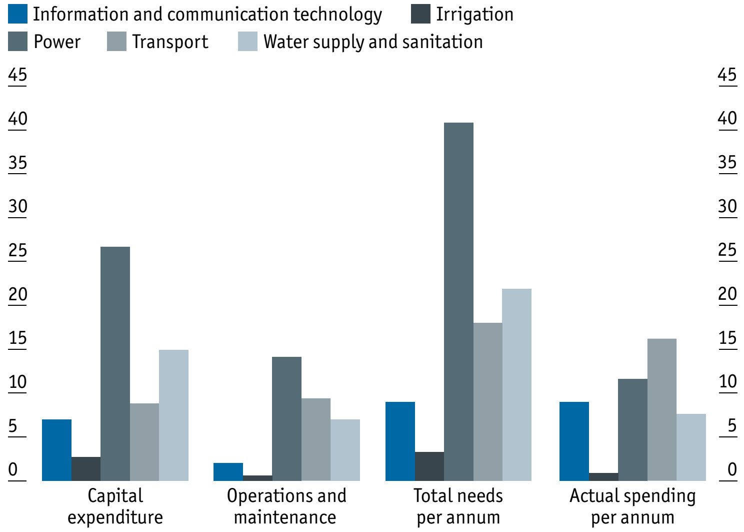
[8] World Bank data, available at: http://data.worldbank.org/

[9] http://www.wateraid.org/~/media/Publications/From-promise-to-reality-English.pdf

Demand and supply

Sub-Saharan Africa's infrastructure spending/needs versus actual

(US$ bn a year)



Sources: World Bank; Agence Francaise de Developpement.

Only 19% of roads in Sub-Saharan Africa are paved, compared with 27% in Latin America and 43% in South Asia[10]. North Africa outperforms its neighbours to the south, but overall road infrastructure development has stagnated across the continent. African transport costs are among the highest in the world.

Railways, a potentially powerful mode of transport in a continent of Africa's size, are in short supply, and rail capacity shortfalls are slowing growth. While natural resource deposits have been found in Guinea and Mozambique, for instance, timelines for revenue realisation are long, in part as a result of insufficient rail capacity. Finally, the quality of port infrastructure is a hindrance to trade integration for several African economies, with congestion and under-performance affecting the likes of Algeria, Angola, Libya and Kenya[11].

[10] http://www.worldbank.org/content/dam/Worldbank/document/Africa/Report/africa-competitiveness-report-2013-main-report-web.pdf

[11] http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf

African infrastructure in numbers

- Over 1bn people, with 41% under the age of 15
- Africa's population will more than double by 2050 on current trends, to 2.4 billion
- Over 50 cities of at least 1m people
- Nearly 600 million people in Africa lack access to electricitiy
- Only 65% of the urban population and 38% of the rural population has access to improved water and sanitation networks
- Just 19% of Sub-Saharan Africa's roads are paved

Sources: World Bank; African Development Bank; UN Economic Commission for Africa (ECA), Population Reference Bureau.

2 The investment response

While Africa's infrastructure shortfalls are sobering, the continent is seeing a steadily increasing stream of investment. The current investment average for sub-Saharan Africa is US$45bn per year, roughly half the required total of US$93bn, which covers both capital expenditure and maintenance[12]. A series of potentially transformative projects are in play. Airport projects are under way in Senegal and Rwanda. Kenya is developing Lamu Port in a multi billion dollar project. The Democratic Republic of Congo (DRC) is rehabilitating the massive Inga Dam hydropower assets. New and upgraded railway systems are strengthening linkages between Angola and the DRC, Ethiopia and Djibouti, and the East African region. Western mining companies are including infrastructure offers in bids for resource contracts to stay competitive with Asian rivals. By 2010 around one-quarter of natural-resource contracts in Africa had been tied to an "infrastructure industrialisation component", up from 1% in the 1990s, according to a report by McKinsey & Company[13].

[12] http://www.oecd.org/daf/inv/investment-policy/MappingReportWeb.pdf

[13] http://www.mckinsey.com/insights/africa/lions_on_the_move

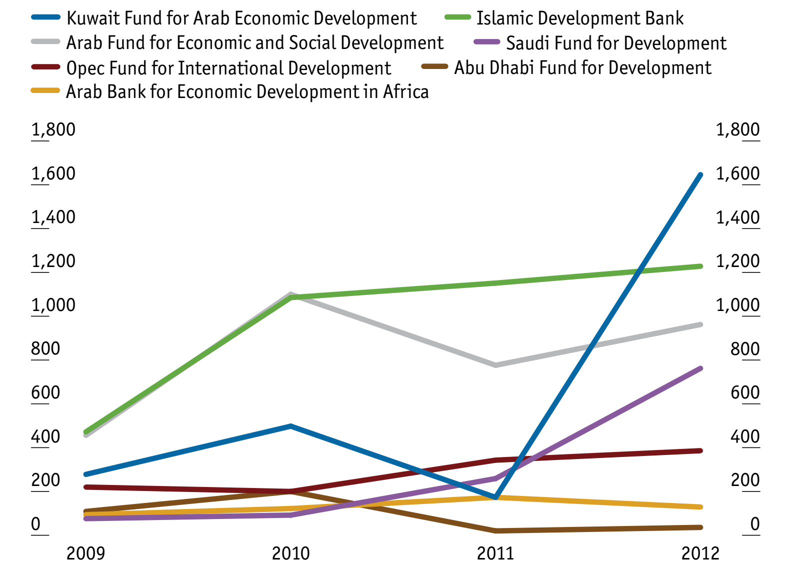
New financing mechanisms are coming to market, including the infrastructure bond scheme of the African Development Bank (AfDB). Investment banks and commercial lenders have raised infrastructure financing and African governments have tapped the bond markets multiple times over the last two years, raising money for roads, ports and utility systems.

