

AFRICA'S  
FINANCIAL MARKETS:  
A REAL  
DEVELOPMENT TOOL?

Enko Capital Management LLP is an Africa-focused asset management firm with offices in London and Johannesburg. It manages two funds, an open-ended fund investing in listed securities across Africa and a closed-end, pre-IPO private equity fund that will invest in fast-growing African companies wishing to list on an African stock exchange. Founding member, Cyril Nkontchou, will analyse recent evolution of African financial markets and observe their increased role in providing capital to the private sector.

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Cyril Nkontchou is the founder and managing partner of Enko Capital Management LLP, an Africa-focused asset management firm with offices in Johannesburg and London. He is also the founder and executive chairman of LiquidAfrica Holdings Limited. He started his career as a consultant with Andersen Consulting (now Accenture) in France, and worked as a banker with Merrill Lynch in London. He holds a degree in Economics from Institut d'Études Politiques de Paris and an MBA from the Harvard Business School.

# Recent Evolution of the African Financial Markets

*Financial markets play an increasingly important role in financing Africa's private sector. Their recent growth in strength is unquestionable – despite the sudden standstill caused by the 2008 crisis: sixfold increase in capital flows in 10 years, opening of stock markets, initial public offerings by public and private companies, etc. If these markets are to continue to develop, it is essential to free up African savings – which are trapped by low-return assets and the lack of quality products – and to learn to attract higher portfolio investment flows.*

**By Cyril Nkontchou, Managing Partner of Enko Capital Management LLP**

The first decade of the 21<sup>st</sup> century has seen a sixfold increase in private capital flows in Sub-Saharan Africa. Foreign direct investment in Africa has traditionally been dominated by large multinationals mainly investing in resources projects, but the second half of this decade has witnessed the emergence of financial markets as a major source of finance for investments. Between 2007 and 2009, USD 10 billion of equity capital was raised on local African stock exchanges. Many first-time issuers such as Gabon and Ghana successfully raised debt sovereign bonds on the international market.

The financial markets are playing an increasingly important role in providing capital for the private sector in Sub-Saharan Africa, particularly in the financial services and telecommunication sectors. They are also playing a pivotal role in providing alternative investment opportunities for local savings, as seen in Nigeria where the bulk of the recapitalisation of the banking sector was achieved by channelling local savings into the stock market. However, despite recent successes, the development of African financial markets is hindered by a lack of accurate data, preventing both governments and development institutions from implementing adequate policies.

## The rise of financial markets in Sub-Saharan Africa

The second half of this decade has witnessed a remarkable growth in African financial markets. The number of stock exchanges has risen from a dozen in the early 90s to over 23 today, including two regional stock exchanges. Over two-thirds of African countries are covered by a local or regional stock exchange.

With less than 2000 listed companies across all African markets (compared with 3500 for India alone, and 1700 for China), the number of companies that have tapped into the capital markets

to fund their growth remains relatively small. However, over the past three years, we have witnessed an acceleration in the number of African companies going public. Between 2007 and 2009, over USD 10 billion of share capital was raised across 18 stock exchanges, mostly thanks to the listing of 170 new companies. The market capitalisation of the 10 largest markets grew from USD 222 billion to over USD 700 billion between 2002 and 2008, a compound annual growth rate (CAGR) of 18%. In Nigeria, the recapitalisation of the banking sector between 2005 and 2008 attracted over USD 4 billion of new investment through the stock market, mainly from local investors. The strong aftermarket performance of initial public offerings (IPOs) in Africa drew even more investors into pre-IPO investments. In Nigeria alone between 2007 and 2009, over USD 8 billion of equity capital was raised in such pre-IPO private placements<sup>1</sup>.

Increased investor appetite for shares in utility companies such as Kengen and Safaricom in Kenya and banks such as Zanaco in Zambia allowed African states to benefit by successfully offloading large stakes in these companies. They also took advantage of the renewed investor appetite for African sovereign credit to raise bonds on the international market. The Government of Ghana raised USD 750 million in debt sovereign bonds, while the Republic of Gabon successfully raised a USD 1 billion 10-year bond on the international market. The Government of Seychelles raised a USD 230 million three-year bond. In effect, these flows enhance governments' financing capacities and constitute fresh money for public investments.

