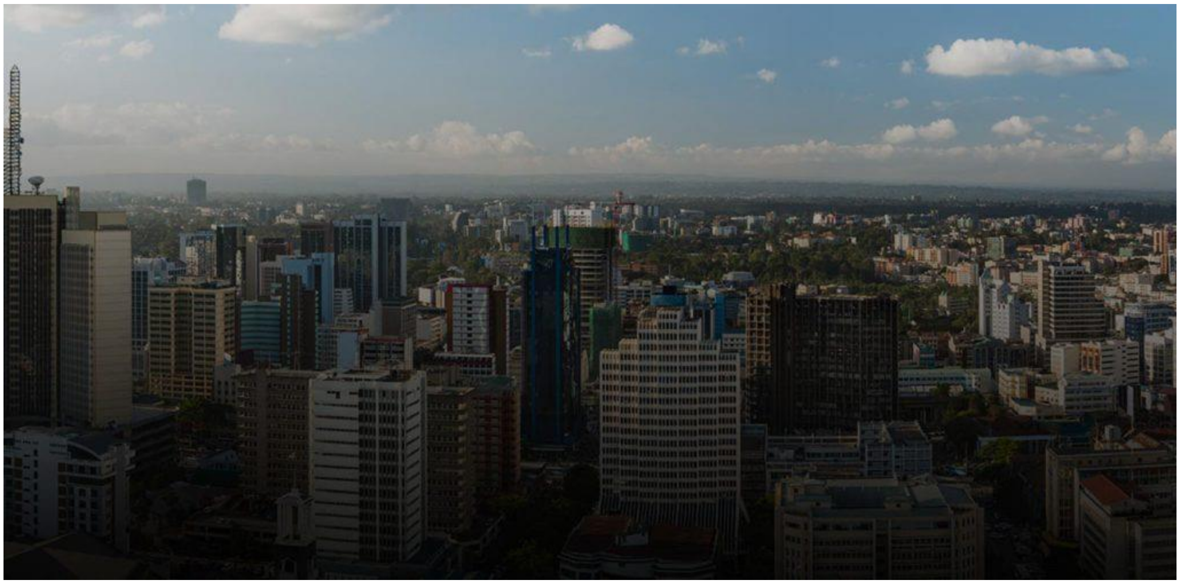
Published On: November 20th, 2021.

How investors can create wealth for themselves and for Africa



How to detect investment opportunities that can create prosperity for Africa

Africa is becoming fertile ground for investors seeking above average returns over a long-term horizon. The continent's growing population (50% of global population growth between now and 2050 is expected to occur in Africa; United Nations, 2019), improved political environment, and greater regional integration are creating a large 1.2-billion-person market that has the potential to unlock significant wealth for its citizens. Achieving this potential, however, will require innovative and patient capital with a focus on long-term prosperity for all.

Until recently, the majority of investment in Africa was predominantly focused on extractive industries (for example in 2013 resource rich industries accounted for 95% increase in FDI to Africa; IMF, 2013) and although investors have begun to invest in sectors with stronger wealth creation potential, there is still a gap of understanding regarding how to build long-term prosperity on the continent.

In regions like Africa, the performance of an individual company cannot be separated from its larger context; the strength of the industry, the economic sector, as well as the nation itself are all intertwined with the performance of the company. If the larger systems are underperforming, an individual company will find it difficult to actualize its potential. Hence, to unleash prosperity and wealth creation across the continent, it is crucial for investors to deploy capital in a manner that considers the need to affect change across several different contexts.

Create a Prosperity Generating Investment Strategy

In order to invest in a manner that builds long term wealth, investors must explicitly plan to do this and should reflect this within their investment strategy. At Consonance Investment Managers, we have built a long-term strategy based on the Milken Institute's Prosperity Formula. This framework proposes

that the four components of prosperity-driven investing are human capital, social capital, real assets and financial innovation. The thought process is that if a nation can improve the productivity of its people, provide access to social services like health and education, build real infrastructure and finally provide suitable financial tools, then the nation has built a productive ecosystem that can enable prosperity.

Investors seeking to do business in Africa should perform a similar exercise — figure out what system they believe will create long-term prosperity and think holistically about how to deploy capital in a manner that enables this productive ecosystem. Investors who fail to be systems thinkers in the African context are unlikely to create long-term wealth for themselves or the continent.

(Human Capital + Social Capital + Real Assets) * Financial Innovation = National Prosperity

Invest in "Trust Infrastructures"

If a transaction is going to occur, both parties must trust each other. To buy apples at a grocery store, you must trust that the apples are safe to eat. In developed countries, this trust is ensured by standard boards that regulate grocery stores. For the grocer, he must also trust that if he lets you into the store, you will pay for the apple before you eat it. This trust is assured by laws which deter most people from stealing and enhanced with security systems and professional staff.

As is typical in many developing countries, Africa has a deficit of trust across its formal value chains due to the lack of trust-enabling systems, such as identification, enforced laws, security, and standards (for instance, 74% of countries in Africa still use manual and error prone identity registration methods with an average national identity registration rate of 40%; World Bank, 2017). This trust deficit impedes the flow of business, leading to a continued reliance on informal systems which have a high level of trust and acceptance.

Given the trust gap, there is a large opportunity to invest in companies that create systems enabling trust, collaboration, and innovation in African markets. To succeed, an investor must identify the key players in value chains and invest in a system that allows them to trust each other due to a transparent set of rules that are easily enforceable.

For example, much of Nigeria's agriculture production is still dominated by smallholder farmers who have low yields. Their efficiency is inhibited by the lack of access to inputs, such as quality seeds and fertilizers. The disconnect between farmers and factors of production exists even though there are plenty of banks ready to lend as well as fertilizer and seed firms ready to sell their goods. The lack of trust among all parties means that banks will not lend to farmers due to the lack of identity and credit systems, and farmers will therefore not buy seeds and fertilizers at scale due to a lack of capital.

To help tackle this problem, Consonance Investment Managers invested in AFEX Commodities Exchange which is building the "trust infrastructure" in the agricultural value chain. AFEX now has a detailed database of thousands of farmers and can therefore provide collateral management services to banks and institutions who want to lend to farmers. They also provide further credit enhancement by purchasing and distributing inputs, providing agri–extension services and post–harvest training.

Companies like AFEX are necessary in Africa where value chains need exchange-like firms, systems or structures which stand in place of low trust and an ineffective business environment. Investors should identify and invest in these companies as they can create value for all participants in the value chain and can establish new markets.

Have a Long-Term Orientation

Lastly, to build wealth in Africa, an investor must be in it for the long term. While investing requires a high level of subject matter expertise, investing in Africa needs a studied approach. It is important to spend time doing the research through a disciplined and hyperlocal methodology which can provide deep insight into the inner workings of Africa's informal systems. This method will help to unearth localized solutions and will strengthen the investor's investment strategy.

Investors must create value, which brings up the question of whether this long-term approach deprioritized return over impact. It is our belief at Consonance that due to Africa's current stage of development, the greatest return will come with the greatest impact. Given this, the investors who will do the best in Africa will also do the best for Africa, and the only way to do this is with long-term, deeply knowledgeable, patient and resilient capital.

Article by Mobolaji Adeoye Founder and Chief Investment Officer at Consonance Investment Managers