The presence of the BRICS—an emerging-markets grouping comprising Brazil, Russia, India, China and South Africa—is relevant, not just in construction but also in financing, with the Export-Import Bank of India (Exim Bank) and a range of Chinese lenders bringing capital. China-backed projects, in particular, are worth many billions of dollars— US$13bn in 2012 alone—while Exim Bank is co-financing projects with the AfDB and encouraging its own companies to enter. The Brazilian Development Bank (BNDES) recently opened its first African office, and Brazilian firms have invested in infrastructure projects throughout southern Africa, spanning hydroelectric plants, ports, roads and housing through the likes of Odebrecht, Andrade Gutierrez and Queiroz Galvão. BNDES helped Marcopolo and Scania build the Johannesburg bus system for the 2010 FIFA World Cup. And South Africa, the final member of the BRICS group, has been increasingly active in the

Gulf aid for Africa

Arab Co-ordination Group Commitments 2009-12

(US$ m)



Source: Infrastructure Consortium for Africa.

infrastructure space north of its border and was one of the top renewable-energy investors on the continent in 2012[14].

The BRICS are also looking to catalyse investment as a unit through the much-vaunted BRICS bank. In July 2014 the five nations met in Fortaleza, Brazil, to add detail to the long-discussed concept, agreeing to set up a US$100bn development institution that would lend to infrastructure projects and provide an emergency reserve line of credit to members. The Russian finance minister, Anton Siluanov, said the five nations were in effect constructing a mini-World Bank and a mini-IMF.

The implications for Africa remain unclear. The South African president, Jacob Zuma, claimed last year that the infrastructure needs of the BRICS alone amounted to US$4.5trn over the next five years, suggesting the fledgling bank's members have plenty to focus on among themselves. Yet thanks to the integration of South Africa into its surrounding economies, even an infrastructure lift for Africa's southernmost country could help its neighbours.

Against this backdrop, where do the states of the Gulf Co-operation Council (GCC) fit in? And are Gulf-based companies and investors in this cash-rich neighbouring region, with long-standing ties to numerous African countries, playing any part in the African infrastructure opportunity? If so, what is driving them? If not, what is holding them back?

While hitherto GCC-based investors have tended to focus on investment opportunities in North Africa owing to cultural and linguistic ties, this report finds that they have broadened their focus to encompass the rest of the continent in recent years. This mirrors a wider increase in GCC engagement with Africa. According to the Gulf Research Centre, a think-tank, GCC exports to Africa grew by an average of 14.7% per year and imports increased by an average of 27.5% in the first decade of this century[15].

John Sfakianakis, chief investment strategist at Masic Group, a Saudi-based investment firm, believes the Gulf-Africa relationship could go further. "The trade flow is not representative of the opportunities, and the reason why we do not see enough momentum is that the Gulf region does not understand Sub-Saharan Africa as well as other regions," he says. "The Gulf tends to look more to the West or Asia, and there is an equal amount of neglect of Sub-Saharan Africa as there is of Latin America. In the case of Latin America, it is due to geographical distance, but in Sub-Saharan Africa you cannot claim that distance makes it less attractive... I think it is lack of information, lack of understanding."

[14] http://ppi-re.worldbank.org/Snapshots/Region/ssa#top-sponsors

[15] http://www.meed.com/supplements/2013/africa/gcc-africa-trade-flows-to-grow/3176874.article

3 GCC infrastructure spend in Africa

Gulf entities have provided at least US$30bn of funding, at current prices, to African infrastructure over the past decade, which amounts to between 7% and 10% of total inflows[16]. This figure includes approximately US$15bn in loans and grants from Gulf development agencies[17] and their shares in regional multilateral bodies such as the Islamic Development Bank, and approximately US$15bn in direct investments[18]. Both aid and investment have intensified in recent years and, on current trends, the annual contributions are likely to average over US$5bn in the coming years, which equates to at least 10% of the total average annual inflows to this sector[19].

This is a significant sum, and putting it into context, the Infrastructure Consortium for Africa, established as a result of the 2005 G8 summit, estimates that US$89bn was spent in 2012, with 44% funded by foreign donors, 9% by the private sector and 47% by national governments. Arab funding, both public and private, was equivalent to over 10% of total external funding. This was comparable to funding from European donors and more than the US$4bn from the World Bank. However, it was dwarfed by Chinese spending of US$13bn in 2012.

The Gulf companies investing in Africa are doing so following a decade of frenetic (and continuing) oil boom-driven infrastructure expansion in their home markets. During this period many state-owned companies were corporatised and part-privatised. The restructured companies, ranging from Qatar's telecoms firm Ooredoo to Abu Dhabi's TAQA energy company, are now increasingly looking abroad for profits.

Although a few bold construction firms entered road and airport projects in the 1990s, the first major wave of Gulf investment began in 2005 in the telecoms sector. Soon after the Dubai-based marine terminal operator DP World, which was already developing its first foreign port operation in Djibouti, began expanding on the continent. More recently, there has been a growing focus on power projects, an area where Gulf companies can leverage their access to capital both from their own resources and from their governments (for example, the Abu Dhabi Fund for Development recently provided US$100m in support of a power plant in Ghana being developed by TAQA).

Mapping public and private shares

Judging by the available data, Gulf funding for African infrastructure has focused on North Africa, which has received the bulk of aid (about 65% of the total) and also a large share of the direct private investment (60%). Further south, there has been a focus on fellow Muslim countries such as Djibouti and Senegal, but there are increasingly exceptions to this rule, such as the Saudi electricity company ACWA Power focusing its efforts mainly in South Africa and telecoms companies exploring increasing swathes of East and West Africa (see Chapter 3). To date, there has been relatively little Gulf investment in the continent's fast-growing economies of Angola, Ethiopia and Nigeria, which have attracted considerable

[16] EIU estimate based on publicly available information.