The rise in African financial markets was underpinned by improved macroeconomic fundamentals in the region, but also by a stellar performance of African stock markets during that period. ...

<sup>1</sup> Pre-IPO placements refer to initiatives from investors to acquire capital shares of firms before their introduction on the stock exchange. These transactions are aimed at benefiting from a substantial upside by selling the acquired shares after the IPO (resulting from oversubscriptions and an increase in share prices).

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... One of the most visible positive impacts of the rise of African financial markets in the past few years has been the recapitalisation of the banking and insurance sectors in Nigeria. On the other hand, the sector recently experienced troubles as the newly recapitalised banks aggressively started to provide loans to finance the purchase of shares in an inflated stock market. The global market meltdown in 2008 clearly put a brake on the exuberance of African financial markets. New issuance decreased dramatically as local stock markets indices collapsed. Foreign portfolio investors shied away from African markets and began returning cautiously in 2009, but only in the most advanced and liquid markets, such as South Africa and Egypt. The recent successful IPO of the CFAO group<sup>2</sup> in Paris however suggests that there is a renewed appetite for quality African assets among emerging market investors.

## Unlocking trapped African savings

The rise of financial markets in Sub-Saharan Africa over the past few years has uncovered the importance of the often underestimated role of African investors eager to invest in financial assets. Among the sources of funds available for investment on African stock exchanges – some of which are not well utilised at present – are the following: (1) individual savings (for example, wealthy Nigerians), (2) funds collected by institutional investors (insurance companies and pension funds) and (3) funds deriving from loans given by banks to their clients for helping them to invest on the markets (margin loans).

The recapitalisation of the financial sector in Nigeria was a case in point. The decision in 2004 by the governor of the Central Bank of Nigeria to raise the minimum capital requirement for banks licensed in Nigeria to USD 250 million by December 2005 was initially met with scepticism. But most observers underestimated the pool of local African savings trapped in sub-optimal investment products<sup>3</sup> as a result of a relative lack of available assets in African financial markets. ...

**Table 1: Subscription levels of African IPOs, 2009**

Company	Sector	Country	Issue Size (USD million)	Subscription Level
Compagnie Generale Immobilier	Real Estate	Morocco	426	142x
Taalat Moustafa	Real Estate	Egypt	688	41x
Maridive	Oil Services	Egypt	278	31x
Alliances Development Immob.	Real Estate	Morocco	275	29x
Delta Holdings	Construction	Morocco	129	22x
GB Auto SAE	Automobile	Egypt	213	7x
Dangote Flour Mills	Food	Nigeria	146	6x
Kenya Reinsurance	Insurance	Kenya	34	4x
Safaricom	Telecom	Kenya	786	4x
AccessKenya	IT	Kenya	11	4x
Stanbic Bank	Banking	Uganda	39	3x
Celtel	Telecom	Zambia	174	2x
National Microfinance Bank	Banking	Tanzania	53	1x
Dangote Sugar	Food	Nigeria	404	1x

*Safaricom's IPO was successful: the subscription level of 4 x means that subscribers proposed to acquire four times more shares than the number of shares that Safaricom was selling.*  
Source: Enko Capital research, 2009

<sup>2</sup> The Compagnie française de l'Afrique occidentale (CFAO), a subsidiary of the Pinault-Printemps-Laredoute group, is the leader in specialised distribution in Africa and the French Overseas Collectivities (Collectivités d'outre-mer). The English translation for CFAO is French Occidental Africa Company.

<sup>3</sup> Such products are sub-optimal because they can provide relatively low returns for investors and/or low impacts on the local private sector. Examples of these are sight deposits, treasury bills (short-term), funds to be invested abroad, etc.

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... Between 2005 and 2008, the banking sector recapitalisation was successfully achieved thanks to a combination of both private and public, primary and secondary issues mainly on the local market. These issues were mostly subscribed to by local institutions and individuals. There is evidence that many wealthy private Nigerian investors repatriated some of their offshore investments to participate in this recapitalisation.