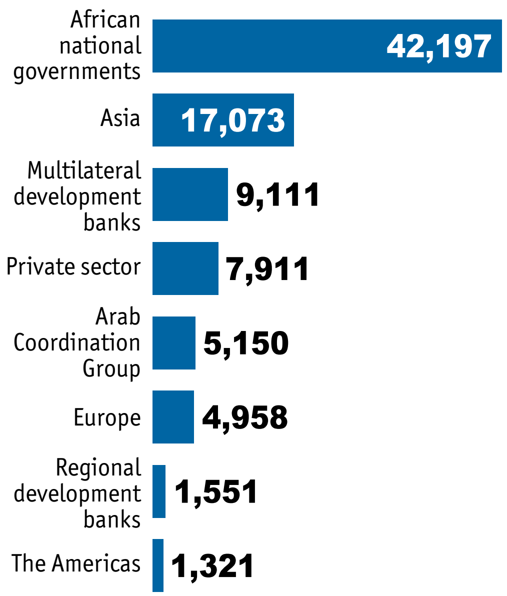
[17] This includes national funds in Abu Dhabi, Kuwait and Saudi Arabia and four multilateral bodies: the Arab Fund for Economic and Social Development, the Arab Bank for Economic Development in Africa, the Islamic Development Bank and the OPEC Fund for International Development.

[18] This calculation excludes acquisitions such as Etisalat's US$5.7bn acquisition of Maroc Telecom, as this does not represent new financing for infrastructure; it also excludes portfolio investments in African infrastructure companies (Gulf sovereign wealth funds may make substantial investments here, but there is no comprehensive public information available on this).

[19] This is an estimate based on publicly available data and could be in the region of 5-15% in any given year. Investment figures can fluctuate year on year, particularly the private-sector component, while the total spend on African infrastructure is a hard number to measure owing to frequent long delays of projects (and therefore the potential for funds to remain unspent despite commitments) and the non-public nature of certain investments—notably from China or government-linked entities.

Spreading the weight

Geographical sources of finance for African infrastructure, 2012
(US$ m)



Source: Infrastructure Consortium for Africa.

infrastructure funding from Brazilian and Chinese entities, as well as—in the case of Nigeria—companies based in the US and Europe.

The growing political dialogue between the GCC and many parts of Africa is facilitating both aid and investment. An important development was the Third Africa Arab Summit in Kuwait in November 2013. The summit agreed to increase the capital of the Arab Bank for Economic Development in Africa by 50%, and its closing statement urged banks and companies to "support the implementation of the infrastructure development programme of the African Union". Given that much of the private sector Gulf investment in Africa comes from state-backed companies, bilateral relations are extremely important.

Gulf aid and the private sector have tended to focus on different infrastructure sectors—with the exception of power, in which both are engaged. On a sectorial basis, more than half of Gulf aid has gone to transport projects, mainly road building, with about 30% on power (ranging from hydroelectric dams to rural electrification) and 15% on water projects, but very little on telecoms infrastructure[20]. By contrast, the telecoms sector has been the main infrastructure focus of the GCC private sector, followed by ports and, increasingly, power generation. Gulf investors have been less involved with roads and water infrastructure because of a lack of potentially profitable projects.

Seeking yield: Infrastructure-sector trends among Gulf investors

Telecoms

A strong focus of GCC investors in African infrastructure has been the telecoms sector. This has been especially true since 2005, with Zain of Kuwait's US$3.4bn acquisition of Celtel, an Amsterdam-based telecoms company founded by Sudanese entrepreneur Mo Ibrahim, which had 24m subscribers in 14 African countries. In 2010 Zain sold most of these operations to India's Bharti Airtel[21]. The other major Gulf player is Etisalat of Abu Dhabi. In 2005 it purchased a stake in Atlantique Telecom, an Ivory Coast operator in the West Africa region, and made subsequent investments in Sudan, Egypt, Tanzania and Nigeria. Then, in 2013-14, it acquired 53% of Maroc Telecom from France's Vivendi for US$5.7bn, strengthening its presence in West Africa.

Gulf interest in telecoms is largely a result of the sector's relatively low risk compared with other infrastructure areas. "When one turns to the actual examples of what Gulf players have done in the African infrastructure market, it's quite interesting that they would be more successful in those sectors where consumers pay upfront and where the cost in physical infrastructure investments in advance is relatively rather lower contrasted with the amount of business you get," says Paul Melly, associate fellow at Chatham House, a London-based think-tank. "Mobile telecoms are the most obvious example because many of those risks associated with a poor, economically fragile, low-income market do not really apply. In mobile, people have to pay upfront. They buy their credit in advance. Your risk is fairly minimal." Companies face the relatively low cost of erecting masts, developing networks and paying for the licences.

The challenge is that, below the Sahara, markets look very different to the Gulf. The Etisalat-Maroc deal, for instance, demonstrates that

[20] Economist Intelligence Unit estimates based on publicly available data.

[21] The reasons may have been attributable more to the group's need for cash (including paying dividends) than a lack of faith in the African market. Another contributing factor was the sharp depreciation of most emerging-market currencies against the US dollar (to which the Kuwaiti dinar is pegged) following the global financial crisis.

Etisalat could not go it alone in unfamiliar low-income markets, but it also showed that such challenges were not sufficient to deter it from alternative models. The Maroc Telecom deal signalled Etisalat's interest in tapping Maroc's regional experience and expertise in serving low-income customers, both in Morocco and in francophone West Africa, something that Abu Dhabi-based Etisalat lacked.

"Maroc Telecom is used to working out how to price its products and services at a level that is accessible to people who are on very low incomes," says Mr Melly at Chatham House. "Although the proportion of people in Mali who are in that low income bracket is obviously much higher, there are plenty of people in Moroccan households who live on US$1,000 or US$2,000 a year equivalent. And Maroc Telecom knows how to viably provide services for them."

This poses a challenge for Gulf investors since the African environment is very different—and in some ways the opposite—of what they might be used to at home. "Most Sub-Saharan African economies are low-income countries. They do have small elites with consumer demand comparable with those in the Gulf countries, the home market of Gulf investors, but most people in Sub-Saharan Africa are not remotely in the same spending power bracket. And many of them are outside the formal economic structures and reach that a Gulf investor would be used to at home or in most of the Middle East," says Mr Melly.

One question emerging from the telecoms story is whether companies such as Bharti Airtel—used to operating on a shoestring margin in India—are better placed than Gulf firms to operate in African markets, which have potentially high infrastructure costs (owing to distances and remoteness) but low revenue per subscriber, given average income levels. Bharti Airtel's acquisition of Zain's assets and its 2013 purchase of assets from Warid Telecom, an Abu Dhabi firm with operations in Uganda and the Republic of Congo, suggest it may have an edge in the African market. To compete, Gulf companies may need to partner as Etisalat has, or to draw more from their own experience of serving lower-income customers at home, notably the significant African and Asian expatriate communities in the GCC region. "If Gulf countries can adapt and operate in a low-income environment, there is massive potential," says Mr Melly.

Different local market conditions need not necessarily be a disadvantage. It could give Gulf investors opportunities they may not have at home. "If you look at it from a market potential point of view, Gulf countries—with the exception of Saudi Arabia—have very small populations and small domestic markets. And in their social make-up, because of their reliance on migrant labour, which is transient and tends to live in specially reserved areas, the potential for growing certain types of infrastructure business is rather limited. Whereas Africa, even if starting from a low-income base, has a very large population, high rates of population growth and, over the last 8-9 years, a really strong record of sustained GDP growth and rising consumer demand," says Mr Melly. If Gulf countries can master the art of operating in a low-income environment, there is "massive potential", he adds.

Even for those who cannot, the South African market still provides an environment closer to home conditions. In March 2013 the GCC-owned Gulf Investment Corporation announced an investment of US$50m in Virgin Mobile Middle East & Africa, a Dubai-based mobile telecoms firm with operations in South Africa, and Saudi Telecom Company (STC) indirectly holds a 75% share in South Africa's third operator, Cell C, through its stake in Dubai-based Oger Telecom.

Transport

In transport, Gulf investors are most heavily involved in ports, followed to a much lesser extent by airport and road construction and, increasingly, aviation. A landmark investment was DP World's concession to manage the Doraleh Container Terminal in Djibouti. Awarded in 2000, this was DP World's first investment outside Dubai and one of the first significant Gulf infrastructure deals in Africa. It has since invested around US$1.5bn and made Djibouti, the maritime gateway for Ethiopia, into the third-largest container port in Africa, contributing around one-quarter of Djibouti's GDP. DP World went on to invest in ports in Algeria, Egypt, Senegal and Mozambique, giving it coverage across the continent and substantially boosting the integration of African economies into global trade.

Ports also proved a draw to the MENA Infrastructure Fund, a US$300m private-equity vehicle backed by three Gulf investors, which in 2008 chose a minority stake in Egypt's Alexandria International Container Terminal as its first investment. Kenya has been looking for investment into its Lamu Port-South Sudan-Ethiopia Transport Corridor (LAPSSET) project, and discussions with Qatar were renewed in May 2014. Gulf logistics firms, such as Agility of Kuwait, which operates in 11 African countries, are involved in port projects.

In aerospace, while Gulf carriers such as Emirates have expanded in Africa, related construction projects are small in number. The Kharafi Group of Kuwait built the runway for Ethiopia's Addis Ababa airport a decade ago, and the Bin Laden Group of Saudi Arabia is nearing completion of a new airport in Senegal. Kharafi Group was an early mover in Africa, opening offices in nine countries between 1980 and 2002 and building roads in Tanzania and Gambia. Gulf-led development agencies, by contrast, have been very active in funding road building. In part, the low commercial appeal of roads is a reflection of the fact that few African governments can impose wide-scale toll systems because of low income levels, which substantially undermines the commercial appeal of road investment. There is no direct Gulf involvement in the rail sector, although Gulf aid here, as well as in roads, has been forthcoming[22].

Electric power

At home, Gulf power companies have expanded significantly in recent years thanks to the part-privatisation of state-backed firms in the region. Their experience in implementing power projects, including through independent power plant (IPP) public-private partnership (PPP) structures, has helped meet rapid growth in Gulf power demand over the last decade. Their interests are extending to Africa, especially North Africa and some economies below the Sahara.

The first mover was Mubadala, an Abu Dhabi sovereign wealth fund, which in 2006 took a 25% stake in the development of the Hadjret en-Nouss power plant in Algeria. Today three big players, ACWA Power (Saudi Arabia), TAQA (Abu Dhabi) and QEWC (Qatar) have projects on the continent.

As of today, ACWA Power, founded in 2002 by a consortium of family conglomerates with state backing, has the most aggressive Africa expansion strategy of the Gulf players, having invested nearly US$500m in African power so far. It was part of a consortium that won the 2012 tender for the Ouarzazate solar power plant in Morocco, contributing to the country's ambitious solar energy plans.

Moroccan solar also appealed to TAQA, the part-privatised national power company in Abu Dhabi, which lost the bid for Ouarzazate. It has been exploring other options in the Moroccan market, though, working on the expansion of the Jorf Lasfar coal plant, to which it has committed US$400m in equity, raising a further US$1bn in syndicated bank loans in 2013, as well as funds from floating a minority stake on the Casablanca stock exchange in 2014. While there have been no major acquisitions of African

[22] Transport commitments include the 2012, US$709m Kétou-Igodja-Savè road in Benin, funded by the Kuwait Fund for Arab Economic Development (KFAED); the US$200m Tangier to Casablanca high-speed train project (Saudi Fund for Development); and a US$106.4m commitment to the El Jadida-Safi motorway in Morocco by the Arab Fund for Economic and Social Development.

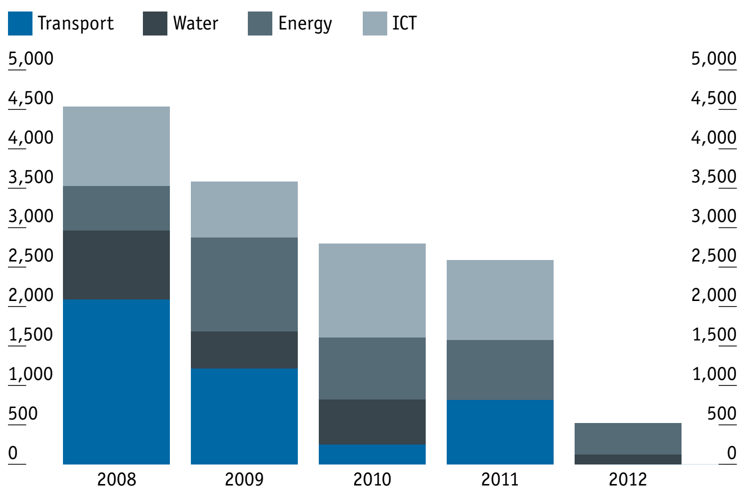
power companies, there are rumours that a stake in the Moroccan state-owned power and water company might become available, and it is likely that the major Gulf power companies would be interested, given their strong history of energy investments in this state.