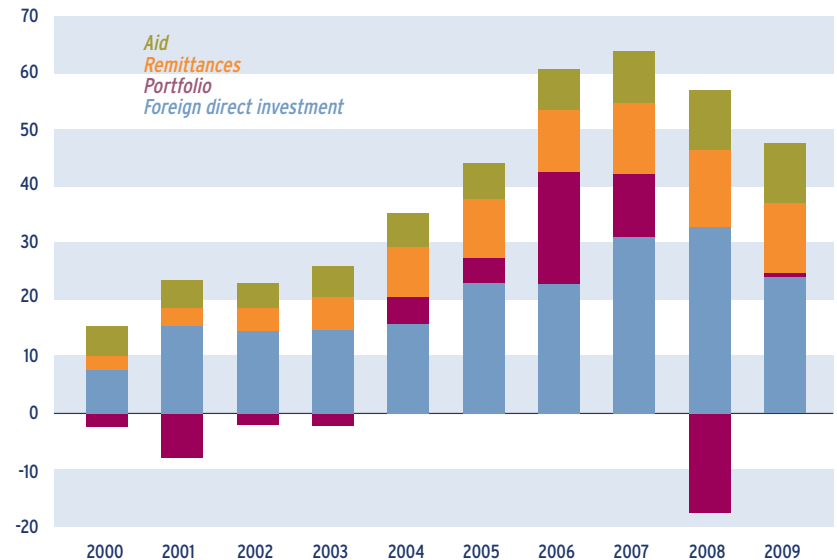
The importance of African savings available for quality financial assets is further evidenced by the level of oversubscription observed for many recent new IPOs on African stock markets (Table 1). This data indicates that apart from real estate and local government paper such as treasury bills, African investors have very few investment opportunities available. Moreover, local institutional investors such as insurance companies and pension funds are typically restricted from making investments outside of their home countries or monetary zone. As a result, a large pool of savings ideally suited to investment in financial markets is trapped. This increased appetite of African savers for local financial assets was further fuelled by local banks that in Nigeria, Kenya and Zambia provided personal loans to invest in the stock market (e.g. margins loans in Nigeria).

## Attracting emerging market portfolio flows

Until the global market meltdown in 2008, African financial markets – particularly the more developed ones – have seen a steady rise in emerging market portfolio flows<sup>4</sup> (Table 2). In part, abundant global liquidity was responsible for the surge of private capital flows into Africa, but investors were also attracted by Sub-Saharan Africa's recent solid macroeconomic performance, more stable political environments, and high expected returns, given increasing commodity prices. With the exception of South Africa, Egypt and to some extent Nigeria, emerging market portfolio flows have played a limited role as a source of investments in the local capital market. Investors of emerging market portfolio flows have been more actively investing in African debt securities, buying securities issued by many first-time sovereign issuers (Gabon, Ghana, Seychelles).

The combined African equity markets account for about 12% of global emerging markets, but attract less than 2% of portfolio equity flows. This under allocation is mainly the result of a relatively poor liquidity in African markets and difficult access to quality financial information and research

**Table 2: Financial flows in Sub-Saharan Africa 2000 - Q1 2009 (USD Billion)**



Source: IMF, 2009 (2009 data are estimates)

on many African companies and issuers. Despite their volatility, emerging market portfolio flows remain a vast untapped potential source of capital for frontier African markets.

## Supporting the development of African financial markets

The importance and the impact of financial markets in Africa are often underestimated, if not overlooked. This is the result of a relative lack of understanding of African financial markets among governments and multilateral institutions, making it difficult for them to design appropriate and effective policies. The lack of timely and accurate data and the relative weakness of market participants is a major impediment to attracting emerging market portfolio flows. Governments should lead the way by further promoting the sale of state-owned assets through financial markets<sup>5</sup>, create sovereign benchmarks to provide reference points for private sector borrowings and create fiscal incentives for investing in financial assets. Development agencies could also play a key role by investing in strengthening the capacity of market participants and by subscribing to and exiting from more investments *via* the financial market, in order to improve their liquidity. There needs to be a proactive approach to promoting the creation of more financial assets, including listed companies, corporate bonds issues, collective investment schemes, among others, to offer a broader investment spectrum to local savers. ●

<sup>4</sup> Emerging market portfolio flows refer mainly to the investment holdings of international investors in local securities (listed equities and long- and short-term debt) as opposed to direct investments by international investors in local assets, which are recorded as foreign direct investments.

<sup>5</sup> On this subject, see Laurent Demey's article on the political use of stock markets to promote privatisation programmes.