While North African energy projects have proved attractive to Gulf investors in past years, they have not been afraid to venture below the Sahara. Indeed, ACWA's first African investment, in 2010, was the Moatize coal IPP in Mozambique. It has also invested in the Bokpoort solar plant in South Africa, and the company has been shortlisted in Botswana to develop a coal power plant and is bidding to build the Kudu gas power plant in neighbouring Namibia. Abu Dhabi's TAQA is active in Ghana, where it is building the country's first IPP, the Takoradi 2 gas-fired power plant, partly financed through a loan from the Abu Dhabi Development Fund—a rare example of a Gulf development agency working on a project alongside one of its domestic companies. QEWC also received a helpful hand from its home government, signing a Memorandum of Understanding (MoU) in April 2014 to build a gas plant in Mombasa in a joint venture with the Qatari state.

Seeking yield

Total private investment by sector 2008-12, less South Africa and Morocco energy projects in 2012

($m)



Source: Infrastructure Consortium for Africa.

While gas and coal projects are common in Sub-Saharan Africa, there is growing interest in renewable energy as Gulf countries, particularly Saudi Arabia, look to reduce domestic oil and gas consumption. The presence of the International Renewable Energy Agency (IRENA) in Abu Dhabi helps embed this agenda in the region.

Although most Gulf funding of renewable energy projects in Africa has been for small aid-driven projects, commercially viable ventures are increasingly in evidence. Masdar, Abu Dhabi's renewable organisation, has built the largest solar photovoltaic plant so far in Africa, a 15-mw facility in Mauritania, and has installed a wind farm in the Seychelles. One Red Sea wind project moving forward is a farm off Djibouti; Qatar's former emir discussed the project with the president of Djibouti, Ismail Omar Guelleh, at a global climate change conference in Doha in 2012, and subsequently Qatar Petroleum International and EDD, the Djiboutian state-owned utility, signed an MoU for the project.

Lastly, there are small and medium-sized Gulf firms working in the power sector in Africa. Smart Energy Solution, based in three hubs in Dubai, Qatar and Saudi Arabia, specialises in installing small-scale power generators in remote places and renting them out. It has around 250 mw of capacity in the Gulf and Africa, starting with Tanzania, and recently received a loan from the Emerging Africa Infrastructure Fund (EAIF) to help add another 50 mw of generators to its portfolio. Such low-cost distributed power solutions are popular in Africa, which has a very large landmass-to-population ratio.

Such approaches are also in vogue in Africa on the grounds of execution: some industry experts are growing cynical of mega-projects, calling for more focus on smaller-scale, achievable ones. Advocates of this approach include Jay Ireland, the Africa CEO for General Electric. Critics of hydropower projects, observing long delays afflicting projects such as the Inga Dam, have made similar arguments[23].

This presents a problem for Gulf investors commonly used to mega-investments. "Sovereign wealth funds in the GCC don't get out of bed for something that is less than US$500m, making most African infrastructure projects too small," says Angus Downie, head of economic research at Ecobank Transnational. It may prove more logical for aid funds to focus on the mega-projects, which they have already done to some extent. Most notable is the Saudi Fund for Development, which helped fund the Marawi Dam in Sudan, to which it contributed US$310m, along with US$200m each from the Kuwait Fund and Abu Dhabi Fund for Development, US$106m from Oman, and US$15m from Qatar.

But it is an opportunity for smaller firms.The shift towards smaller projects among investors is not unique to the GCC private sector. A 2013 World Bank energy report[24] found that in the Middle East and North Africa (MENA) region investors were moving towards lower-risk deals, such as contracts for existing assets, small-scale greenfield projects or user-funded, cash-generating assets such as power-generation capacity. Smaller-scale renewable energy projects, including wind and solar investments, are appealing in this regard for projects that require less upfront commitment owing to their scale compared with projects such as coal plants, refineries or electricity transmission systems. Continued investments in this sector are likely, with an active pipeline especially in Morocco and Egypt.

Water

Water, one of the most pressing infrastructure deficits in Africa, has received little attention from Gulf investors. Most funding is coming from development agencies. In 2012, Arab funds co-financed projects with the World Bank, such as the Niger River Basin Resources project, which comprised investment from the Abu Dhabi Fund (US$10m), Kuwait (US$38.42m), Saudi Arabia (US$38.62m) and OPEC (US$15m).

Of the private companies in this sector, the largest and most interesting is Metito, a Dubai-based firm which has desalination and water treatment operations in North Africa. Metito is one of the four bidders shortlisted for Egypt's US$750m Abu Rawash wastewater treatment PPP; the Kharafi Group from Kuwait is another. If one of the two is successful, it would be the first time a Gulf firm was involved in such a large water project in Africa and could set the stage for future investments, including by the likes of QEWC and TAQA. Egypt has a huge need to increase its capacity for both water treatment and desalination. Should the country attain the elusive peace and stability it seeks, Gulf companies would be well positioned to participate.

[23] http://www.ft.com/intl/cms/s/0/e9ade726-ed69-11e3-8a1e-00144feabdc0.html#axzz36xVI4EZY

[24] Infrastructure Policy Unit 2012 Middle East and North Africa PPI Data Update. Available at: http://ppi.worldbank.org/features/December-2013/2012-MNA-Regional-Note-Final.pdf

4 Assessing Africa's risk profile

As noted above, Gulf entities have provided at least US$30bn (at current prices) of funding to African infrastructure over the last decade. This figure compares favourably with sums from other emerging markets and multilateral and bilateral lenders, with the exception of China.

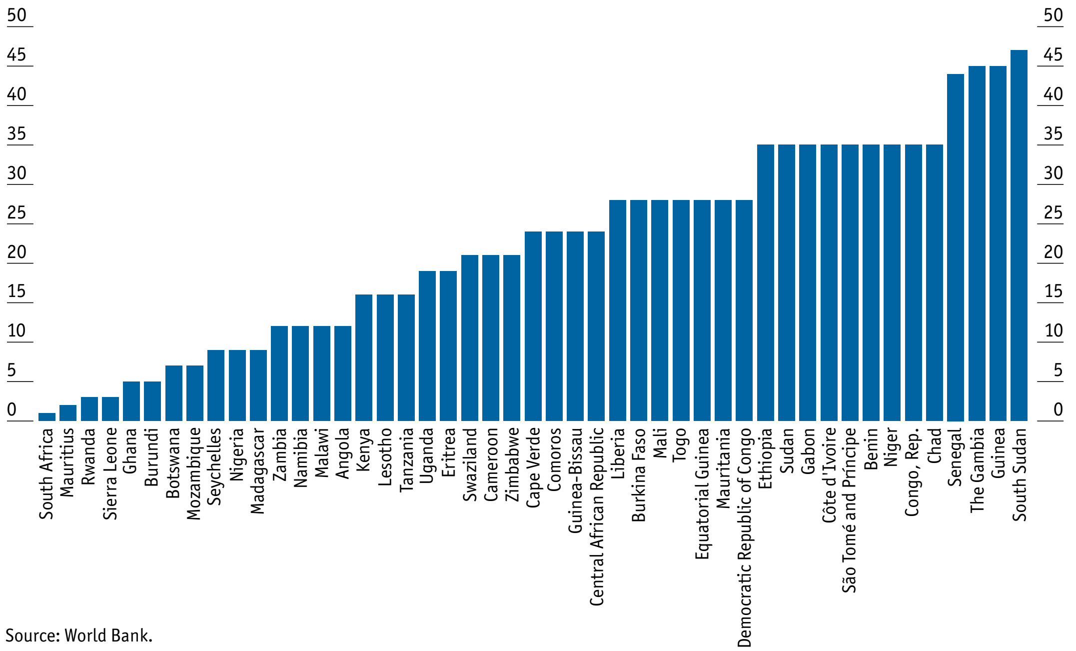
Yet while Chinese entities have invested far more in African infrastructure, a direct comparison is problematic. For Chinese companies, infrastructure deals in Africa are often part of broader commercial engagements with an eye on African resources. As such, the infrastructure is often a sweetener to win resource concessions. But Africa's natural assets are not of such vital interest to Gulf countries (although some Gulf firms are investing in the sector). Gulf investors are usually more concerned about the economics of the infrastructure project itself, and these do not always add up owing to their high upfront costs as well as long-term revenue and political risks heightened by the duration of the projects.

Yet given the large pool of capital in the Gulf, particularly in sovereign wealth funds, which have done few major deals in Africa, the region could play a bigger role. One of the main factors preventing a more ambitious push is the high-risk perception of Africa among Gulf investors, particularly in the poorly understood countries across the centre of the continent.

Peace of mind

Sub-Saharan rankings: "protecting investors"

(ranking 1=Best, 50=worst)



Source: World Bank.

Gulf investors continue to see Africa as a risky market, especially where large-scale, long-term public infrastructure is concerned. Water, public transport and electricity infrastructure are particularly problematic. The politically sensitive nature of pricing for water, transport and power raises the chance of government interventions such as price controls or expropriation. "The duration of the investments is guided by the friendliness of the investment environment, and there is this perception of Sub-Saharan Africa being a very difficult place to do business" says Mr Sfakianakis of the Masic Group.

The existence of projects with long life cycles can be in doubt if governments change and key policies over infrastructure pricing, or decisions over assets, are reversed. "With the long-term nature of infrastructure projects in Africa, investors are scared that a change of government means a previous agreement between the private sector and the government will be torn up," says Mr Downie of Ecobank Transnational. Amadou Sy, senior fellow in the African Growth Initiative at the Brookings Institution, adds: "Private investors do not really want to take this big risk of having the government basically responsible for the payment."

Wary Gulf investors have evidence to support their claims, spanning a variety of risks from operational headaches to major governance-related and political risks. Kroll, a security company, found a range of fraud threats in African infrastructure[25], ranging from regulatory and compliance breaches to management conflicts of interest and vendor, supplier or procurement fraud. Large public infrastructure projects such as ports and railways involve lengthy decision-making processes, which raises the threat of political meddling and corruption. Operational challenges, such as payment problems, have surfaced in some countries attempting rapid development. In April 2013 a Chinese company, Sinopec International Petroleum Service Corporation, warned that it would cease working on the Atuabo gas processing plant in Ghana because it had not been paid.

Political risk, spanning conflict, state-investor disputes, expropriation and non-honouring of contracts, are legitimate concerns. Egypt's post-2011 turmoil has caused the stalling of a number of infrastructure plans. The status of investments made under successive regimes, from the Mubarak era to the Muslim Brotherhood era, is uncertain. Notably, many of Qatar's Egypt investments are on hold, while Abu Dhabi's Masdar was in discussion with Egypt in 2010 for an offshore project in the Red Sea, but the project has not materialised. Egypt's ambitious PPP programme has been set back by the instability, not least because of its negative impact on the currency, which has deterred some investors.

Currency volatility is a common route through which African conflict can affect infrastructure companies. The mobile operator Etisalat Misr faced currency woes in volatile Egypt, as did Zain in Sudan owing to devaluations of the Sudanese pound. Sudan's instability also had a direct negative bearing on Zain's infrastructure. After Sudan split from the South, Zain had to separate operations and staff in the two countries, even though its infrastructure spanned both regions.

While South Sudan is obviously among the most difficult environments on the continent, established markets such as Nigeria have their own governance-related challenges. South Africa's MTN, the biggest mobile telecoms operator in Nigeria, faces threats of disruption from criminal gangs and corrupt community groups that operate protection rackets—practices that are a far cry from what Gulf companies might be accustomed to at home.

State-investor disputes are another area of political risk. DP World has reduced its exposure in Djibouti, selling two-thirds of its stake to the China Merchants Group in 2013 after

[25] http://fraud.kroll.com/articles/investment-african-infrastructure-opportunity-private-sector/

being caught in the middle of a major dispute between the government and the former head of the port authority, who has been accused of corruption and terrorism. In July 2014 the government of Djibouti filed an arbitration case in London against DP World in a dispute over the concession of the Doraleh Container Terminal in 2000[26]. In April 2013 corruption charges were lodged against Karim Wade, the son of the former Senegalese president, Abdoulaye Wade, for illicitly acquiring assets in DP World Dakar. DP World denied that this had happened, and to dispel any doubts it created a new company in Senegal with known shareholders to manage the port. The new president of Senegal, Macky Sall, has reassured DP World about the security of its investment and its importance to the country. It is interesting that similar issues related to shifting political alliances in Djibouti and Senegal have apparently resulted in quite different outcomes for the company so far.

A diverse continent

Despite Africa's governance gains over the last decade, political risks are real. But are investors taking a crude continent-wide view of risk on the basis of a few bad cases?

All emerging markets have their risks. Many investors have been burned in state disputes, currency problems, local conflicts or non-honouring of contracts in China, Brazil, India, Mexico, Indonesia, and many others besides. Moreover, Africa is composed of 54 sovereign states, each with its own risk profile. When problems emerge, onlookers too often brandish the continent as suffering a universal trend. A more nuanced approach is needed. Corruption provides a good example of the differentiation, with marked differences between Botswana, Rwanda and Cape Verde, for example, and the likes of Eritrea, South Sudan and Somalia. Yet many Gulf-based investors look at the continent, especially below the Sahara, as one homogenous market. Mr Sy at the Brookings Institution believes that discussions about Africa do not always reflect the reality on the ground. "In many cases the perceived risks are far greater than the actual risks," he says.

One way to better manage risk is through joint investment with global actors such as development banks and multilateral agencies. Such joint investment brings together several players and institutions, ensuring that no single investor is exposed to the full risk of a project and reducing the likelihood of a government choosing not to honour an agreement, since offending multiple parties is likely to have broader economic and diplomatic implications than disappointing a single entity.

Such is the conservatism of many Gulf sovereign investors, for instance, that this type of approach may be necessary even in stable markets. "If an attractive project in Africa came along in one of the countries with very high GDP growth and low political risk, I can definitely see a wealth fund investing in it, but it would need to have lots of actors involved to mitigate the risk," says Michael Maduell, president of the Sovereign Wealth Fund Institute.

African governments already partner with international institutions such as the African Development Bank or the International Finance Corporation, and investors have other options to protect themselves. The Multilateral Investment Guarantee Agency (MIGA), a member of the World Bank Group, offers political risk insurance in all countries eligible for World Bank assistance. In fiscal year 2014 the MIGA covered US$516m of new projects in Sub-Saharan Africa[27]. A similar service is provided by the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), part of the Islamic Development Bank.

Moreover, a growing number of African states have ratified bilateral investment treaties (BITs) that provide investor protection and commit governments to an independent tribunal in the event of a dispute. Kuwait has entered into an agreement with Ethiopia, locking protections

[26] http://online.wsj.com/articles/djibouti-files-arbitration-against-dp-world-over-alleged-corruption-in-port-deal-1404895724?tesla=y&mod=rss_africa&mg=reno64-wsj

[27] http://www.worldbank.org/en/news/press-release/2014/07/01/world-bank-group-commitments-rise-sharply-in-fy14-amid-organizational-change

for an initial period of 30 years, compared with the average of ten years found in European BITs. As more of these agreements are signed, such as the one between Qatar and Kenya in May 2014, Gulf investors can feel more comfortable about managing investment risk on the continent.

Another risk protection method is to ensure that investments have clear value to the surrounding economy, lessening the chances of backtracking on the part of government. "If investors collaborate to develop, say, the transport corridor from Djibouti to South Sudan, they will succeed because the project will benefit agricultural investors in rural areas of Ethiopia," says Kimiaki Jin, chief representative of the Japan International Cooperation Agency in Ethiopia. But projects in remote areas with no benefit to a greater economic cause are less likely to thrive. "You need to look for projects that create an economic win-win," he notes.

Islamic finance

A further effort by African regulators to encourage Gulf investment in infrastructure is the deepening of Islamic financial systems. Sukuk—sharia-compliant bonds—are financial products structured to pay a fixed profit rather than interest. Since these products require clear links to real economic activity and tangible, identifiable assets, they are well suited for infrastructure projects.

Gulf banks are already present on the continent. The largest, Qatar National Bank, is already present in six countries (Egypt, Libya, Tunisia, Sudan, South Sudan and Mauritania), and Dubai Islamic Bank is considering a Kenya branch.

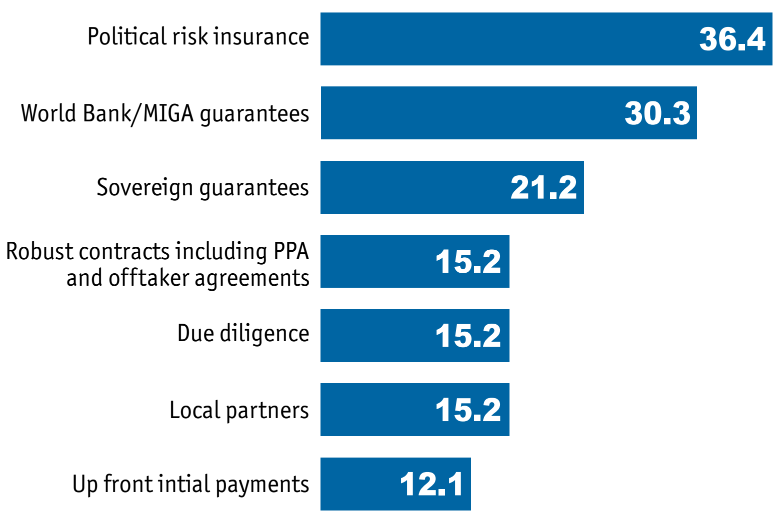
The sukuk market in Africa is modest, accounting for just 0.6% of total global sukuk issuances outstanding[28]. However, several institutions, including Standard & Poor's[29,30], and the Malaysia International Islamic Financial Centre have indicated potential for growth.

Senegal, which is 90% Muslim, opened a CFAfr100bn (US$206m) Islamic bond in June 2014. The Islamic Corporation for the Development of the Private Sector (ICD), a multilateral organisation affiliated with the Islamic Development Bank, said this issuance would be the first of a series of programmes offered in West African countries[31]. Senegal's government sees infrastructure as a beneficiary of its bond programmes, and investors are showing interest in its issuances. Senegal's July bond offering was seven times oversubscribed, with proceeds expected to be invested in public infrastructure, and especially power[32].

Nigeria provides a tantalising prospect for the further growth of sukuk. Now the largest economy in Africa, with a significant Muslim population, Nigeria is advancing its architecture for Islamic finance. In 2013 the Securities and Exchange Commission approved new rules facilitating sukuk issuance, and in September the state of Osun issued a local-currency sukuk. Nigeria's central bank, along with that of Mauritius, is also acquiring greater familiarity with Islamic finance since becoming

Managing risk

Top measures used by private sector to mitigate risk in African infrastructure
(% respondents)



Note: Some respondees indicated more than one measure.
Source: Infrastructure Consortium for Africa.

[28] https://www.zawya.com/story/Sukuk_issuance_on_the_rise_in_Africa-ZAWYA20140521063554/

[29] http://www.standardandpoors.com/spf/upload/Ratings_EMEA/IslamicFinanceOutlook_2014.pdf

[30] http://www.mifc.com/index.php?ch=28&pg=72&ac=72&bb=uploadpdf

[31] http://www.brookings.edu/blogs/africa-in-focus/posts/2013/10/17-islamic-sukuk-finance-africa-infrastructure-sy

[32] http://country.eiu.com/article.aspx?Country=Senegal&articleid=1312058715&oid=141998398&pid=141998398&subsubtopic=Policy+trends&subtopic=Forecast&topic=Economy&u=1&uid=1

a shareholder in Malaysia-based International Islamic Liquidity Management Corp, which issues sukuk to finance Islamic banks' short-term funding needs.

Islamic finance is not just an option in African countries with large Muslim populations. Kenya may offer sukuk to broaden its investor base going forward, while South Africa's Treasury announced plans for a debut sovereign sukuk last year and is considering a US dollar-denominated five-year issuance of between US$500 and US$700m.

However, experience shows that between announcing an interest and the actual issuance there are often long time lags, partly because of political and legal hurdles and the costs of issuance. A second challenge is ensuring that regulators have the skills and resources to execute Islamic finance reforms. If the architecture is put in place, however, the impact on GCC-based financiers and investors would be salutary, owing to their familiarity and comfort with Islamic financial systems and the broadening effects of Islamic finance reforms on the infrastructure investment landscape.

Conclusion and recommendations

Africa's infrastructure deficit is an increasing constraint on growth. Yet investment, while short of the sums needed, suggests optimism about the sector's potential. GCC-based players, both aid givers and private investors, have contributed an average of 10% of the annual financing, based on available data. In total, Gulf funds, both public and private, have contributed around US$30bn over the last decade, with a trend of US$5bn annually going forward—which equates to around 10% of total external financing—and investors have been venturing into unfamiliar new markets with which they do not share a long history of doing business.

Among GCC entities, funds allocated to infrastructure have hitherto focused on a selective set of countries and sectors that is now widening. Private investment is growing in telecoms, ports and power, and in future it may encompass water, roads and railways if suitable projects of sufficient size and profitability emerge.

Investment deterrents remain, such as greater opportunities in home markets, high risk in a number of African countries and unfamiliarity with low-income environments. However, with the exception of North Africa and a number of countries below the Sahara with which they have established links, Gulf investors do not necessarily have a nuanced understanding of the risk differentiation between countries. The following measures would give GCC investors a better understanding of these risks and encourage African governments to attract a wider range of players into the infrastructure space.

Pooling investment

Joint investments bring together GCC-based companies with multilateral lenders, private investors and risk-protection bodies such as the MIGA, providing a more secure "investment club" approach that could entice conservative investors. Such collaboration offers greater security to cautious investors by spreading risk and increasing the potential damage caused to host governments that renege on agreements or intervene unfairly into infrastructure ventures. African governments can signal their intention to protect infrastructure investment through the active signing of bilateral, multilateral and regional investment protection agreements that would bind governments and investors to the ruling of an independent tribunal in the case of disputes.

Adding nuance to the risk map

Observers often group Africa's diverse countries together when it comes to risk—and this is especially true of Gulf investors. While Africa's strong economic performance over the last decade has gone some way to challenge negative stereotypes, greater efforts are needed to inform investors about each country's distinct risk profile.

For African governments, implementing best practice on procurement, tendering, payment and contract stability will contribute to investor confidence—as will the communication of reforms to potential investors. Both African governments and those of the Gulf can work together to provide trade and investment fairs and information resources to increase awareness about the opportunities, and risks, of Africa. African investment promotion agencies can create a virtuous cycle of Gulf investment by showcasing successful examples of GCC-backed investment on the continent.

In the government-led economies of the GCC, personal relationships with decision-makers are important for boosting trade. African countries would do well to expand their diplomatic resources in Gulf countries in order to foster greater understanding and awareness of the opportunities in their home countries. Such a strategy will also help stimulate and encourage investments outside of the traditional aid programmes, although political priorities among Gulf countries will continue to influence the investment plans of companies. As understanding improves, partly through strengthening bilateral relations, Gulf investors will feel more confident about exploring the continent, aided by geographical proximity and expanding air links between the two regions.

Diversifying financial sources

African governments have fruitfully tapped bond markets over the last two years, raising financing for critical infrastructure projects. Islamic finance products such as sukuk, sharia-compliant bonds, remain somewhat nascent, despite their increasingly mainstream status globally and their natural fit with tangible asset projects. This ought to be the next phase. Promoting such instruments could widen the investor base for infrastructure and provide Gulf entities with new opportunities that could promote Africa's infrastructure financing.

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